



INDEPENDENT AUDITOR’S REPORT

To the Minister for Defence

Opinion

In my opinion, the financial statements of the Department of Defence for the year ended 30 June 2017:

- (a) comply with Australian Accounting Standards - Reduced Disclosure Requirements and the *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015*; and
- (b) present fairly the financial position of the Department of Defence as at 30 June 2017 and its financial performance and cash flows for the year then ended.

The financial statements of the Department of Defence, which I have audited, comprise the following statements as at 30 June 2017 and for the year then ended:

- Statement by the Accountable Authority and Chief Finance Officer;
- Statement of Comprehensive Income;
- Statement of Financial Position;
- Statement of Changes in Equity;
- Cash Flow Statement;
- Administered Schedule of Comprehensive Income;
- Administered Schedule of Assets and Liabilities;
- Administered Reconciliation Schedule;
- Administered Cash Flow Statement; and
- Notes to and forming part of the financial statements, comprising a Summary of Significant Accounting Policies and other explanatory information.

Basis for Opinion

I conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. My responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of my report. I am independent of the Department of Defence in accordance with the relevant ethical requirements for financial statement audits. These include the relevant independence requirements of the Accounting Professional and Ethical Standards Board’s APES 110 *Code of Ethics for Professional Accountants* to the extent that they are not in conflict with the *Auditor-General Act 1997* (the Code). I have also fulfilled my other responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the financial statements of the current period. These matters were addressed in the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

Key audit matter

Existence, completeness and valuation of specialist military equipment

Refer to Notes 3.2A ‘Reconciliation of the opening and closing balances of property, plant and equipment, and intangibles’

How the audit addressed the matter

I addressed the existence, completeness and valuation of specialist military equipment through:

- testing controls that apply to key system components, processes and data within the logistics and financial management information systems;

The Department of Defence (Defence) has balances of \$58.6 billion in specialist military equipment.

Specialist military equipment was measured at year-end at its fair value. Specialist military equipment includes platform assets in use and under construction and spare parts for these assets.

I focused on this area because:

- the measurement of specialist military equipment at fair value involves a high degree of management judgement due to the highly specialised nature of the assets and the subjectivity of the valuation; and
- Defence is in the process of implementing the Warehouse Management System, which manages components of the specialist military equipment balance. The implementation of a new system presents a risk that the control environment is not secure and the transactions processed in this new system are incomplete or inaccurate.

- assessing the significant judgements made by Defence throughout the process of determining a fair value for specialist military equipment;
- assessing whether the useful lives applied to specialist military equipment (for the calculation of depreciation) are consistent with other available information such as the expected withdrawal dates for these assets;
- testing of the data migrated on implementation between the existing logistics information system and the new Warehouse Management System and re-performance of a sample of daily reconciliations between the systems;
- inspecting a sample of specialist military equipment for existence and indicators of impairment;
- observation and re-performance of Defence's stocktaking activities at selected locations; and
- substantiation of a sample of transactions processed through Defence's logistics and financial management information systems.

Key audit matter

Completeness and valuation of general and intangible assets

Refer to Note 3.2A 'Reconciliation of the opening and closing balances of property, plant and equipment, and intangibles'

Defence has a balance of \$27.0 billion in general and intangible assets. General assets include land and buildings, infrastructure, plant and equipment and heritage and cultural assets.

I focused on this area because:

- the capitalisation of intangible assets is subject to judgement in respect of classifying project costs as capital or expense;
- the completeness of the asset register is reliant on detailed information being provided by service groups;
- the valuation of general and intangible assets is subjective and based on assumptions and judgements made by management; and
- the recognition of impairment of general and intangible assets due to damage, obsolescence or discontinued use is subject to judgement as it is based on assumptions and decisions made by management.

How the audit addressed the matter

I addressed the completeness and valuation of general and intangible assets by:

- assessing Defence's methodologies and assumptions used in the valuation of general and intangible assets;
- assessing whether the useful lives applied to the various asset classes (for the calculation of depreciation) is consistent with Defence's plans for replacement of each asset;
- assessing the assumptions and judgements used by Defence to determine the impairment of general and intangible assets;
- assessing a sample of cost attribution models, approvals of cost allocations and year-end accruals relating to the roll-out of general assets under construction;
- substantiating a sample of transactions for acquisitions, rollouts, disposals, transfers, write-downs, and other adjustments to supporting documentation; and
- inspecting a sample of general assets for indicators of impairment.

Key audit matter**Accuracy and completeness of inventories**

Refer to Note 3.2B 'Inventories'

Defence has a balance of \$6.8 billion in inventories which include general inventories, fuel and explosive ordnance.

I focused on this area because:

- of the number of inventory items which are managed across a large number of geographically dispersed locations and are valued using a weighted average cost methodology; and
- Defence is implementing a new Warehouse Management System which will manage a large volume of inventory items. The implementation of a new system presents a risk that the control environment is not secure and the transactions processed in this new system are incomplete or inaccurate.

How the audit addressed the matter

I addressed the accuracy and completeness of the balance of inventories through:

- testing of the controls that apply to key system components, processes and data for the new Warehouse Management System;
- testing of the data migrated on implementation between the existing logistics information system and the new Warehouse Management System and re-performance of a sample of daily reconciliations between these systems;
- re-performance of a sample of Defence's testing of the accuracy of price records for general inventory;
- re-performance of a sample of Defence's testing of the appropriate use of fuel cards;
- observation and re-performance of Defence's stocktaking activities at selected locations; and
- substantiation of a sample of transactions processed through Defence's logistics and financial management information systems.

Key audit matter**Valuation of employee provisions**

Refer to Note 4.4A 'Employee provisions'

Defence has a balance of \$107.0 billion in administered employee provisions. The department administers two superannuation defined benefit plans that entitle Australian Defence Force members to retirement and death benefits based on past service.

I focused on this area because the complexity of the calculation and the sensitivities of the assumptions applied.

In addition, the Australian Accounting Standards include detailed requirements for the presentation and disclosure of defined benefit superannuation schemes.

How the audit addressed the matter

I addressed the valuation of administered employee provisions by:

- assessing the control processes relating to the management of military superannuation schemes;
- engaging an independent actuary to assist in assessing the methodology, assumptions and judgements used by Defence in relation to the estimation of the superannuation provision;
- testing the completeness and accuracy of data used by Defence in the year-end estimation process;
- confirming that the journals processed by Defence are based on their estimate of the superannuation provision; and
- assessing the presentation and disclosure of military superannuation schemes in the Defence's financial statements against the requirements of the Australian Accounting Standards.

Accountable Authority's Responsibility for the Financial Statements

As the Accountable Authority of Defence the Secretary is responsible under the *Public Governance, Performance and Accountability Act 2013* for the preparation and fair presentation of annual financial statements that comply with Australian Accounting Standards - Reduced Disclosure Requirements and the rules made under that Act. The Secretary is also responsible for such internal control as the Secretary determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Secretary is responsible for assessing Defence's ability to continue as a going concern, taking into account whether the entity's operations will cease as a result of an administrative restructure or for any other reason. The Secretary is also responsible for disclosing matters related to going concern as applicable and using the going concern basis of accounting unless the assessment indicates that it is not appropriate.

Auditor's Responsibilities for the Audit of the Financial Statements

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian National Audit Office Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with the Australian National Audit Office Auditing Standards, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Accountable Authority;
- conclude on the appropriateness of the Accountable Authority's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern; and
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

From the matters communicated with those charged with governance, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. I describe these matters in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Australian National Audit Office



Grant Hehir
Auditor-General
Canberra
27 September 2017

Department of Defence

STATEMENT BY THE ACCOUNTABLE AUTHORITY AND CHIEF FINANCE OFFICER

In our opinion, the attached financial statements for the year ended 30 June 2017 comply with subsection 42(2) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), and are based on properly maintained financial records as per subsection 41(2) of the PGPA Act.

In our opinion, at the date of this statement, there are reasonable grounds to believe that the Department of Defence will be able to pay its debts as and when they fall due.

Signed



Mr. Greg Moriarty
Secretary - Defence

27 September 2017

Signed



Mr. Phillip Prior
Chief Finance Officer - Defence

27 September 2017

Department of Defence

Financial Statements

For the period ended 30 June 2017

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Department of Defence
STATEMENT OF COMPREHENSIVE INCOME

For the period ended 30 June 2017

		2017	2016	Original Budget ¹
		\$'000	\$'000	\$'000
NET COST OF SERVICES				
	Notes			
EXPENSES				
Employee benefits	1.1A	11,393,321	11,655,972	11,636,412
Suppliers expenses	1.1B	13,352,279	12,191,530	13,041,999
Grants	1.1C	133,651	128,625	106,833
Depreciation and amortisation	3.2A	5,462,402	4,511,504	4,893,340
Finance costs	1.1D	124,430	114,908	152,971
Write-down and impairment of assets	1.1E	909,831	696,765	991,461
Foreign exchange losses	1.1F	7,826	18,624	-
Losses from asset sales		15,007	657	-
Other expenses	1.1G	163,187	244,917	5,985
Total Expenses		31,561,934	29,563,502	30,829,001
LESS:				
OWN-SOURCE INCOME				
Own-Source Revenue				
Provision of goods and rendering of services (including cost recovery)	1.2A	456,853	447,417	451,204
Rental income	1.2B	6,414	5,722	9,638
Other revenue	1.2C	36,954	74,864	39,256
Total Own-Source Revenue		500,221	528,003	500,098
Gains				
Gains from asset sales		-	-	3,252
Reversals of previous asset write-downs and impairment	1.2D	214,703	258,502	304,308
Other gains	1.2E	146,598	70,218	4,818
Total Gains		361,301	328,720	312,378
Total own-source income		861,522	856,723	812,476
Net cost of services		30,700,412	28,706,779	30,016,525
Revenue from Government	1.2F	30,914,234	28,900,438	30,016,525
Surplus attributable to the Australian Government		213,822	193,659	-
OTHER COMPREHENSIVE INCOME				
Items not subject to subsequent reclassification to net cost of services				
Changes in asset revaluation reserves	3.2A	492,703	9,775,665	-
Total other comprehensive income		492,703	9,775,665	-
Total comprehensive income attributable to the Australian Government		706,525	9,969,324	-

¹ Defence's original budgeted financial statement that was first presented to parliament in respect of the reporting period (i.e. from Defence's 2016-17 Portfolio Budget Statements). The budget is not audited.

The above statement should be read in conjunction with the accompanying notes.

Department of Defence
STATEMENT OF COMPREHENSIVE INCOME (continued)

For the period ended 30 June 2017

Budget Variances Commentary

Explanations are only provided where the variance at a financial statement line item level is greater than 10% of the Original Budget for that line item.

Statement of Comprehensive Income

Affected line items	Explanation of major variances
<i>Grants</i> <i>Variance: \$27m; 25%</i>	Grants predominantly relate to the overseas payment of USD80m to the Afghan National Army Trust Fund. The depreciation of the Australian dollar to the USD has resulted in additional payments being made.
<i>Depreciation and amortisation</i> <i>Variance: \$569m; 12%</i>	During the 2015-16 financial year, Defence were required to adopt a fair value policy in relation to Specialist Military Equipment. As a result of this policy, the fair value increased by \$9.8bn (21%) which in turn has driven an increase in depreciation expense which was not anticipated in the Original Budget.
<i>Finance costs</i> <i>Variance: \$29m; 19%</i>	As a result of the early payout of housing projects and the upfront payment made in relation to the refinancing leases, finance costs are less than that anticipated in the Original Budget.
<i>Foreign exchange losses</i> <i>Variance: \$8m</i>	The actual loss has resulted from currency fluctuations against the Australian dollar throughout the year. This was not included in the Original Budget as the Budget is constructed on a no win/no loss basis for foreign exchange movements.
<i>Losses from asset sales</i> <i>Variance: \$15m</i>	During 2016-17 sales of land and buildings resulted in unanticipated losses as a result of market conditions. The Original Budget does not account for any losses from sales of assets.
<i>Other expenses</i> <i>Variance: \$157m; 2,627%</i>	Land decontamination work continued to be carried out for certain Defence facilities during 2016-17. This work provided a more reliable basis to determine future costs which resulted in a much higher than anticipated increase in the provision in 2016-17 compared to the Original Budget.
<i>Rental income</i> <i>Variance: \$3m; 33%</i>	The actual rental of non-housing properties was less than budgeted.
<i>Reversals of previous asset write-downs and impairment</i> <i>Write-down and impairment of assets</i> <i>Variance: \$8m; 1%</i>	In aggregation, reversal of previous asset write-downs and write-down expenses is consistent with the Original Budget.
<i>Other gains</i> <i>Variance: \$142m; 2,943%</i>	Defence reduced the decommissioning provisions for some of its Specialist Military Equipment in 2016-17 based on observable costs and activities, resulting in higher than expected other gains. Land decontamination activities for the Maribyrnong site were re-estimated to a cost that was lower than initially anticipated resulting in a write-back of the decontamination provision for that facility.
<i>Changes in asset revaluation reserves</i> <i>Variance: \$493m</i>	The revaluation of all property, plant and equipment is not included in the Original Budget due to the uncertainty of the movement in the market for these assets.

Department of Defence
STATEMENT OF FINANCIAL POSITION

as at 30 June 2017

		2017	2016	Original Budget ¹
		\$'000	\$'000	\$'000
ASSETS				
Financial Assets				
Cash and cash equivalents	3.1A	88,823	47,597	11,530
Trade and other receivables	3.1B	1,005,919	1,406,929	595,186
Total financial assets		1,094,742	1,454,526	606,716
Non-financial assets				
Land and buildings	3.2A	17,492,218	17,641,072	18,275,135
Specialist military equipment	3.2A	58,572,944	56,217,433	47,848,649
Infrastructure	3.2A	5,874,047	5,630,439	5,890,336
Plant and equipment	3.2A	2,286,663	2,111,345	2,019,147
Heritage and cultural assets	3.2A	607,285	623,102	907,345
Intangibles	3.2A	749,190	794,155	722,199
Inventories	3.2B	6,775,387	6,729,988	6,107,144
Prepayments	3.2C	1,909,787	2,874,690	3,203,904
Total non-financial assets		94,267,521	92,622,224	84,973,859
Assets held for sale	3.2D	62,436	63,538	37,684
Total Assets		95,424,699	94,140,288	85,618,259
LIABILITIES				
Payables				
Suppliers	3.3A	2,304,285	2,539,881	2,412,367
Personal benefits	3.3B	54,578	27,776	304,061
Other payables	3.3C	293,267	225,123	43,461
Total Payables		2,652,130	2,792,780	2,759,889
Interest bearing liabilities				
Finance leases	3.4A	1,549,237	1,534,423	1,390,347
Total interest bearing liabilities		1,549,237	1,534,423	1,390,347
Provisions				
Employee provisions	3.5A	2,627,662	2,705,095	2,589,834
Restoration, decontamination and decommissioning	3.5B	1,166,051	1,286,184	1,048,168
Other provisions	3.5C	51,693	29,193	290
Total provisions		3,845,406	4,020,472	3,638,292
Total Liabilities		8,046,773	8,347,675	7,788,528
NET ASSETS		87,377,926	85,792,613	77,829,731
EQUITY				
Contributed equity		26,519,722	25,810,891	27,218,461
Reserves		25,250,201	24,757,498	15,299,751
Retained surpluses		35,608,003	35,224,224	35,311,519
TOTAL EQUITY		87,377,926	85,792,613	77,829,731

¹ Defence's original budgeted financial statement that was first presented to parliament in respect of the reporting period (i.e. from Defence's 2016-17 Portfolio Budget Statements). The budget is not audited.

The above statement should be read in conjunction with the accompanying notes.

Department of Defence
STATEMENT OF FINANCIAL POSITION (continued)

as at 30 June 2017

Budget Variances Commentary

Explanations are only provided where the variance at a financial statement line item level is greater than 10% of the Original Budget for that line item.

Statement of Financial Position

Affected line items	Explanation of major variances
<i>Cash and cash equivalents</i> Variance: \$77m; 670%	Defence had an unanticipated net over spend in operations and foreign exchange (no-win/no-loss), resulting in the need for unspent prior period appropriations to be drawn down, leading to an increase in cash and cash equivalents at year end.
<i>Trade and other receivables</i> Variance: \$411m; 69%	Trade and other receivables exceeded budget due to Defence maintaining a legal right to those amounts of prior period's unspent appropriations which are yet to be quarantined. The unspent appropriations were unanticipated in the Original Budget.
<i>Specialist military equipment</i> Variance: \$10,724m; 22%	In the 2015-16 financial year, Defence was required to adopt a fair value policy in relation to Specialist Military Equipment, resulting in a revaluation increment being recorded against Specialist Military Equipment for that year. The Original Budget was constructed on the basis of these assets being at cost.
<i>Plant and equipment</i> Variance: \$268m; 13%	During 2016-17, \$250m of plant and equipment was acquired which was not included in the Original Budget.
<i>Heritage and cultural assets</i> Variance: \$300m; 33%	The variance results from downward revaluations of Heritage buildings in 2015-16, which were previously valued on the reproduction costs basis and now valued on the depreciated reproduction cost basis consistent with the current accounting treatment for Heritage buildings. Due to the uncertain nature of revaluations these were not included in the Original Budget.
<i>Inventories</i> Variance: \$668m; 11%	The variance relates to a timing difference between budgeted and actual consumption and purchases.
<i>Prepayments</i> Variance: \$1,294m; 40%	Prepayments include amounts paid to Foreign Military Sales (FMS) Account in the United States of America for purchases of Military Equipment. Payments are made in accordance with the Special Billing Arrangements in the Memorandum of Understanding. The decreased balance reflects increased utilisation of existing prepayments and a decreased level of cash payments than was anticipated in the Original Budget.
<i>Assets held for sale</i> Variance: \$25m; 66%	The variance for assets held for sale is predominantly due to additional Defence properties and Specialist Military Equipment being held for sale as at 30 June 2017 which was not in the Original Budget.
<i>Personal Benefits</i> Variance: \$249m; 82%	The variance arises due to the timing of the last pay run in the financial year. In 2016-17 the last pay run was on 29 June 2017, resulting in accrual of an additional day compared to 2015-16.
<i>Other Payables</i> Variance: \$250m; 575%	The variance relates to the timing of PAYG tax paid.
<i>Finance Leases</i> Variance: \$159m; 11%	The difference is due to a new Navy lease entered into the previous year which was not included in the Original Budget.
<i>Restoration decontamination and decommissioning</i> Variance: \$118m; 11%	The variance is predominantly due to a significant increase in a number of Defence's existing land decontamination provisions. Remediation work on the sites provided a more reliable basis to estimate the decontamination cost for these facilities.
<i>Other provisions</i> Variance: \$51m; 17,725%	In 2016-17, Defence increased other provisions due to a higher probability for legal claims against the Department. Due to the uncertain nature of these items, the movement in the provision was not anticipated in the Original Budget.
<i>Reserves</i> Variance: \$9,950m; 65%	The revaluation of all property, plant and equipment is not included in the Original Budget due to the uncertainty of the movement in the market for these assets.

Department of Defence
STATEMENT OF CHANGES IN EQUITY

For the period ended 30 June 2017

	2017	2016	Original Budget ¹
	\$'000	\$'000	\$'000
Notes			
CONTRIBUTED EQUITY			
Opening balance			
Balance carried forward from previous period	25,810,891	22,321,616	24,898,031
Adjustment for errors	-	-	-
Adjusted opening balance	25,810,891	22,321,616	24,898,031
Transactions with owners			
<i>Distribution to owners</i>			
Returns on capital - other	-	-	(897)
<i>Contribution by owners</i>			
Equity injection - Appropriation	5.1A 1,064,704	2,942,961	2,321,327
Restructuring	8.2A -	444,566	-
Transfers from/(to) other entities	(355,873)	101,748	-
Total transactions with owners	708,831	3,489,275	2,320,430
Closing balance as at 30 June	26,519,722	25,810,891	27,218,461
RETAINED EARNINGS			
Opening balance			
Balance carried forward from previous period	35,224,224	34,347,064	35,311,519
Adjustment for errors	169,957	683,501	-
Adjusted opening balance	35,394,181	35,030,565	35,311,519
Transactions with owners			
<i>Contribution by owners</i>			
Transfers from/(to) other entities	-	-	-
Total transactions with owners	-	-	-
Comprehensive income			
Surplus/(deficit) for the period	213,822	193,659	-
Total comprehensive income	213,822	193,659	-
Closing balance as at 30 June	35,608,003	35,224,224	35,311,519
ASSET REVALUATION RESERVE			
Opening balance			
Balance carried forward from previous period	24,757,498	15,299,466	15,299,751
Adjustment for errors	-	(317,633)	-
Adjusted opening balance	24,757,498	14,981,833	15,299,751
Comprehensive income			
Other comprehensive income	492,703	9,775,665	-
Total comprehensive income	492,703	9,775,665	-
Closing balance as at 30 June	25,250,201	24,757,498	15,299,751

The above statement should be read in conjunction with the accompanying notes.

Department of Defence
STATEMENT OF CHANGES IN EQUITY (Continued)

<i>For the period ended 30 June 2017</i>	2017	2016	Original Budget ¹
	\$'000	\$'000	\$'000
Notes			
TOTAL EQUITY			
Opening balance			
Balance carried forward from previous period	85,792,613	71,968,146	75,509,301
Adjustment for errors	<u>169,957</u>	<u>365,868</u>	-
Adjusted opening balance	<u>85,962,570</u>	<u>72,334,014</u>	<u>75,509,301</u>
Comprehensive income			
Surplus/(deficit) for the period	213,822	193,659	-
Other comprehensive income	<u>492,703</u>	<u>9,775,665</u>	-
Total comprehensive income	<u>706,525</u>	<u>9,969,324</u>	<u>-</u>
Transactions with owners			
<i>Distribution to owners</i>			
Returns on capital - other	-	-	(897)
<i>Contribution by owners</i>			
Equity injection - Appropriation	1,064,704	2,942,961	2,321,327
Restructuring	8.2A	444,566	-
Transfers from/(to) other entities	<u>(355,873)</u>	<u>101,748</u>	-
Total transactions with owners	<u>708,831</u>	<u>3,489,275</u>	<u>2,320,430</u>
Closing balance as at 30 June	<u>87,377,926</u>	<u>85,792,613</u>	<u>77,829,731</u>

¹ Defence's original budgeted financial statement that was first presented to parliament in respect of the reporting period (i.e. from Defence's 2016-17 Portfolio Budget Statements). The budget is not audited.

Budget Variances Commentary

Explanations are only provided where the variance at a financial statement line item level is greater than 10% of the Original Budget for that line item.

Statement of Changes in Equity

Affected line items	Explanation of major variances
<i>Adjustment for errors</i> Variance: \$170m	Accounting errors are not budgeted for. These errors were identified in 2016-17, but relate to prior years and as a result have been recorded to equity rather than in the Statement of Comprehensive Income.
<i>Other comprehensive income</i> Variance: \$493m	The revaluation of all property, plant and equipment is not included in the Original Budget due to the uncertainty of the movement in the market for these assets.
<i>Equity Injection - Appropriation</i> Variance: \$1,257m; 54%	Through the provision of Appropriation Bill 4 2016-17, a revision was made to the appropriation available to Defence that was not known at the time of the Original Budget.
<i>Transfers (from)/to other entities</i> Variance: \$356m	During the year, the Department of Defence transferred land to the Department of Infrastructure. The transfer was unanticipated at the time of the Original Budget.

Accounting Policy

(a) Equity Injections

Amounts appropriated which are designated as 'equity injections' (less any formal reductions) are recognised directly in contributed equity in that year. Equity injection appropriations in Acts passed after the commencement of the period are recognised from the date of royal assent.

(b) Restructuring of Administrative Arrangements

Net assets/liabilities received from or relinquished to another Australian Government agency or authority under a restructuring of administrative arrangements are recognised as contributions or distributions of equity respectively, at their net book value.

(c) Other Distributions to Owners including Repayments of Appropriations

The *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015* (FRR) requires that distributions to owners be debited to contributed equity unless it is a dividend. Repayments and reductions of Appropriations are recognised either as a reduction of appropriation revenue or as a reduction of contributed equity.

The above statement should be read in conjunction with the accompanying notes.

Department of Defence
CASH FLOW STATEMENT

For the period ended 30 June 2017

	2017	2016	Original Budget ¹
	\$'000	\$'000	\$'000
Notes			
OPERATING ACTIVITIES			
Cash received			
Appropriations (current year)	30,837,008	28,882,900	30,016,525
Appropriations (prior year)	97,000	145,264	-
Section 74 receipts from OPA	438,036	358,227	-
Goods and services (including cost recovery)	451,446	535,650	451,204
Interest received	4,526	2,751	-
Net GST received	1,655,319	1,490,160	1,619,911
Other	167,856	137,944	48,894
Total cash received	33,651,191	31,552,896	32,136,534
Cash used			
Employees	(11,312,760)	(11,693,870)	(11,570,112)
Suppliers	(11,595,716)	(11,375,647)	(11,520,104)
Net GST paid	(1,695,179)	(1,495,981)	(1,619,911)
Grants	(128,960)	(129,411)	(106,833)
Section 74 receipts transferred to OPA	(404,672)	(352,406)	-
Cash returned to OPA	(39,861)	(10,064)	(897)
Other	(23,893)	(34,217)	(5,985)
Total cash used	(25,201,041)	(25,091,596)	(24,823,842)
Net cash flows from operating activities	8,450,150	6,461,300	7,312,692
INVESTING ACTIVITIES			
Cash received			
Proceeds from sales of land and buildings	73,670	44,360	14,127
Proceeds from sales of specialist military equipment	17,999	14,860	7,549
Proceeds from sales of plant and equipment	22,142	26,905	23,312
Other	2,712	619	-
Total cash received	116,523	86,744	44,988
Cash used			
Purchase of land and buildings	(1,107,404)	(672,507)	(865,627)
Purchase of specialist military equipment	(5,992,262)	(5,918,596)	(6,097,456)
Purchase of infrastructure	(335,398)	(187,327)	(678,114)
Purchase of plant and equipment	(461,903)	(389,284)	(291,967)
Purchase of heritage and cultural assets	(343)	(6,301)	-
Purchase of intangibles	(49,400)	(93,879)	(105,535)
Purchase of inventory	(1,512,076)	(1,654,853)	(1,491,637)
Selling costs on sale of assets	(6,276)	(4,271)	(4,982)
Finance costs	(90,952)	(87,585)	(111,233)
Total cash used	(9,556,014)	(9,014,603)	(9,646,551)
Net cash flows used by investing activities	(9,439,491)	(8,927,859)	(9,601,563)

The above statement should be read in conjunction with the accompanying notes.

Department of Defence
CASH FLOW STATEMENT (Continued)

For the period ended 30 June 2017

	2017	2016	Original Budget ¹
	\$'000	\$'000	\$'000
Notes			
FINANCING ACTIVITIES			
Cash received			
Contributed equity (current year)	<u>1,064,704</u>	<u>2,535,548</u>	<u>2,321,327</u>
Total cash received	<u>1,064,704</u>	<u>2,535,548</u>	<u>2,321,327</u>
Cash used			
Repayments of debt (including finance lease principal)	<u>(30,700)</u>	<u>(32,498)</u>	<u>(32,456)</u>
Total cash used	<u>(30,700)</u>	<u>(32,498)</u>	<u>(32,456)</u>
Net cash from financing activities	<u>1,034,004</u>	<u>2,503,050</u>	<u>2,288,871</u>
Net increase in cash held	<u>44,663</u>	<u>36,491</u>	<u>-</u>
Cash and cash equivalents at the beginning of the reporting period	47,597	44,150	11,530
Opening cash transferred in relation to DMO	-	(32,619)	-
Effect of exchange rate movements on cash and cash equivalents at the beginning of the reporting period	(3,437)	(425)	-
Cash and cash equivalents at the end of the reporting period	<u>3.1A</u> <u>88,823</u>	<u>47,597</u>	<u>11,530</u>

¹ Defence's original budgeted financial statement that was first presented to parliament in respect of the reporting period (i.e. from Defence's 2016-17 Portfolio Budget Statements). The budget is not audited.

The above statement should be read in conjunction with the accompanying notes.

Department of Defence
CASH FLOW STATEMENT (continued)

For the period ended 30 June 2017

Budget Variances Commentary

Explanations are only provided where the variance at a financial statement line item level is greater than 10% of the Original Budget for that line item.

Cash Flow Statement

Affected line items	Explanation of major variances
<i>Appropriations (prior year)</i> <i>Variance: \$97m</i>	The variance is due to additional appropriations required to be drawn down to meet cash flow requirements. This was not expected at the time of the Original Budget.
<i>Section 74 receipts from OPA;</i> <i>Section 74 receipts transferred to OPA; and</i> <i>Cash returned to the OPA</i> <i>Aggregated Variance: \$6m</i>	Defence is entitled to retain Section 74 receipts under the <i>Public Governance, Performance and Accountability Act 2013</i> . These receipts are returned to OPA and drawn down as Appropriations when required. The Original Budget did not include the transfer of funds to and from the OPA as the receipts transferred and amounts ultimately drawn down as Appropriations are budgeted to be the same.
<i>Other cash received from operating activities</i> <i>Variance: \$119m; 243%</i>	During the 2016-17 financial year, Defence received operating cash for liquidated damages, and refunds relating to Foreign Military Sales (FMS). Due to the uncertain nature of these activities, the Original Budget does not anticipate such receipts.
<i>Grants</i> <i>Variance: \$22m; 21%</i>	Grants predominantly relate to the overseas payment of USD80m to the Afghan National Army Trust Fund. The depreciation of the Australian dollar to the USD has resulted in additional payments being made.
<i>Other cash used in operating activities</i> <i>Variance: \$18m; 299%</i>	Other cash used in operating activities predominantly relates to cash paid to complete decontamination activities. The payment of these amounts was ahead of schedule and unanticipated at the time of the budget.
<i>Proceeds from sale of land and buildings</i> <i>Variance: \$60m; 421%</i>	A number of properties which were anticipated to be sold by Defence in 2015-16 were sold in 2016-17, resulting in more proceeds from the sales of land and buildings than budgeted.
<i>Proceeds from sale of specialist military equipment</i> <i>Variance: \$10m; 138%</i>	This relates to proceeds from the sale of a number of assets that were not anticipated to be sold in the Original Budget.
<i>Purchase of land and buildings</i> <i>Variance: \$242m; 28%</i>	The variance in cash utilised to purchase land and buildings is predominantly due to the purchase of additional properties not anticipated at the time of the Original Budget.
<i>Purchase of infrastructure</i> <i>Variance: \$343m; 51%</i>	The variance in cash utilised to purchase infrastructure is predominantly due to the deferral of payments in the facilities and infrastructure program from the current period to future years. This was not anticipated at the time of the Original Budget.
<i>Purchase of plant and equipment</i> <i>Variance: \$170m; 58%</i>	The purchase of plant and equipment was over expectations due to a number of additional purchases made that were not anticipated at the time of the budget.
<i>Purchase of intangibles</i> <i>Variance: \$56m; 53%</i>	The variance in the purchase of intangibles is predominantly due to fewer acquisitions of software made in the current period than was anticipated at the time of the Original Budget.
<i>Selling costs on sales of assets</i> <i>Variance: \$1m; 26%</i>	The variance in selling costs of assets predominantly relates to more land and buildings sold than was expected at the time of the Original Budget.
<i>Finance costs</i> <i>Variance: \$20m; 18%</i>	As a result of the early payout of housing projects and the upfront payment made in relation to the refinancing leases, finance costs are less than that anticipated in the Original Budget.
<i>Contributed Equity</i> <i>Variance: \$1,257m; 54%</i>	Through the provision of Appropriation Bill 4 2016-17, a revision was made to reduce the appropriation available to Defence that was not known at the time of the Original Budget.

Department of Defence

ADMINISTERED SCHEDULE OF COMPREHENSIVE INCOME

Original

For the period ended 30 June 2017

2017

2016

Budget¹

\$'000

\$'000

\$'000

NET COST OF SERVICES

	Notes			
EXPENSES				
Employee benefits	2.1A	7,869,872	6,750,415	5,230,036
Subsidies	2.1B	98,403	104,569	111,627
Write-down and impairment of assets	2.1C	143	72	-
Foreign exchange losses	2.1D	154	-	-
Other expenses	2.1E	41	-	-
Total expenses		7,968,613	6,855,056	5,341,663
LESS:				
INCOME				
Revenue				
Non taxation revenue				
Fees and fines	2.2A	16,871	15,094	15,644
Interest	2.2B	25,866	26,479	28,027
Dividends	2.2C	39,585	62,719	50,767
Military superannuation contributions	2.2D	1,462,077	1,522,810	1,358,948
Other revenue	2.2E	48,655	46,643	27,253
Foreign exchange gains	2.2F	-	148	-
Total non-taxation revenue		1,593,054	1,673,893	1,480,639
Total revenue		1,593,054	1,673,893	1,480,639
Net cost of services		6,375,559	5,181,163	3,861,024
Deficit attributable to the Australian Government		(6,375,559)	(5,181,163)	(3,861,024)
OTHER COMPREHENSIVE INCOME				
Items not subject to subsequent reclassification to net cost of services				
Changes in asset revaluation reserves		98,910	75,374	-
Actuarial gains/(losses) on defined benefits plans		23,171,300	(25,997,700)	36,507,182
Total other comprehensive income		23,270,210	(25,922,326)	36,507,182
Total comprehensive income/(loss)		16,894,651	(31,103,489)	32,646,158

¹ Defence's original budgeted financial statement that was first presented to parliament in respect of the reporting period (i.e. from Defence's 2016-17 Portfolio Budget Statements). The budget is not audited.

The above schedule should be read in conjunction with the accompanying notes.

Department of Defence
ADMINISTERED SCHEDULE OF COMPREHENSIVE INCOME (continued)

For the period ended 30 June 2017

Budget Variances Commentary

Explanations are only provided where the variance at a financial statement line item level is greater than 10% of the Original Budget for that line item.

Administered Schedule of Comprehensive Income

Affected line items	Explanation of major variances
<i>Employee Benefits</i> Variance: \$2,640m; 50%	The variance predominantly relates to the basis of the unfunded superannuation liabilities based on which the superannuation expenses are projected. The balance is based on the actual liabilities as at 30 June 2016. However, the Original Budget is prepared based on the long term superannuation liabilities estimate using the long term discount rate of 6%.
<i>Subsidies</i> Variance: \$13m, 12%	The variance against the prior year of \$13.6m predominantly relates to subsidy payments under Defence Home Ownership Assistance Scheme (DHOAS). The movement is due to the interest rate being lower than last year, despite the fact that the number of beneficiaries have increased. The average interest rate during FY2016-17 was 4.50% (FY2015-16: 4.83%).
<i>Other Revenue</i> Variance: \$21m, 79%	The variance predominantly relates to DHA State Tax Equivalent Payment (STEP) receipts being higher than forecast.
<i>Changes in asset revaluation reserves</i> Variance: \$99m	The variation is due to the revaluation of investments accounted for using the equity method not included in the Original Budget due to the uncertainty of the movement in the fair value for these assets.
<i>Dividends</i> Variance: \$11m; 22%	The variation is due to the lower dividend income from related parties as a result of related parties achieving lower net profit after tax.
<i>Actuarial gains/(losses) on defined benefits plans</i> Variance: \$13,336m, 37%	The variation is due to the budget being developed utilising a discount rate of 6.0% as compared to a lower actual interest rate that has ultimately been used by the Australian Government Actuary to determine the actual defined benefit superannuation liability as at 30 June 2017.

Department of Defence
ADMINISTERED SCHEDULE OF ASSETS AND LIABILITIES

Original

as at 30 June 2017

2017

2016

Budget¹

\$'000

\$'000

\$'000

	Notes			
ASSETS				
Financial assets				
Cash and cash equivalents	4.1A	-	-	-
Trade and other receivables	4.1B	572,385	588,444	569,151
Investment accounted for using the equity method	4.1C	2,662,673	2,563,763	2,459,537
Total financial assets		3,235,058	3,152,207	3,028,688
Non-financial assets				
Prepayments	4.2A	240,452	203,121	271,556
Total non-financial assets		240,452	203,121	271,556
TOTAL ASSETS ADMINISTERED ON BEHALF OF GOVERNMENT		3,475,510	3,355,328	3,300,244
LIABILITIES				
Payables				
Other payables	4.3A	6,427	8,262	5,502
Total Payables		6,427	8,262	5,502
Provisions				
Employee provisions	4.4A	106,972,301	124,727,700	64,437,987
Total provisions		106,972,301	124,727,700	64,437,987
TOTAL LIABILITIES ADMINISTERED ON BEHALF OF GOVERNMENT		106,978,728	124,735,962	64,443,489
NET LIABILITIES		(103,503,218)	(121,380,634)	(61,143,245)

¹ Defence's original budgeted financial statement that was first presented to parliament in respect of the reporting period (i.e. from Defence's 2016-17 Portfolio Budget Statements). The budget is not audited.

Budget Variances Commentary

Explanations are only provided where the variance at a financial statement line item level is greater than 10% of the Original Budget for that line item.

Administered Schedule of Assets and Liabilities

Affected line items	Explanation of major variances
<p><i>Prepayments</i> Variance: \$31m; 11%</p>	<p>The balance as at 30 June was higher than last year as the payments made to new beneficiaries will outweigh the winding down of the prepayment for existing benefit. The scheme has since been closed to members enlisted after October 2005, the continual reduction of the prepayment over long-term is expected.</p>
<p><i>Other Payables</i> Variance: \$0.925m; 17%</p>	<p>The variation is due to Fringe Benefit Tax (FBT) being higher than budgeted.</p>
<p><i>Employee Provisions</i> Variance: \$42,534m; 66%</p>	<p>The variance predominantly relates to the unfunded superannuation liabilities. The balance is based on the actual liabilities as at 30 June 2017 discounted using discount rates of 2.7% (DFRB), 3.4% (DFRDB) and 3.5% (MSBS and ADF Cover). However, the Original budget is prepared based on the long term superannuation liabilities estimate using the long term discount rate of 6%.</p>

The above schedule should be read in conjunction with the accompanying notes.

ADMINISTERED RECONCILIATION SCHEDULE

For the period ended 30 June 2017

	2017 \$'000	2016 \$'000
Opening assets less administered liabilities as at 1 July	(121,380,634)	(90,861,050)
Adjustment for errors	-	-
Adjusted opening assets less administered liabilities	<u>(121,380,634)</u>	<u>(90,861,050)</u>
Net (cost of)/contribution by services		
Income	1,593,054	1,673,893
Expenses		
Payments to entities other than corporate Commonwealth entities	(7,968,613)	(6,855,056)
Other comprehensive income:		
Revaluations taken to/(from) reserves:		
– Defence Housing Authority (DHA)	99,446	70,297
– Small portfolio entities	(536)	5,077
Actuarial gains/(losses)	23,171,300	(25,997,700)
Transfers (to)/from Australian Government:		
Appropriation transfers from Official Public Account:		
Special appropriations (unlimited) (non corporate Commonwealth entities)	5.1C 2,471,514	2,338,744
Transfers to Official Public Account	(1,713,749)	(1,754,913)
Funded benefit payments to the members, not drawn down from Special Appropriations	225,000	-
Restructuring	-	74
Closing assets less administered liabilities as at 30 June	<u>(103,503,218)</u>	<u>(121,380,634)</u>

Accounting Policy

Cash Transfers to and from the Official Public Account

Revenue collected by Defence for use by the Government rather than Defence is administered revenue. Collections are transferred to the Official Public Account (OPA) maintained by the Department of Finance. Conversely, cash is drawn from the OPA to make payments under Parliamentary appropriations on behalf of Government. These transfers to and from the OPA are adjustments to the administered cash held by Defence on behalf of the Government and reported as such in the schedule of administered cash flows and in the administered reconciliation schedule.

The above schedule should be read in conjunction with the accompanying notes.

Department of Defence
ADMINISTERED CASH FLOW STATEMENT

For the period ended 30 June 2017

	2017 \$'000	2016 \$'000
	Notes	
OPERATING ACTIVITIES		
Cash received		
Fees	14,731	13,960
Interest	19,418	26,552
Superannuation contributions	1,566,878	1,608,048
Other	50,003	51,716
Total cash received	1,651,030	1,700,276
Cash used		
Subsidies paid	(100,238)	(101,810)
Employees	(2,371,235)	(2,236,934)
Section 77 payments	(41)	-
Total cash used	(2,471,514)	(2,338,744)
Net cash flows from/(used by) operating activities	(820,484)	(638,468)
INVESTING ACTIVITIES		
Cash received		
Dividends	62,719	54,637
Total cash received	62,719	54,637
Net cash flows from/(used by) investing activities	62,719	54,637
Net increase/(decrease) in cash held	(757,765)	(583,831)
Cash from the Official Public Account for:		
Appropriations	2,471,514	2,338,744
Cash to the Official Public Account for:		
Appropriations	(1,713,749)	(1,754,913)
Cash and cash equivalents at the end of the reporting period	4.1A <u>-</u>	<u>-</u>

The above statement should be read in conjunction with the accompanying notes.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

OVERVIEW

The Basis of Preparation

The financial statements and notes are required by section 42 of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) and are general purpose financial statements.

The financial statements and notes have been prepared in accordance with:

- *Public Governance, Performance and Accountability (Financial Reporting) Rule 2015* (FRR) for reporting periods ending on or after 1 July 2016; and
- Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board (AASB) that apply for the reporting period.

The financial statements and notes have been prepared on an accrual basis and are in accordance with the historical cost convention, except for certain assets at fair value. Except where stated, no allowance is made for the effect of changing prices on the results or the financial position.

The financial statements and notes are presented in Australian dollars and values are rounded to the nearest thousand dollars unless otherwise specified.

New Accounting Standards

There were no new standards and/or interpretations issued during the financial year that was applicable to the 2016-17 financial year. However, there was one new standard issued in the current financial year that will have a future material impact on the Defence financial statements being:

- AASB 16 *Leases* (effective from 1 January 2019).

Defence expects to apply AASB 16 from 2019-20 financial year. This standard will require the net present value of payments under most operating leases to be recognised as assets and liabilities.

Taxation

Defence is exempt from all forms of taxation except Fringe Benefits Tax (FBT), the Goods and Services Tax (GST) and certain excise and customs duties.

Revenues, expenses, assets and liabilities are recognised net of GST, except:

- where the amount of GST incurred is not recoverable from the Australian Taxation Office; and
- for receivables and payables which are recognised inclusive of GST.

Reporting of Administered activities

Administered revenues, expenses, assets, liabilities and cash flows are disclosed in the administered schedules and related notes.

Except where otherwise stated, administered items are accounted for on the same basis and using the same policies as for departmental items, including the application of Australian Accounting Standards.

Events After the Reporting Period

Departmental

There are no post balance date events with a material effect on the financial statements.

Administered

There are no post balance date events with a material effect on the financial statements.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

FINANCIAL PERFORMANCE

This section analyses the financial performance of Defence for the year ended 30 June 2017.

1.1: Expenses

	2017	2016
	\$'000	\$'000
1.1A: Employee benefits		
Australian Public Service (APS) employee benefits		
Wages and salaries	1,399,994	1,470,251
Superannuation:		
Defined contribution plan	115,942	111,985
Defined benefit plans	159,336	172,310
Leave and other entitlements	148,046	225,183
Fringe benefits tax	19,595	16,438
Separation and redundancies	12,039	63,549
Other allowances	42,862	42,776
Health expenses	5,718	5,315
Other employee expenses	1,370	889
Total APS employee benefits	1,904,902	2,108,696
Australian Defence Force (ADF) employee benefits		
Wages and salaries	4,877,027	4,731,482
Superannuation:		
Defined contribution plan	29,286	-
Defined benefit plans	1,653,559	1,659,137
Housing ¹	870,413	877,990
Leave and other entitlements	454,386	683,554
Fringe benefits tax	512,423	517,478
Overseas allowances	157,165	158,391
Separation and redundancies	11,047	12,152
Other allowances	357,028	347,354
Health expenses	438,444	429,805
Other employee expenses	127,641	129,933
Total ADF employee benefits	9,488,419	9,547,276
Total employee benefits	11,393,321	11,655,972

¹ Housing expenses include lease payments made to DHA for the provision of Housing for ADF members with families. Due to their nature, these payments are classified as employee expenses. Residences leased from DHA are subleased by Defence to ADF members for a nominal charge. Sublease expenses are paid by Defence to DHA and recognised as part of ADF housing expenses.

For the current financial period, sublease expenses were \$532.5m (2015-16: \$530.1m).

Accounting Policy

Defence's workforce comprises APS (i.e. civilians) and ADF (i.e. military) personnel. Employee benefits for each workforce component are based on the relevant employment agreements and legislation. Liabilities for services rendered by employees are recognised at the reporting date to the extent that they have not been settled.

Liabilities for wages and salaries (including non-monetary benefits), annual leave and other entitlements expected to be wholly settled within 12 months of the reporting date are measured at their nominal amounts which are calculated with regard to the rates expected to be paid on settlement of the liability.

All other employee benefit liabilities (including long service leave) are measured at the present value of the estimated future cash outflows to be made in respect of services provided by employees up to the reporting date.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

1.1A: Employee benefits (continued)

(a) Leave

The liability for employee benefits includes provisions for annual leave and long service leave. No provision has been made for sick leave as all sick leave is non-vesting and the average sick leave taken in future years by employees of Defence is estimated to be less than the annual entitlement for sick leave. The leave liabilities are calculated on the basis of employees' remuneration, including Defence's employer superannuation contribution, at the estimated rates that will be applied at the time that leave is taken, to the extent that leave is likely to be taken during service rather than paid out on termination.

The liability for long service leave has been determined by reference to the work of the Australian Government Actuary in the current year. The estimate of the present value of the liability takes into account attrition rates and pay increases through promotion and inflation.

(b) Separation and Redundancy

Provision is made for separation and redundancy benefit payments. Defence recognises a provision for termination when it has a detailed formal plan for the terminations and has informed those employees affected that the terminations will be carried out.

(c) Superannuation – APS Employees

Permanently appointed APS employees of Defence are members of the Commonwealth Superannuation Scheme (CSS), the Public Sector Superannuation Scheme (PSS), the PSS Accumulation Plan (PSSap) and other superannuation schemes held outside the Commonwealth.

The CSS and PSS are defined benefit schemes for the Australian Government. The PSSap is a defined contribution scheme.

The liability for defined benefits is recognised in the financial statements of the Australian Government and is settled by the Australian Government in due course. This liability is reported by the Department of Finance as an administered item.

Defence makes employer contributions to the employee superannuation schemes at rates determined by an actuary to be sufficient to meet the current cost to the Government of the superannuation entitlements of Defence's employees.

Defence accounts for these contributions as if they were contributions to defined contribution plans in accordance with AASB 119.

The liability for superannuation recognised in the departmental statements as at 30 June represents outstanding contributions yet to be paid.

(d) Superannuation – ADF Members

Permanently appointed ADF employees of Defence are members of The Defence Force Retirement and Death Benefits Scheme (DFRDB), the Military Superannuation Benefits Scheme (MSBS) and Australian Defence Force Superannuation (ADF Super).

DFRDB and MSBS are defined benefit superannuation plans for ADF members. Defence accounts for these contributions in its departmental statements as if they were contributions to defined contribution plans in accordance with AASB 119.

ADF Super is a defined contribution scheme which commenced on 1 July 2016.

The liability for superannuation recognised in the departmental statements as at 30 June represents outstanding contributions yet to be paid.

(e) Paid Parental Leave

Defence provide payments to employees under the Government Paid Parental Scheme. The receipts received are offset by the payments made to the employees and any balance outstanding at the end of the year is recognised as a liability.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017 \$'000	2016 \$'000
1.1B: Suppliers expenses		
Goods and Services		
Inventory consumption	1,259,406	1,187,375
Sustainment (including repair and overhaul)	4,705,151	4,299,288
Garrison support and mess operations	301,225	292,909
Travel	236,962	235,910
Freight, storage and removal	454,379	465,636
Training	477,108	458,422
Communications and information technology	1,503,948	1,327,870
Professional services/technical advice	406,521	276,454
Estate upkeep	987,066	996,115
Research and development	241,668	164,614
Utilities	336,739	326,207
Purchase of minor assets	203,732	161,027
Other	1,901,751	1,632,059
Total goods and services	13,015,656	11,823,886
Goods and services are made up of:		
Provision of goods	2,206,807	1,848,111
Rendering of services	10,808,849	9,975,775
Total goods and services	13,015,656	11,823,886
Other supplier expenses		
Operating lease rentals	304,536	330,027
Workers compensation premiums	32,087	37,617
Total other supplier expenses	336,623	367,644
Total supplier expenses	13,352,279	12,191,530

Leasing commitments

The operating leases are non-cancellable and are described in the table below:

Nature of leases	General description of leasing arrangement
DHA property leases	Defence leases residences under a service agreement with Defence Housing Australia (DHA) to provide accommodation to eligible service members. The total commitment has been calculated based on an initial forecast of housing demand for the period of the agreement, which is currently 6 years. Lease payments are subject to the terms and conditions of the lease and are payable to DHA.
Other property leases	Defence leases both residential and commercial properties in Australia and overseas in support of its activities. Lease payments are subject to the terms and conditions of the lease. Generally the leases are subject to market reviews, reviews in accordance with agreed indexation or a combination of both. The terms range between 1 and 100 years.
Aircraft leases	Defence leases aircraft in support of scientific and military operations and in support of parliamentary services. Lease terms range between 3 and 15 years.
Equipment leases	Defence has leases for items of equipment including computer hardware, multifunction devices and communication equipment. General lease terms are 2 to 5 years.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017 \$'000	2016 \$'000
1.1B: Suppliers expenses (continued)		
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within 1 year	1,048,640	901,494
Between 1 to 5 years	3,805,101	3,801,715
More than 5 years	2,654,611	3,473,211
Total operating lease commitments	7,508,352	8,176,420

Accounting Policy

A distinction is made between finance and operating leases. Finance leases effectively transfer from the lessor to the lessee substantially all the risks and benefits incidental to ownership of leased assets. In operating leases, the lessor effectively retains substantially all such risks and benefits.

Where an asset is acquired by means of a finance lease, the asset is capitalised and recognised at the lower of the fair value of the leased asset or the present value of minimum lease payments at the inception of the contract and a corresponding liability is also recognised at this time for the same amount. The discount rate used to calculate the present value of the minimum lease payments is the interest rate implicit in the lease. Assets acquired under a finance lease are amortised over the useful life of the asset. Lease payments are allocated between the principal component and the interest expense.

Operating lease payments are expensed on a straight line basis over the term of the lease which is representative of the pattern of benefits derived from the leased assets.

Lease incentives taking the form of 'free' leasehold improvements and rent holidays are recognised as an integral part of the total consideration agreed for the use of the leased asset.

1.1C: Grants

State and Territory Governments	7,219	2,794
Non-profit organisations	19,687	17,840
Overseas	106,745	107,991
Total grants	133,651	128,625

Accounting Policy

Contributions by Defence to other government entities, private sector organisations and individuals which have been identified as a grant are recognised as an expense when incurred.

1.1D: Finance costs

Finance leases	104,554	94,332
Unwinding of discount - restoration, decontamination and decommissioning	19,869	20,557
Bank interest	7	19
Total finance costs	124,430	114,908

1.1E: Write-down and impairment of assets

Impairment on financial instruments	5,392	473
Write-down of property, plant and equipment	348,432	250,380
Write-down and impairment on intangible assets	14,322	1,680
Write-down of inventory	541,685	444,232
Total write-down and impairment of assets	909,831	696,765

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017	2016
	\$'000	\$'000
1.1F: Foreign exchange		
Foreign exchange gains		
Non-speculative	45,116	61,376
Foreign exchange losses		
Non-speculative	(52,942)	(80,000)
Total net gain/(loss) foreign exchange	(7,826)	(18,624)

Accounting Policy

Transactions denominated in a foreign currency are converted at the exchange rate on the date of transaction. Foreign currency receivables and payables are translated at the exchange rate at the balance date.

Non-financial items that are measured at cost in a foreign currency are translated using the spot exchange rate at the date of the initial transaction. Non-financial items that are measured at fair value in a foreign currency are translated using the spot exchange rates at the date when the fair value was determined.

All exchange gains and losses are reported in the Statement of Comprehensive Income.

1.1G: Other expenses

Act of Grace payments (section 65)	520	2,185
Tactical Payment Scheme payments	2	6
Defective Administration Scheme payments	2,623	1,623
Restoration, decontamination and decommissioning costs	153,195	236,860
Other	6,847	4,243
Total other expenses	163,187	244,917

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
For the period ended 30 June 2017

1.2: Own-Source Revenue and gains

Own-Source Revenue	2017 \$'000	2016 \$'000
1.2A: Provision of goods and rendering of services (including cost recovery)		
Provision of goods		
Rations and quarters - cost recovery	69,373	65,324
Provision of fuel - cost recovery	51,943	49,047
Other (including sale of obsolete and surplus inventory)	15,210	21,326
Total provision of goods	136,526	135,697
Rendering of services		
Group rental scheme	208,135	210,929
Logistics support recovery	23,616	18,991
s74 recoveries	36,875	34,675
Other governments/agencies	-	1,586
Other	51,701	45,539
Total rendering of services	320,327	311,720
Total provision of goods and rendering of services (including cost recovery)	456,853	447,417

Accounting Policy

Revenue from the provision of goods is recognised when:

- the risks and rewards of ownership have been transferred to the buyer;
- Defence retains no managerial involvement nor effective control over the goods;
- the revenue and transaction costs can be reliably measured; and
- it is probable that the economic benefits associated with the transaction will flow to Defence.

Revenue from the rendering of services is recognised by reference to the stage of completion of contracts at reporting date. The revenue is recognised when:

- the amount of revenue, stage of completion and transaction costs incurred can be reliably measured; and
- it is probable the economic benefits of the transaction will flow to Defence.

The stage of completion of contracts at the reporting date is determined by reference to the proportion that costs incurred to date bear to the estimated costs of the transaction.

1.2B: Rental income

Operating leases:

Other	6,414	5,722
Total rental income	6,414	5,722
Commitments for sublease rental income are receivable as follows:		
One year or less	19,362	20,895
From one to five years	5,370	6,500
Over five years	8,137	8,521
Total sublease rental income commitments	32,869	35,917

The lease rental income includes rental contributions from Defence service members for residences sub-leased by Defence. The Lease term is normally 3 to 12 years. The lease rental receivable is calculated for 28 days which is the minimum period of notice Defence members are required to provide before terminating the lease.

Defence receives revenue from the lease of property and office space. Office space is generally let to contractors in support of Defence activities and to other government agencies or to local civic authorities. The terms of these leases range between 1 and 99 years.

Accounting Policy

Rental revenue is accounted for on a straight line basis over the lease term. Contingent rental revenue is recognised as revenue in the periods in which it is earned. Lease incentives granted are recognised as an integral part of the total rental revenue.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017	2016
	\$'000	\$'000
1.2C: Other revenue		
Excise refunds	4,766	2,568
Settlement of damages	2,378	47,772
Foreign military sales refunds	16,749	5,309
Other minor revenues	9,231	10,909
Resources received free of charge		
Remuneration of auditors	3,800	4,700
Assets received free of charge	30	3,606
Total other revenue	36,954	74,864

Accounting Policy

Resources received free of charge for goods and services are recognised as revenue when and only when a fair value can be reliably determined and the services would have been purchased if they had not been donated. Use of those resources is recognised as an expense. Fair value is determined based on actual full cost if the resources were to be purchased. Resources received free of charge are recorded as either revenue or gains depending on their nature.

1.2D: Reversals of previous asset write-downs and impairment

Land and buildings	6,724	785
Specialist military equipment	10,593	44,625
Infrastructure	7,418	2,299
Plant and equipment	19,825	16,155
Heritage and cultural assets	3,618	107
Software and intangibles	27	-
Total property, plant and equipment and intangibles	48,205	63,971
Receivables	452	343
Inventory	166,046	194,188
Total reversal of previous asset write-downs and impairment	214,703	258,502

1.2E: Other gains

Other gains	146,598	70,218
Total other gains	146,598	70,218

Accounting Policy

(a) Contributions of Assets

Contributions of assets at no cost or for nominal consideration are recognised as gains at their fair value when the asset qualifies for recognition (with the exception of assets valued at cost), unless received from another Government agency as a consequence of a restructuring of administrative arrangements. Fair value is assessed by asset class as described in 3.2A(f).

(b) Sale of Assets

Gains or loss from disposal of non-current assets are recognised when control of the asset has passed to the buyer. The gain or loss on disposal of non-current assets is determined as the difference between the carrying amount of the asset at the time of disposal and the net proceeds of disposal (after deducting sale costs).

(c) Other Gains

Other gains relate to the reversals and/or write backs of provisions based on changes in estimates.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017 \$'000	2016 \$'000
1.2F: Revenue from Government		
Departmental Appropriations:		
Departmental appropriations: 2016-17 Supply Act 1, Appropriation Act 1 and Appropriation Act 3	30,817,179	-
Drawdown of prior year appropriation: 2015-16 Appropriation Act 3	97,055	-
Total revenue from Government	<u>30,914,234</u>	<u>28,900,438</u>

Defence is appropriated on a net cash basis which includes the appropriation revenue of \$30,914m (2015-16: \$28,900m) included in the Statement of Comprehensive Income, and the equity injection of \$1,065m (2015-16: \$2,943m) included in the Statement of Financial Position.

Accounting Policy

Amounts appropriated for departmental appropriation for the year (adjusted for any formal additions and reductions) are recognised as revenue when Defence gains control of the appropriation, except for certain amounts that relate to activities that are reciprocal in nature, in which case revenue is recognised only when it has been earned.

Defence draws down appropriations on a just-in-time basis. The undrawn appropriations as at 30 June 2017 are reflected as a receivable and are available to be drawn down to meet future obligations. Appropriations receivable are recognised at their nominal amounts.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

INCOME AND EXPENSES ADMINISTERED ON BEHALF OF THE GOVERNMENT

This section analyses the activities that Defence does not control but administers on behalf of the Government. Unless otherwise noted, the accounting policies adopted are consistent with those applied for departmental reporting.

2.1: Administered - Expenses

		2017	2016
		\$'000	\$'000
2.1A: Employee benefits			
Superannuation:			
Defined benefit plans			
Net service cost		4,397,255	3,180,083
Net interest cost		3,394,400	3,502,000
Retention benefits		78,217	68,332
Total employee benefits		<u>7,869,872</u>	<u>6,750,415</u>
2.1B: Subsidies			
Related parties:			
Defence Home Owner Scheme		587	828
Defence Home Ownership Assistance Scheme		97,816	103,741
Total subsidies		<u>98,403</u>	<u>104,569</u>
2.1C: Write-down and impairment of assets			
Impairment of financial instruments	7.3B	143	72
Total write-down and impairment of assets		<u>143</u>	<u>72</u>
2.1D: Foreign exchange losses			
Foreign exchange losses:			
Non-speculative	7.3B	154	-
Total foreign exchange losses		<u>154</u>	<u>-</u>
2.1E: Other expenses			
Section 77 payments		41	-
Total other expenses		<u>41</u>	<u>-</u>
2.2: Administered - Income			
Non-Taxation Revenue			
2.2A: Fees and fines			
License fees		16,871	15,094
Total fees and fines		<u>16,871</u>	<u>15,094</u>
Accounting Policy			
All administered revenues relate to activities performed by Defence on behalf of the Australian Government. Administered revenues mainly comprise military superannuation contributions, payments received from the United Nations and foreign governments, bank interest, dividends, loan interest and State Tax Equivalent payments received from Defence Housing Australia and licence fees received under the Defence Home Ownership Assistance Scheme.			
2.2B: Interest			
Deposits		-	(42)
Loans to Defence Housing Australia		25,866	26,521
Total interest		<u>25,866</u>	<u>26,479</u>

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017	2016
	\$'000	\$'000
2.2C: Dividends		
Australian Government Entities - Defence Housing Australia	39,585	62,719
Total dividends	<u>39,585</u>	<u>62,719</u>
2.2D: Military superannuation contributions		
Military Superannuation contributions	1,462,077	1,522,810
Total military superannuation contributions	<u>1,462,077</u>	<u>1,522,810</u>
2.2E: Other revenue		
Competitive Neutrality Revenue - Defence Housing Australia	42,158	42,159
Other	6,497	4,484
Total other revenue	<u>48,655</u>	<u>46,643</u>
2.2F: Foreign exchange gains		
Non-speculative	-	148
Total foreign exchange gains	<u>-</u>	<u>148</u>

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

FINANCIAL POSITION

This section analyses Defence's assets used to conduct its operations and the operating liabilities incurred as a result.

3.1: Financial Assets

	2017	2016
	\$'000	\$'000
3.1A: Cash and cash equivalents		
Cash on hand	4,563	5,144
Cash at bank - at call	84,260	42,453
Total cash and cash equivalents	<u>88,823</u>	<u>47,597</u>

Accounting Policy

Cash and cash equivalents includes notes and coins held, any deposits in bank account held at call with a bank, and cash held in special accounts. Cash is measured at its nominal amount.

3.1B: Trade and other receivables

Goods and services receivables

Goods and Services	45,624	98,815
Total receivables for goods and services	<u>45,624</u>	<u>98,815</u>

Appropriations receivable

For existing programs	425,991	687,345
Total appropriations receivable	<u>425,991</u>	<u>687,345</u>

Other receivables

GST receivable from the Australian Taxation Office	234,527	243,199
Accrued revenue	31,264	11,907
Other	276,331	368,866
Total other receivables	<u>542,122</u>	<u>623,972</u>
Total trade and other receivables (gross)	<u>1,013,737</u>	<u>1,410,132</u>

Less impairment allowance

Goods and services	(7,818)	(3,203)
Total impairment allowance	<u>(7,818)</u>	<u>(3,203)</u>
Total trade and other receivables (net)	<u>1,005,919</u>	<u>1,406,929</u>

Credit terms for goods and services were within 1-30 days (2015-16: 1-30 days).

Accounting Policy

Trade receivables, loans and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. The relevant accounting policy is detailed in note 7.2A on Financial Instruments.

Receivables for goods and services are generally receivable within the short term and are measured at their nominal amounts less any allowance for impairment. The collectability of receivables is assessed periodically with allowances made for doubtful debts when there is objective evidence that Defence will not be able to collect the debt. No allowance is made for Australian Government, foreign government and employee debts as they are normally deemed to be collectable unless there is objective evidence to the contrary. Long term receivables are discounted to the present value using the effective interest method.

Department of Defence**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS***For the period ended 30 June 2017*

	2017	2016
	\$'000	\$'000
3.1B: Trade and other receivables (continued)		
Reconciliation of the impairment allowance:		
Opening balance	(3,203)	(3,390)
Adjustment to opening balance for DMO amounts transferred in	-	(188)
Amounts written off	-	272
Amounts recovered and reversed	452	343
(Increase)/decrease recognised in net cost of services	(5,067)	(240)
Closing balance	<u>(7,818)</u>	<u>(3,203)</u>

Accounting Policy

Financial assets are assessed for impairment at the end of each reporting period.

**Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**

For the period ended 30 June 2017

3.2: Non-Financial Assets

3.2A: Reconciliation of the opening and closing balances of property, plant and equipment, and intangibles (2016-2017)

Item	Land ¹	Buildings ¹	Specialist Military Equipment	Infra-structure	Plant and Equipment ¹	Heritage and Cultural Assets ²	Computer Software - Purchased	Computer Software - Internally Generated	Other Intangibles Purchased	Other Intangibles Internally Generated	Total
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
As at 1 July 2016											
Gross Book value	5,505,638	12,568,373	56,217,433	5,846,671	2,324,503	682,484	1,059,046	385,700	294,001	23,953	84,907,802
Accumulated depreciation/amortisation	-	(432,939)	-	(216,232)	(213,158)	(59,382)	(599,722)	(185,564)	(167,176)	(16,083)	(1,890,256)
Net book value 1 July 2016	5,505,638	12,135,434	56,217,433	5,630,439	2,111,345	623,102	459,324	200,136	126,825	7,870	83,017,546
Additions:											
By purchase	15,666	978,701	6,197,407	486,726	371,912	1,613	57,418	65,657	1,198	-	8,176,298
By finance lease	4,394	37,325	-	-	4,548	-	-	-	-	-	46,267
Adjustments to opening balance	-	26,400	126,951	34,202	(114)	(297)	(1,015)	1,294	3	-	187,424
Revaluations/impairments recognised in other comprehensive income	251,727	(314,175)	431,180	8,433	98,447	17,091	-	-	-	-	492,703
Reclassification	(71,394)	(17,442)	12,857	90,417	(18,428)	672	(11,729)	15,047	-	-	-
Depreciation/amortisation expense	-	(606,846)	(4,045,922)	(376,713)	(237,548)	(36,830)	(64,479)	(53,113)	(39,114)	(1,837)	(5,462,402)
Revaluations/write-downs and impairment recognised in net cost of services	-	(6,082)	(292,560)	(2,358)	(46,724)	(708)	(13,682)	(133)	(507)	-	(362,754)
Other movements	-	-	-	-	-	-	-	-	-	-	-
Reversal of previous asset write-downs	319	6,405	10,593	7,418	19,825	3,618	27	-	-	-	48,205
Transfers in/(out)	(351,900)	(7,625)	(78,953)	(3,974)	(278)	(976)	-	-	-	-	(443,706)
Transfers (to)/from Assets Held for Sale	(11,418)	4,008	8,329	218	(35)	-	-	-	-	-	1,102
Disposals:											
Other disposals	(7,090)	(79,827)	(14,371)	(761)	(16,287)	-	-	-	-	-	(118,336)
Net book value 30 June 2017	5,335,942	12,156,276	56,572,944	5,874,047	2,286,663	607,285	425,864	228,888	88,405	6,033	85,562,347
Net book value as at 30 June 2017 represented by:											
Gross book value	5,335,942	12,565,368	59,274,566	6,122,273	2,497,423	672,641	1,089,063	461,367	295,199	23,953	88,337,815
Accumulated depreciation/amortisation and impairment	-	(409,112)	(701,622)	(248,226)	(210,760)	(65,356)	(663,199)	(232,479)	(206,794)	(17,920)	(2,755,468)
Closing net book value at 30 June 2017	5,335,942	12,156,276	56,572,944	5,874,047	2,286,663	607,285	425,864	228,888	88,405	6,033	85,562,347

¹ The carrying amount of land, buildings, infrastructure and plant and equipment under finance lease as at 30 June 2017 were \$75.6m, \$1,051.4m, \$111.7m and \$191.2m respectively.

² Where land, buildings, infrastructure and plant and equipment meet the definition of a heritage and cultural item, they have been disclosed in the heritage and cultural assets class.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

3.2A: Reconciliation of the opening and closing balances of property, plant and equipment, and intangibles (2015-2016)

Item	Land ¹ \$'000	Buildings ¹ \$'000	Specialist Military Equipment ¹ \$'000	Infra- structure ¹ \$'000	Plant and Equipment ¹ \$'000	Heritage and Cultural Assets ² \$'000	Computer Software - Purchased \$'000	Computer Software - Internally Generated \$'000	Other Intangibles Purchased \$'000	Other Intangibles Internally Generated \$'000	Total ³ \$'000
As at 1 July 2015											
Gross Book value	5,110,068	12,903,108	81,185,331	5,780,270	1,925,942	1,060,336	962,513	361,225	294,001	23,953	109,606,747
Accumulated depreciation/amortisation	-	(358,863)	(38,534,094)	(208,276)	(145,296)	(53,388)	(538,244)	(143,579)	(127,335)	(14,204)	(40,123,079)
Net book value 1 July 2015	5,110,068	12,544,445	42,651,237	5,571,994	1,780,646	1,006,948	424,269	217,646	166,666	9,749	69,483,668
Additions:											
By purchase	168	553,779	6,753,067	287,422	390,754	1,252	94,816	29,246	-	-	8,110,504
By finance lease	1,452	4,240	-	-	120,127	-	-	-	-	-	125,819
Adjustments to opening balance	-	11,058	601,311	3,587	(10,030)	(318,704)	-	-	-	-	287,222
Revaluations/impairments recognised in other comprehensive income	459,966	(147,839)	9,388,585	131,948	(34,877)	(22,118)	-	-	-	-	9,775,665
Reclassification	(31,619)	(173,640)	46,968	(53,376)	202,534	5,964	1,946	1,223	-	-	-
Depreciation/amortisation expense	-	(619,488)	(2,976,143)	(392,703)	(323,720)	(49,724)	(61,477)	(46,532)	(39,838)	(1,879)	(4,511,504)
Revaluations/write-downs and impairment recognised in net cost of services	-	(22,510)	(213,709)	(2,357)	(11,111)	(693)	(230)	(1,447)	(3)	-	(252,060)
Other movements	-	785	44,625	2,299	16,155	107	-	-	-	-	63,971
Reversal of previous asset write-downs	-	18,864	(59,654)	82,190	5,805	70	-	-	-	-	47,275
Transfers in/(out)	-	(15,693)	(310)	(453)	25	-	-	-	-	-	(26,232)
Transfers (to)/from Assets Held for Sale	-	-	-	-	-	-	-	-	-	-	-
Disposals:											
Other disposals	(18,704)	(33,950)	(9,053)	(112)	(24,963)	-	-	-	-	-	(86,782)
Net book value 30 June 2016	5,505,638	12,135,434	56,217,433	5,630,439	2,111,345	623,102	459,324	200,136	126,825	7,870	83,017,546
Net book value as at 30 June 2016 represented by:											
Gross book value	5,505,638	12,568,373	56,217,433	5,846,671	2,324,503	682,484	1,059,046	385,700	294,001	23,953	84,907,802
Accumulated depreciation/amortisation and impairment	-	(432,939)	-	(216,232)	(213,158)	(59,382)	(599,722)	(185,564)	(167,176)	(16,083)	(1,890,256)
Closing net book value at 30 June 2016	5,505,638	12,135,434	56,217,433	5,630,439	2,111,345	623,102	459,324	200,136	126,825	7,870	83,017,546

¹ The carrying amount of land, buildings, infrastructure and plant and equipment under finance lease as at 30 June 2016 were \$80.9m, \$1,102.3m, \$118.3m and \$219.5m respectively.

² Where land, buildings, infrastructure and plant and equipment meet the definition of a heritage and cultural item, they have been disclosed in the heritage and cultural assets class.

³ This balance was impacted by the integration of Defence Materiel Organisation on 1 July 2015 - refer to Note 8.2A.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

3.2A: Reconciliation of the opening and closing balances of property, plant and equipment, and intangibles (continued)

	2017 \$'000	2016 \$'000
Commitments payable relating to property, plant and equipment and intangibles		
Land and buildings ¹	1,302,461	1,963,498
Specialist military equipment ²	14,328,701	14,586,125
Infrastructure, plant and equipment ³	1,583,427	1,478,157
Intangibles ⁴	167,101	95,107
Total capital commitments	17,381,690	18,122,887

1. Outstanding contractual payments for buildings under construction.
2. Outstanding contractual payments for specialist military equipment under construction.
3. Infrastructure, plant and equipment capital commitments include outstanding contractual payments relating to the Major Capital Facilities (MCF) program.
4. Intangible commitments include contractual payments for software licence agreements.

Accounting Policy

(a) Individual Asset Recognition Threshold

Purchases of property, plant and equipment including land, buildings and infrastructure are recognised initially at cost where they meet the individual asset recognition threshold. Individual items are capitalised where the individual value is equal to or exceeds \$5,000 for buildings, infrastructure and heritage and cultural assets; \$2,000 for other plant and equipment; and nil for specialist military equipment and land.

(b) Componentisation

Major assets, such as specialist military equipment, are componentised if it is likely that the components will have useful lives that differ significantly from other parts of the asset. The useful lives of components may be determined with reference to the individual component or the related primary asset.

(c) Decontamination, Restoration and Decommissioning Costs

Where a legal or constructive obligation arises on acquisition to restore an asset back to its original condition, or dismantle an asset at the end of its useful life, the net present value of estimated restoration and/or decommissioning costs are capitalised and added to the cost of the underlying asset and depreciated over the asset's useful life.

(d) Reversal of Previous Asset Write-Downs

These are amounts relating to assets which have been previously written down or expensed in prior periods. In the current year, these items have been either reversed as a write down or capitalised for the first time due to either exceeding the capitalisation threshold or through identification during stock takes. They may include identification of heritage and cultural assets not previously recognised as assets.

(e) Assets under construction

Assets under construction (AUC) include expenditure to date on major military capability and facilities projects. AUC projects are reviewed annually for indicators of impairment. Prior to rollout into service, the accumulated AUC balance is reviewed to ensure accurate capitalisation.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

3.2A: Reconciliation of the opening and closing balances of property, plant and equipment, and intangibles (continued)

Accounting Policy (continued)

(f) Subsequent valuations

All property, plant and equipment is measured and disclosed at fair value, less any accumulated depreciation and accumulated impairment losses.

The basis for determining fair value is by reference to the highest and best use that is physically possible, legally permissible and financially feasible. Where an active and liquid market exists, fair value is determined by reference to market values, noting the highest and best use criteria and any specific factors that have been noted by the valuer.

Specialist Military Equipment is valued internally by the Department of Defence. Valuation techniques include reference to comparable assets, recently purchased assets and indexation based on the country of manufacture. Valuation for land, buildings, infrastructure, other plant and equipment and heritage and cultural assets are performed by independent external valuers using inputs such as sales prices of comparable assets, replacement cost, expected useful life and adjustments for obsolescence.

Following initial recognition at cost, valuations for land, buildings, infrastructure and specialist military equipment are conducted every year; other plant and equipment are revalued annually on a sample basis and heritage and cultural assets are revalued over a five year period.

Revaluation adjustments are made on a class basis. Any revaluation increment is recognised as Other Comprehensive Income under the heading of Changes in Asset Revaluation Reserves except to the extent that it reverses a previous revaluation decrement of the same class that was previously recognised in the surplus/deficit. Revaluation decrements for a class of assets are recognised directly in the surplus/deficit except to the extent that they reverse a previous revaluation increment for that class.

Any accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the asset is restated to the revalued amount.

(g) Depreciation

Property, plant and equipment items having limited useful lives are systematically depreciated over their estimated useful lives on a straight-line basis.

Depreciation rates (useful lives) are determined upon acquisition and are reviewed at each subsequent reporting date, and necessary adjustments are made in the current, or current and future reporting periods, as appropriate. Residual values are re-estimated only when assets are revalued.

The following are minimum and maximum useful lives for the different asset classes. These are not necessarily indicative of typical useful lives for these asset classes.

	2016-17	2015-16
Buildings	1 to 100 years	1 to 100 years
Infrastructure	2 to 99 years	2 to 99 years
Specialist military equipment	1 to 48 years	1 to 54 years
Other plant and equipment	1 to 100 years	2 to 100 years
Assets under finance lease	5 to 48 years	5 to 60 years
Heritage and cultural	10 to Indefinite	10 to Indefinite

Road earthworks are depreciated over the estimated useful life of the asset except where an engineering review has determined the useful life to be indefinite, in which case no depreciation is applied.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

3.2A: Reconciliation of the opening and closing balances of property, plant and equipment, and intangibles (continued)

Accounting Policy (continued)

(h) Heritage and Cultural Assets

Heritage and cultural items include:

- artefacts and memorabilia that are or may be of national historical or cultural significance. While many of these items represent military achievements, including paintings, memorabilia and other military items, others are associated with developments in science and exploration such as museum pieces, decommissioned aircraft and military equipment, or with significant personal achievements, such as medals, badges, uniforms and other regalia.
- buildings of historical or cultural significance. These buildings may be used for office accommodation, residences, chapels, storage and gymnasiums but are primarily held for heritage and cultural purposes.

Artefacts and memorabilia are stored and managed by Service Museums (Navy, Army and Air Force). Each Service maintains their own documented processes and procedures for the storage, documentation, restoration and preservation of various artefacts depending on their type and sensitivity.

Conservation and preservation policies include the storage of these items under appropriate conditions including, exposure to minimal UV light, stable humidity and temperatures and maintaining a dust and pest free environment as well as cataloguing and maintenance. In addition, conservation programs within Service Museums aim to identify items requiring restoration.

Heritage and cultural estate assets are amortised on a straight-line basis over their anticipated useful lives. Heritage and cultural assets are stored, managed, displayed, repaired and restored in ways that will maintain their cultural or heritage value over time. Where conservation, restoration and preservation activities demonstrate that an asset will be maintained for an indefinite period, these items are considered to have indefinite useful lives and therefore, are not subject to depreciation which is in accordance with the implementation guidance (G4) provided in AASB 116.

Heritage buildings are managed by Defence Environmental Management. All Defence heritage buildings are included in the Defence Heritage Register and managed using the Defence Heritage Toolkit. This Toolkit sets out the strategies and policies for managing heritage buildings across the Defence estate as well as ensuring all disposals, acquisitions and development activities to these sites look at heritage issues and assess possible risks to any values and mitigation strategies via Heritage Impact Assessments. The Toolkit has been established in accordance with the *Environment Protection and Biodiversity Conservation Act 1999*. Further information on heritage management across the Defence estate can be obtained from the following site: <http://www.defence.gov.au/estatemangement/governance/Policy/Environment/Heritage/default.asp>.

(i) Intangible Assets

Defence's intangibles comprise externally acquired and internally developed computer software for internal use and other externally acquired and internally developed intangibles. Intangibles with gross values greater than \$150,000 are capitalised when they meet the recognition criteria in AASB 138.

All intangibles are amortised on a straight-line basis over their anticipated useful lives. The useful lives of Defence software are 2-24 years (2015-16: 1-24 years) and the useful lives of Defence's other intangibles are 4-35 years (2015-16: 3-35 years). All intangible assets are assessed annually for indications of impairment.

Defence recognises its intangible assets initially at cost and measures those which have an active market at fair value subsequent to initial recognition. If an intangible asset is acquired at no cost or for nominal consideration, other than those acquired through restructuring, it is recognised initially at fair value as at the date of acquisition.

All Defence intangible assets are currently stated at cost less any subsequent accumulated amortisation and accumulated impairment losses.

Acquired intellectual property may form part of the acquisition of particular tangible assets. Where the acquired intellectual property is inseparable from the underlying tangible asset it is reflected in the value of the tangible asset in the statement of financial position.

Defence reviews the useful life of intangible assets annually based on the service potential of the assets. All Defence intangible assets have finite useful lives and are amortised over their anticipated useful lives. Where there is an indication that the service potential of an intangible asset is impaired, the recoverable amount of that asset is determined based on the remaining service potential. Where the recoverable amount is lower than the carrying amount, the asset is written down to its recoverable amount.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

3.2A: Reconciliation of the opening and closing balances of property, plant and equipment, and intangibles (continued)

Accounting Policy (continued)

(j) Acquisition of Assets

Assets are initially recorded at cost on acquisition which includes the fair value of assets exchanged and liabilities undertaken. Financial assets are initially measured at their fair value plus transaction costs where appropriate.

Assets acquired at no cost, or for nominal consideration are initially recognised as assets and revenues at their fair value at the date of acquisition, unless acquired as a consequence of restructuring of administrative arrangements. In the latter case, assets are initially recognised at the amounts at which they were recognised in the transferor agency's accounts immediately prior to the restructuring.

(k) Impairment of Assets

Defence applies its impairment testing to the smallest identifiable group of assets that is useful to Defence in achieving its objectives and whose utility/usefulness is largely independent of the utility provided to Defence by other assets or groups of assets. All relevant assets were assessed for impairment during the year. Where indications of impairment exist, the asset's recoverable amount is estimated and an impairment adjustment made if the asset's recoverable amount is less than its carrying amount.

The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Value in use is the present value of the future cash flows expected to be derived from the asset. Where the future economic benefit of an asset is not primarily dependent on the asset's ability to generate future cash flows, and the asset would be replaced if Defence was deprived of the asset, its value in use is taken to be its depreciated replacement cost.

(l) Derecognition of Assets

Assets are derecognised upon disposal or when no further economic benefits or capability are expected from their use or disposal.

Significant Accounting Judgements and Estimates

Defence assesses non-financial assets for impairment by monitoring impairment indicators specific to an asset's use in the Defence context. Where these indicators signify that an asset is impaired, management has made an estimate of the recoverable amount of those assets to determine any impairment loss.

Property, plant and equipment is measured at fair value using revaluation techniques that require significant judgements and estimates to be made.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017	2016
	\$'000	\$'000
3.2B: Inventories		
Inventories - General	2,409,183	2,480,594
Inventories - Explosive ordnance	4,299,246	4,149,445
Inventories - Fuel	66,958	99,949
Total inventories	6,775,387	6,729,988

No items of inventory were recognised at fair value less cost to sell.

The reversal of previous inventory write downs is attributable to price and quantity adjustments in the current financial year.

Accounting Policy

Defence holds inventory for its own use and does not ordinarily hold inventory for sale. Sales of inventory relate to minor fuel sales to foreign governments. Inventory held for use is valued at cost adjusted where applicable for loss of service potential. Defence considers that loss of operating capacity due to obsolescence is the most appropriate basis for loss of service potential of its inventories.

Costs incurred in bringing each item of inventory (primarily explosive ordnance and general stores inventory) to its present location and condition that are capable of being allocated on a reasonable basis are assigned to inventory. The costs of inventories are assigned by using the weighted average cost formula.

Inventories acquired at no cost or nominal considerations are measured at current replacement cost at the date of acquisition.

Significant Accounting Judgements and Estimates

Estimates and assumptions have been made in relation to inventory obsolescence in order to determine the remaining service potential for inventory items which have experienced obsolescence or impairment and the pricing of certain legacy items.

3.2C: Prepayments

Capital prepayments	1,373,194	1,999,679
Non capital prepayments	536,593	875,011
Total prepayments	1,909,787	2,874,690

Accounting Policy

Prepayments, excluding those paid to employees as retention benefit payments, are recognised if the value of the payment is \$50,000 or greater.

3.2D: Assets held for sale

Land	32,504	25,093
Specialist military equipment	14,043	22,375
Heritage and cultural	-	-
Other infrastructure, plant and equipment	308	489
Inventories	15,581	15,581
Total assets held for sale	62,436	63,538

Accounting Policy

Non-current assets are classified as held for sale if the carrying amount is to be recovered principally through a sale transaction rather than through continuing use. Classification as held for sale occurs when the asset is available for immediate sale in its present condition, and the sale is highly probable. On classification as held for sale, the asset is measured at the lower of its carrying amount and fair value less costs to sell. Any write down to fair value less costs to sell is recognised as an impairment loss. Assets which have been classified as held for sale are no longer subject to depreciation or amortisation.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017	2016
	\$'000	\$'000
3.3: Payables		
3.3A: Suppliers		
Trade creditors and accruals	2,300,716	2,508,872
Operating lease rentals	3,569	31,009
Total suppliers payable	2,304,285	2,539,881
Settlement is usually made within 30 days.		
3.3B: Personal benefits		
Australian Public Service (APS) employee payables		
Salaries and wages	11,929	5,969
Superannuation	2,109	1,040
Separations and redundancies	-	689
Australian Defence Force (ADF) employee payables		
Salaries and wages	32,051	15,642
Superannuation	8,489	4,436
Separations and redundancies	-	-
Total personal benefits payable	54,578	27,776
3.3C: Other payables		
Statutory payable	217,064	141,218
Other	76,203	83,905
Total other payables	293,267	225,123

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017	2016
	\$'000	\$'000
3.4: Interest Bearing Liabilities		
3.4A: Finance leases		
Finance leases	<u>1,549,237</u>	<u>1,534,423</u>
Total finance leases	<u>1,549,237</u>	<u>1,534,423</u>
Minimum lease payments expected to be settled		
Within 1 year	46,557	35,993
Between 1 to 5 years	243,729	204,924
More than 5 years	<u>1,258,951</u>	<u>1,293,506</u>
Total finance leases	<u>1,549,237</u>	<u>1,534,423</u>

31 (2015-16: 33) finance leases exist in relation to properties and technology. The leases are non-cancellable and for fixed terms with an average remaining term of 18.06 years (2015-16: 19.42 years). The maximum number of years remaining is 26.58 years (2015-16: 27.58 years) relating to Single LEAP finance 2 leases (2015-16: Single LEAP finance 2 leases). The lease assets secure the lease liabilities. Interest rates applied averaged 5.78% (2015-16: 6.21%).

Accounting Policy

The relevant accounting policy for leases is detailed in Note 1.1B Suppliers Expenses.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

3.5: Provisions	2017	2016
	\$'000	\$'000
3.5A: Employee provisions		
Australian Public Service (APS) employee provisions		
Leave	<u>681,827</u>	<u>701,604</u>
Total APS employee provisions	<u>681,827</u>	<u>701,604</u>
Australian Defence Force (ADF) employee provisions		
Leave	<u>1,931,394</u>	<u>1,985,493</u>
Other provisions	<u>14,441</u>	<u>17,998</u>
Total ADF employee provisions	<u>1,945,835</u>	<u>2,003,491</u>
Total employee provisions	<u>2,627,662</u>	<u>2,705,095</u>
Employee provisions are expected to be settled in:		
No more than 12 months	<u>779,022</u>	<u>816,295</u>
More than 12 months	<u>1,848,640</u>	<u>1,888,800</u>
Total employee provisions	<u>2,627,662</u>	<u>2,705,095</u>

Accounting Policy

The relevant accounting policy for employee provisions is detailed in Note 1.1A Employee Benefits.

Significant Accounting Judgements and Estimates

Provisions for annual leave and long service leave are estimates based on expert actuarial assumptions on the likely tenure of existing staff, patterns of leave claims and payouts, future salary movements and future discount rates.

3.5B: Restoration, decontamination and decommissioning provisions

Provisions for restoration and decommissioning	<u>533,734</u>	<u>645,747</u>
Provision for decontamination	<u>632,317</u>	<u>640,437</u>
Total restoration, decontamination and decommissioning provisions	<u>1,166,051</u>	<u>1,286,184</u>

Accounting Policy

Where a legal or constructive obligation arises on acquisition to restore an asset back to its original condition, or dismantle an asset at the end of its useful life, the net present value of estimated restoration and/or decommissioning costs are capitalised and added to the cost of the underlying asset and depreciated over the asset's useful life. At the same time, a corresponding provision is recognised for these costs. The carrying amount of the provision is adjusted to reflect the passage of time and any incremental costs are recognised as finance costs.

Where a legal or constructive obligation arises as a result of operations of Defence (i.e. use of the asset) the cost of restoration is recognised as an expense in the period in which the obligation arises.

One of the following past events would give rise to a constructive obligation:

- a public announcement or statement by Government or Defence that a site would be restored;
- the existence of an established pattern of past practice of restoring sites of a particular nature or type; or
- a specific policy adopted by Government with regard to restoration of sites of a particular nature or type.

Significant Accounting Judgments and Estimates

Provisions for specialist military equipment decommissioning are based on Defence's estimates of future obligations relating to the underlying assets. Provisions for land decontamination and site restoration are supported by external valuer's opinions.

Refer to Note 3.5D for a reconciliation of this balance.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017	2016
	\$'000	\$'000
3.5C: Other provisions		
Other provisions	<u>51,693</u>	<u>29,193</u>
Total other provisions	<u><u>51,693</u></u>	<u><u>29,193</u></u>

Refer to Note 3.5D for a reconciliation of this balance.

**3.5D: Reconciliation of provision balances
Movement in relation to 2017**

	Restoration and decommissioning provisions \$'000	Decontamination provisions \$'000	Other provisions \$'000
Carrying amount 1 July 2016	645,747	640,437	29,193
Additional provisions made	27,617	147,792	37,154
Amounts used	(177)	(40,075)	(14,654)
Amounts reversed	(13,327)	(126,752)	-
Unwinding of discount rate	10,699	9,170	-
Parameter changes	(136,825)	1,745	-
Closing balance 30 June 2017	<u>533,734</u>	<u>632,317</u>	<u>51,693</u>

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

ASSETS AND LIABILITIES ADMINISTERED ON BEHALF OF THE GOVERNMENT

This section analyses assets used to conduct operations and the operating liabilities incurred as a result of activities that Defence does not control but administers on behalf of the Government. Unless otherwise noted, the accounting policies adopted are consistent with those applied for departmental reporting.

4.1: Administered - Financial Assets

	2017 \$'000	2016 \$'000
4.1A: Cash and cash equivalents		
Cash on hand or on deposit	-	-
Total cash and cash equivalents	<u>-</u>	<u>-</u>
4.1B: Trade and other receivables		
Goods and services:		
In connection with - external parties	16,882	8,456
Total receivables for goods and services	<u>16,882</u>	<u>8,456</u>
Other receivables:		
Accrued superannuation	61	37
Interest Receivable	-	-
Dividends	39,585	62,719
Loans receivable - Defence Housing Australia	509,580	509,580
Competitive neutrality - Defence Housing Australia	6,706	7,941
Total other receivables	<u>555,932</u>	<u>580,277</u>
Total trade and other receivables (gross)	<u>572,814</u>	<u>588,733</u>
Less impairment allowance:		
Goods and services	(429)	(289)
Total impairment allowance	<u>(429)</u>	<u>(289)</u>
Total trade and other receivables (net)	<u>572,385</u>	<u>588,444</u>

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.1B: Trade and other receivables (continued)

	2017	2016
	\$'000	\$'000

Loans to Defence Housing Australia as at 30 June 2017 have a remaining term of up to 9 years. No security is provided. Principal is required to be repaid in full at maturity, however in practice the principal is normally rolled over in a new loan agreement. Interest rates are fixed. Weighted average interest rate is 5.08%. Interest payments are due every quarter or when the loan matures.

Reconciliation of the impairment allowance

Opening Balance	(289)	(223)
Amount written off	-	-
Amounts recovered and reversed	289	223
Increase recognised in net cost of service	(429)	(289)
Closing Balance	(429)	(289)

Credit terms for goods and services were within 1-30 days (2015-16: 1-30 days).

Accounting Policy

Loans and Receivables

Where loans and receivables are not subject to concessional treatment, they are carried at amortised cost using the effective interest method. Gains and losses due to impairment, derecognition and amortisation are recognised as income or expense.

4.1C: Investments accounted for using the equity method

Other investments shares (or equity in) - Defence Housing Australia	2,573,475	2,474,029
Other investments - Small portfolio entities	89,198	89,734
Total investments	2,662,673	2,563,763

Accounting policy

Defence reports the Australian Government's capital investment in Defence Housing Australia (DHA).

The investment is classified as 'available for sale' and is measured at fair value using the net assets valuation approach in accordance with the FRR. The investment was assessed for impairment at year end and no indicators of impairment were noted.

The Australian Government holds a 100% interest in DHA which is a Government Business Enterprise. The principal activity of DHA is to deliver adequate and suitable housing and housing related services that meet Defence's operational needs.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.1C: Investments accounted for using the equity method (continued)

The following Commonwealth Authorities and Companies are small portfolio bodies within the Defence Portfolio:

- Australian Strategic Policy Institute Limited;
- Army and Air Force Canteen Service (Frontline Defence Services);
- Australian Military Forces Relief Trust Fund (Army Relief Trust Fund);
- Royal Australian Air Force Veterans' Residences Trust Fund;
- Royal Australian Air Force Welfare Trust Fund;
- Royal Australian Navy Central Canteens Board;
- Royal Australian Navy Relief Trust Fund;
- AAF Company; and
- RAAF Welfare Recreational Company.

The Australian Strategic Policy Institute Limited is a Commonwealth company that provides policy-relevant research and analysis to inform Government decisions and public understanding of strategic and defence issues.

The remaining bodies were established through either their own enabling legislation or constitution to provide oversight role on the investment in these bodies on behalf of the beneficiaries.

These investments are classified as 'available for sale' and are measured using the net assets valuation approach in accordance with the FRR.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

	2017 \$'000	2016 \$'000
4.2: Administered - Non-Financial Assets		
4.2A: Other non-financial assets		
Prepayments - retention benefits	240,452	203,121
Total other non-financial assets	240,452	203,121
Accounting policy		
Certain categories of ADF personnel, who are members of the Military Superannuation Benefits Scheme (MSBS) and have had 15 years of service, receive retention benefits as an incentive for continued service. Retention benefit payments are initially recorded as prepayments and amortised over the expected period of service.		
4.3: Administered - Payables		
4.3A: Other payables		
Other payables	6,427	8,262
Total other payables	6,427	8,262
4.4: Administered - Provisions		
4.4A: Employee provisions		
Superannuation - DFRDB	43,502,800	50,358,700
Superannuation - MSBS	63,451,000	74,369,000
Superannuation - ADFC	18,501	-
Total employee provisions	106,972,301	124,727,700
Employee provisions are expected to be settled in:		
No more than 12 months	2,324,000	2,194,000
More than 12 months	104,648,301	122,533,700
Total employee provisions	106,972,301	124,727,700
Accounting Policy		
The Defence Force Retirement and Death Benefits Scheme (DFRDB) is a fully unfunded scheme and the Military Superannuation and Benefits Scheme (MSBS) is a partly funded scheme. MSBS member contributions are paid into the Military Super and Benefits Fund (MSB Fund) that is controlled by the Commonwealth Superannuation Corporation and are therefore not reflected in the administered financial statements. The Australian Government, on behalf of the MSB Fund, makes funded benefit payments to members of the scheme and is reimbursed by the MSB Fund for these payments.		
The Australian Government Actuary (AGA) estimates the provisions and expected future cash flows as at 30 June each year. These estimates are reflected in the administered financial statements. The AGA completes a full review of the unfunded liabilities every three years and issues a Long Term Cost Report. This was last completed in 2014.		
For defined benefit retirement benefit plans, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at the end of each reporting period. Re-measurement comprising of actuarial gains and losses, the effect of the asset ceiling (if applicable) and the return on plan assets (excluding interest) are recognised immediately in the statement of financial position with a charge or credit to other comprehensive income in the period in which they occur. Re-measurement recorded in other comprehensive income is not recycled. However, Defence may transfer those amounts recognised in other comprehensive income within equity. Past service cost is recognised in net cost of services in the period of plan amendment. Net-interest is calculated by applying the discount rate to the net defined benefit liability or asset. Defined benefit costs are split into three categories:		
<ul style="list-style-type: none"> i) service cost, past-service cost, gains and losses on curtailments and settlements; ii) net-interest expense or income; and iii) re-measurement. 		

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.4A: Employee provisions (continued)

Accounting Policy (continued)

Defence presents the first two components of defined benefit costs in the line item 'employee benefits expense' in its income statement. Curtailments gains and losses are accounted for as past-service cost.

Re-measurements are recorded in other comprehensive income.

The retirement benefit obligation recognised in the statement of financial position represents the actual deficit or surplus in Defence's defined benefit plans. Any surplus resulting from this calculation is limited to the present value of any economic benefits available in the form of refunds from the plans or reductions in future contributions to the plans.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.5: Administered - Defined Benefit Superannuation Plans

Defence administers on behalf of the Australian Government, three defined benefit superannuation plans for ADF members. The three plans are the Defence Force Retirement and Death Benefits Scheme (DFRDB), the Military Superannuation and Benefits Scheme (MSBS) and Australian Defence Force Cover (ADF Cover).

The defined benefit plans are administered by separate Funds that are legally separated from Defence. The board of the pension fund is composed of an equal number of representatives from both employers and (former) employees. The board of the pension fund is required by law or by articles of association to act in the interest of the fund and of all relevant stakeholders in the scheme, i.e. active employees, inactive employees, retirees, employers. The board of the pension fund is responsible for the investment policy with regard to the assets of the fund.

Under MSBS, the employees are entitled to post-retirement yearly instalments amounting to 28% of final salary of each year of service until their retirement. The plans are typically exposed to actuarial risks such as: investment risk, interest rate risk, longevity risk and salary risk.

The most recent actuarial valuations of plan assets and the present value of the defined benefit obligation were carried out at 30 June 2017 by the Australian Government Actuary. The present value of the defined benefit obligation, and the related current service cost and past service cost, were measured using the Projected Unit Credit Method.

	2017 \$'000	2016 \$'000
Amounts recognised in comprehensive income in respect of these defined benefit plans are as follows.		
Service cost:		
Current service cost	4,397,201	3,400,000
Past service cost and (gain)/loss from settlements	-	-
Net interest expense	3,596,400	3,761,000
Expected return on plan assets	(202,000)	(259,000)
Components of defined benefit costs recorded in net cost of service	7,791,601	6,902,000
Re-measurement on the net defined benefit liability:		
The return on plan assets (excluding amounts included in net interest expense)	(487,000)	115,000
Actuarial gains and losses arising from changes in liability assumptions	1,189,400	(650,200)
Actuarial gains and losses arising from changes in financial assumptions	(23,873,700)	26,532,900
Adjustments for restrictions on the defined benefit asset	-	-
Other	-	-
Components of defined benefit costs recorded in other comprehensive income	(23,171,300)	25,997,700
Total of components of defined benefit cost	(15,379,699)	32,899,700

The past service cost, the service cost and the net-interest expense for the year is included in the employee benefits expense in the statement of comprehensive income. The re-measurement on the net defined benefit liability is included in the statement of comprehensive income as part of other comprehensive income.

The amount included in the statement of financial position arising from the entity's obligation in respect of its defined benefit plans is as follows.

Present value of defined benefit obligation	115,268,301	132,047,700
Fair value of plan assets	8,296,000	7,320,000
Net liability arising from defined benefit obligation	106,972,301	124,727,700

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.5: Administered - Defined Benefit Superannuation Plans (continued)

	2017 \$'000	2016 \$'000
Movements in the present value of the defined benefit obligation in the current year were as follows:		
Opening defined benefit obligation	132,047,700	100,899,400
Current service cost	4,397,201	3,400,000
Interest cost	3,596,400	3,761,000
Contributions from plan participants	271,000	329,000
Re-measurement (gains)/losses:		
Actuarial gains and losses arising from changes in liability assumptions	1,189,400	(650,200)
Actuarial gains and losses arising from changes in financial assumptions	(23,873,700)	26,532,900
Past service cost	-	-
Losses/(gains) on curtailments	-	-
Liabilities extinguished on settlements	-	-
Liabilities assumed in a business combination	-	-
Benefits paid	(2,359,700)	(2,224,400)
Other	-	-
Closing defined benefit obligation	115,268,301	132,047,700
Movements in the present value of the plan assets in the current year were as follows:		
Opening fair value of plan assets	7,320,000	6,798,000
Interest income	202,000	259,000
Re-measurement gain (loss):		
Actuarial gains and losses	487,000	(115,000)
The return on plan assets (excluding amounts included in net interest expense)	-	-
Contributions from the employer	769,000	697,000
Contributions from plan participants	271,000	329,000
Benefits paid	(753,000)	(648,000)
Assets distributed on settlements	-	-
Other	-	-
Closing fair value of plan assets	8,296,000	7,320,000
The major categories of plan assets at the end of the reporting period for each category, as follows:		
Australian equities	1,659,200	1,317,600
Overseas equities	1,908,080	1,537,200
Property and infrastructure	1,078,480	951,600
Private equity	580,720	585,600
Cash, debt instruments	1,493,280	1,537,200
Other liabilities	1,576,240	1,390,800
Subtotal	8,296,000	7,320,000

4.5: Administered - Defined Benefit Superannuation Plans (continued)

The actual return on plan assets was \$689m.

Significant actuarial assumptions for the determination of the defined obligation are discount rate, expected salary growth, age pension methodology and CPI. The sensitivity analyses below have been determined based on reasonably possible changes of the assumptions occurring at the end of the reporting period.

- If the discount rate would be 50 basis points (0.5 percent) higher (lower), the defined benefit obligation would decrease by \$11,326m (increase by \$13,429m) if all other assumptions were held constant.
- If the expected salary growth and age pension methodology would increase (decrease) by 0.5%, the defined benefit obligation would increase by \$4,906m (decrease \$4,541m) if all other assumptions were held constant.
- If the CPI would increase (decrease) by 0.5%, the defined benefit obligation would increase by \$7,390m (decrease by \$7,515m) if all assumptions were held constant.

The expected superannuation contributions for 2017-18 is \$1,352m per the 2017-18 Portfolio Budget Statements.

In reality one might expect interrelationships between the assumptions, especially between discount rate and expected salary increases that both depends to a certain extent on expected inflation rates. The analysis above abstracts from these interdependence between the assumptions.

Defence should fund the cost of the entitlements expected to be earned on a yearly basis. The residual contribution (including back service payments) is paid by Defence. The funding requirements are based on a local actuarial measurement framework. In this framework the discount rate is set on a risk free rate. Furthermore, premiums are determined on a current salary base. Additional liabilities stemming from past service due to salary increases (back-service liabilities) should be paid immediately to the Fund. Apart from paying the costs of the entitlements Defence is not liable to pay additional contributions in case the Fund does not hold sufficient assets. In that case the Fund should take other measures to restore its solvency such as a reduction of the entitlements of the plan members.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.5: Administered - Defined Benefit Superannuation Plans (continued)

	2017 \$'000	2016 \$'000
Defence Force Retirement and Death Benefits Scheme (DFRDB)		
The amounts recognised in the statement of financial position are as follows:		
Present value of funded obligations	-	-
Fair Value of plan assets	-	-
Present value of unfunded obligations	43,502,800	50,358,700
Unrecognised past service cost	-	-
Net liability in statement of financial position	43,502,800	50,358,700
Amounts in statement of financial position:		
Liabilities	43,502,800	50,358,700
Assets	-	-
Net liability in statement of financial position	43,502,800	50,358,700
The amount recognised in income or expense are as follows:		
Current service cost	173,000	175,000
Net interest	1,340,100	1,563,000
Past service cost	-	-
Expense	1,513,100	1,738,000
Net actuarial losses (gains) recognised in equity	(6,762,300)	7,251,700
Changes in the value of defined benefit obligations are as follows:		
Net liability at 1 July	50,358,700	42,945,400
Current Service cost	173,000	175,000
Interest cost	1,340,100	1,563,000
Actuarial losses (gains)	(6,762,300)	7,251,700
Benefits paid	(1,606,700)	(1,576,400)
Past service cost	-	-
Other	-	-
Net liability as at 30 June	43,502,800	50,358,700
Changes in the fair value of plan assets are as follows:		
Opening fair value of plan assets	-	-
Contributions by employer	1,606,700	1,576,400
Interest on plan assets	-	-
Benefits paid	(1,606,700)	(1,576,400)
Closing value of plan assets	-	-
Principal actuarial assumptions at the reporting date (expressed as weighted averages)		
	2017	2016
Discount rate at 30 June (DFRDB)	3.4%	2.7%
Discount rate at 30 June (DFRB)	2.7%	
Expected return on plan assets	0.0%	0.0%
Future salary increases*	4.0%	4.0%
Future pension increases (aged 55 or more)	4.0%	4.0%
Future pension increases (under age 55)	2.5%	2.5%
Weighted mean term of the DFRDB liabilities is 17.2 years.		
Weighted mean term of the DFRB liabilities is 10.0 years.		
The demographic assumptions are those used for the preparation of the Long Term Cost Report for the MSBS, DFRDB, DFRB and ADF as at 30 June 2014.		
* Separate promotional salary scales are used to allow for promotional salary increase.		

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.5: Administered - Defined Benefit Superannuation Plans (continued)

	2017 \$'000	2016 \$'000
Military Superannuation Benefits Scheme (MSBS)		
The amounts recognised in the statement of financial position are as follows:		
Present value of funded obligations	8,296,000	7,320,000
Fair Value of plan assets	8,296,000	7,320,000
Present value of unfunded obligations	63,451,000	74,369,000
Unrecognised past service cost	-	-
Net liability in statement of financial position	63,451,000	74,369,000
Amounts in statement of financial position:		
Liabilities	71,747,000	81,689,000
Assets	8,296,000	7,320,000
Net liability in statement of financial position	63,451,000	74,369,000
The amount recognised in income or expense are as follows:		
Current service cost	4,203,000	3,225,000
Interest on obligation	2,054,000	1,939,000
Expense	6,257,000	5,164,000
Liability actuarial losses (gains) recognised in equity	(15,919,000)	18,631,000
Actuarial losses (gains) on plan assets recognised in equity	487,000	115,000
Components recorded in equity	(15,432,000)	18,746,000
Changes in the value of defined benefit obligations are as follows:		
Net liability at 1 July	81,689,000	57,954,000
Current Service cost	4,203,000	3,225,000
Non-employer contributions	271,000	329,000
Interest cost	2,256,000	2,198,000
Actuarial losses (gains)	(15,919,000)	18,631,000
Benefits paid	(753,000)	(648,000)
Past service cost	-	-
Closing value of plan liabilities	71,747,000	81,689,000
Changes in the fair value of plan assets are as follows:		
Opening fair value of plan assets	7,320,000	6,798,000
Expected return on plan assets	-	259,000
Interest on plan assets	202,000	-
Actuarial gains and losses	487,000	(115,000)
Contributions by employer	769,000	697,000
Funded non-employer contributions	271,000	329,000
Benefits paid	(753,000)	(648,000)
Closing value of plan assets	8,296,000	7,320,000

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.5: Administered - Defined Benefit Superannuation Plans (continued)

Principal actuarial assumptions at the reporting date (expressed as weighted averages):

	2017	2016
Discount rate at 30 June (unfunded amount)	3.5%	2.7%
Discount rate at 30 June (funded amount)	3.5%	2.7%
Expected return on plan assets	3.5%	2.7%
Future salary increases*	4.0%	4.0%
Future pension increases	2.5%	2.5%

Weighted mean term of the liabilities is 28.7 years.

The demographic assumptions are those used for the preparation of the Long Term Cost Report for the MSBS, DFRDB, DFRB and ADF as at 30 June 2014.

* Separate promotional salary scales are used to allow for promotional salary increase.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

4.5: Administered - Defined Benefit Superannuation Plans (continued)

	2017 \$'000	2016 \$'000
Australian Defence Force Cover (ADF Cover)		
The amounts recognised in the statement of financial position are as follows:		
Present value of funded obligations	-	-
Fair Value of plan assets	-	-
Present value of unfunded obligations	18,501	-
Unrecognised past service cost	-	-
Net liability in statement of financial position	18,501	-
Amounts in statement of financial position:		
Liabilities	18,501	-
Assets	-	-
Net liability in statement of financial position	18,501	-
The amount recognised in income or expense are as follows:		
Current service cost	21,201	-
Net interest	300	-
Past service cost	-	-
Expense	21,501	-
Net actuarial losses (gains) recognised in equity	(3,000)	-
Changes in the value of defined benefit obligations are as follows:		
Net liability at 1 July	-	-
Current Service cost	21,201	-
Interest cost	300	-
Actuarial losses (gains)	(3,000)	-
Benefits paid	-	-
Past service cost	-	-
Other	-	-
Net liability as at 30 June	18,501	-
Changes in the fair value of plan assets are as follows:		
Opening fair value of plan assets	-	-
Contributions by employer	-	-
Interest on plan assets	-	-
Benefits paid	-	-
Closing value of plan assets	-	-
Principal actuarial assumptions at the reporting date (expressed as weighted averages)		
	2017	2016
Discount rate at 30 June	3.5%	0.0%
Expected return on plan assets	0.0%	0.0%
Future salary increases*	4.0%	0.0%
Future pension increases	2.5%	0.0%

Weighted mean term of the ADF Cover liabilities is 29.3 years.

The demographic assumptions are those used for the preparation of the Long Term Cost Report for the MSBS, DFRDB, DFRB and ADF as at 30 June 2014.

* Separate promotional salary scales are used to allow for promotional salary increase.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
For the period ended 30 June 2017

FUNDING

This section identifies Defence's funding structure.

5.1: Appropriations

5.1A: Annual appropriations ('recoverable gst exclusive')

Annual Appropriations for 2016-17

	Annual Appropriation ¹ \$'000	Adjustments to appropriation ² \$'000	Total \$'000	Appropriation applied in 2017 (Current and prior years) \$'000	Variance ³ \$'000
DEPARTMENTAL					
Ordinary annual services	30,826,904	438,036	31,264,940	(31,310,029)	(45,089)
Capital budget ⁴	-	-	-	-	-
Other services					
Equity	2,321,327	-	2,321,327	(1,064,704)	1,256,623
Total departmental	33,148,231	438,036	33,586,267	(32,374,733)	1,211,534
ADMINISTERED					
Ordinary annual services	-	-	-	-	-
Capital budget ⁴	-	-	-	-	-
Administered items	-	-	-	-	-
Payments to corporate Commonwealth entities	-	-	-	-	-
Other Services					
Specific payments to States, ACT, NT and Local government	-	-	-	-	-
New administered outcomes	-	-	-	-	-
Administered assets and liabilities	-	-	-	-	-
Payments to corporate Commonwealth entities	-	-	-	-	-
Total administered	-	-	-	-	-

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

5.1: Appropriations (continued)

5.1A: Annual appropriations ('recoverable gst exclusive') (continued)

Notes:

1 Details of quarantined appropriations are as follows: \$'000

Quarantined appropriations

No Win No Loss - 2012-13 Act 3 (Outputs)	67,349
No Win No Loss - 2013-14 Act 1 (Outputs)	97,994
No Win No Loss - 2013-14 Act 3 (Outputs)	87,801
No Win No Loss - 2013-14 Act 5 (Outputs)	58,495
No Win No Loss - 2013-14 Act 6 (Equity)	103,103
2015-16 Act 2 (Equity)	407,411

Amounts withheld under section 51 determinations

2014-15 Act 4 Portfolio Additional Estimates adjustment Act 2 (Equity)	116,914
No Win No Loss - 2014-15 Act 1 (Outputs)	121,512
2014-15 Act 5 Supplementary Portfolio Additional Estimates adjustment Act 3 (Outputs)	91,401
No Win No Loss - 2015-16 Appropriation Act 1	94,754
No Win No Loss - 2015-16 Appropriation Act 3	69,948
2016-17 Appropriation Act 1	9,725
2016-17 Appropriation Act 2	1,256,623

Total Quarantined 2,583,030

2. Adjustment to appropriations include Advance to the Finance Minister (AFM), PGPA Section 74 receipts and PGPA Act PGPA Act Section 75 transfers.

3. Reasons for material variance:

	Ordinary Annual Service \$'000	Equity \$'000
Section 74 receipts yet to be reflected in ACM	2,239	-
Undrawn departmental annual appropriations 2016-17	87	-
Prior Year Appropriation Drawn Down	(97,000)	-
2016-17 Appropriation Act 1 withheld under Section 51	9,725	-
2016-17 Appropriation Act 2 withheld under Section 51	-	1,256,623
GST Payable made not yet recovered	39,860	-
Total	<u><u>(45,089)</u></u>	<u><u>1,256,623</u></u>

4. Departmental and Administered Capital Budgets are appropriated through Appropriation Acts (No.1,3,5). They form part of ordinary annual services, and are not separately identified in the Appropriation Acts.

5. Reconciliation to appropriation receivable:

	Notes	\$'000
2015-16 Appropriate Act 1		4
2015-16 Appropriation Act 2 (Equity)		407,411
2015-16 Appropriation Act 3		18,489
2016-17 Appropriation Act 1		87
	3.1B	<u><u>425,991</u></u>

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
For the period ended 30 June 2017

5.1: Appropriations (continued)

5.1A: Annual appropriations ('recoverable gst exclusive') (continued)

Annual Appropriations for 2015-16

	Annual Appropriation ¹ \$'000	Adjustments to appropriations ² \$'000	Total Appropriations \$'000	Appropriation applied in 2016 (Current and prior years) \$'000	Variance ³ \$'000
DEPARTMENTAL					
Ordinary annual services	29,162,834	701,833	29,864,667	(29,729,997)	134,670
Capital Budget ⁴	-	-	-	-	-
Other services	2,942,959	-	2,942,959	(2,535,548)	407,411
Equity	-	-	-	-	-
Loans	-	-	-	-	-
Total departmental	32,105,793	701,833	32,807,626	(32,265,545)	542,081
ADMINISTERED					
Ordinary annual services					
Capital Budget ⁴	-	-	-	-	-
Administered items	-	-	-	-	-
Payments to CAC Act bodies	-	-	-	-	-
Other Services					
Specific payments to States, ACT, NT and Local government	-	-	-	-	-
New administered outcomes	-	-	-	-	-
Administered assets and liabilities	-	-	-	-	-
Payments to CAC Act bodies	-	-	-	-	-
Total administered	-	-	-	-	-

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

5.1: Appropriations (continued)

5.1A: Annual appropriations ('recoverable gst exclusive') (continued)

Notes:

1. Details of quarantined appropriations are as follows:	\$'000
No Win No loss - 2012-13 Act 3 (Outputs)	67,349
No win No Loss - 2013-14 Act 1 (Outputs)	97,994
No win No Loss - 2013-14 Act 3 (Outputs)	87,801
No win No Loss - 2013-14 Act 5 (Outputs)	58,495
No win No Loss - 2013-14 Act 6 (Equity)	103,103
2015-16 Act 2 (Equity)	407,411

Amounts withheld under section 51 determinations

No Win No Loss - 2014-15 Act 1 (Outputs)	71,357
No Win No Loss (FX, Ops and LAFHA)- 2014-15 Act 1 (Outputs)	50,155
2014-15 Act 4 Portfolio Additional Estimates adjustment Act 2 (Equity)	116,914
2014-15 Act 5 Supplementary Portfolio Additional Estimates adjustment Act 3 (Outputs)	91,401

Total Quarantined 1,151,980

2. Adjustment to appropriations include Advance to the Finance Minister (AFM), PGPA Section 74 receipts and PGPA Act PGPA Act Section 75 transfers.

3. Reasons for material variance:

	Ordinary Annual Service \$'000	Equity \$'000
Prior year appropriation drawn down	(145,264)	-
Undrawn departmental annual appropriations 2015-16	<u>279,934</u>	<u>407,411</u>
Total	<u><u>134,670</u></u>	<u><u>407,411</u></u>

4. Departmental and Administered Capital Budgets are appropriated through Appropriation Acts (No.1,3,5). They form part of ordinary annual services, and are not separately identified in the Appropriation Acts.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

5.1B: Unspent annual appropriations ('recoverable gst exclusive')

Authority	2017 \$'000	2016 \$'000
DEPARTMENTAL		
Operating		
Act 1 2016-17 ¹	49,672	-
Act 1 2015-16 ¹	94,758	94,498
Act 1 2014-15 ²	121,512	121,512
Act 1 2013-14	97,994	97,994
Act 1 2012-13	67,349	67,349
Act 3 2015-16 ¹	88,437	185,437
Act 3 2014-15 ²	91,401	91,401
Act 3 2013-14	87,801	87,801
Act 5 2013-14	58,495	58,495
Total Operating	757,419	804,487
Equity		
Act 2 2016-17 ²	1,256,623	-
Act 2 2015-16	407,411	407,411
Act 2 2014-15 ²	116,914	116,914
Act 6 2013-14	103,103	103,103
Total Equity	1,884,051	627,428
Total	2,641,470	1,431,915
Cash and cash equivalents	88,823	47,597
Total unspent annual appropriations³	2,730,293	1,479,512

Notes

1. Unspent annual appropriations have been partially extinguished by the Department of Finance. Of the \$232.867m of unspent appropriations, \$174.427m has been formally extinguished, with the remaining \$58.440m being available to the Department.

2. Unspent annual appropriations have been formally extinguished by the Department of Finance.

3. The unspent annual appropriations are \$2,730.293m, allocated as follows:

- a) \$2,583.030m has been formally quarantined and/or extinguished by Department of Finance,
- b) \$107.404m of unspent annual appropriations (including cash and cash equivalents) available to the Department; and
- c) \$39.860m of unspent annual appropriations relating to GST payments made in 2016-17 but not yet recovered.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

5.1: Appropriations (continued)

5.1C: Special appropriations ('recoverable gst exclusive')

Authority	Nature	Type	Purpose	Appropriation Applied	
				2017 \$'000	2016 \$'000
Defence Force Retirement Benefits Act 1948, Administered ^(a)	Administered	Unlimited Amount	To provide Retirement Benefits for Members of the Defence Force who enlisted before 1 October 1972, and for other purposes.	45,668	47,419
Defence Force Retirement and Death Benefits Act 1973, Administered ^(a)	Administered	Unlimited Amount	To make provision for and in relation to a Scheme for Retirement and Death Benefits for Members of the Defence Force who enlisted before 1 October 1991.	1,535,637	1,506,904
Military Superannuation and Benefits Act 1991, Administered ^(a)	Administered	Unlimited Amount	To make provision for and in relation to an occupational superannuation scheme for, and the payment of other benefits to members of the Defence Force, and for related purposes.	674,253	583,909
Defence Force (Home Loans Assistance) Act 1990, Administered	Administered	Unlimited Amount	To provide for the payment of home loan subsidies in respect of certain members of the Defence Force and certain other persons, and for related purposes.	587	828
Defence Home Ownership Assistance Scheme Act 2008, administered	Administered	Unlimited Amount	To provide financial assistance to members of the Defence Force and certain other persons, for the purchase, maintenance and development of their homes, and for related purposes.	99,651	100,981
Military Superannuation and Benefits Act 1991, Administered	Administered	Unlimited Amount	To make provision for and in relation to retention benefits for ADF personnel.	115,656	98,703
Public Governance, Performance and Accountability Act 2013, Administered	Administered	Unlimited Amount	To make provision for and in relation to funds that have been received by Defence that are required or permitted to be repaid where there is no other appropriation for the repayment.	-	-
Australian Defence Force Cover Act 2015, Administered ^(a)	Administered	Unlimited Amount	To make provision for benefits for incapacity or death suffered by certain members of the Australian Defence Force, and for related purposes.	21	-
Public Governance, Performance and Accountability Act 2013, Administered	Administered	Unlimited Amount	To make provision for and in relation to funds that have been received by the Commonwealth or Commonwealth entities that are required or permitted to be repaid where there is no other appropriation for the repayment.	41	-
Total				2,471,514	2,338,744

(a) Commonwealth Superannuation Corporation draw funds from the CRF on behalf of Defence.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

5.1: Appropriations (continued)

5.1D: Disclosure by agent in relation to annual and special appropriations ('recoverable gst exclusive')

2017	Department of Finance ¹ \$'000
Total receipts	-
Total payments	6,079

2016	Department of Finance ¹ \$'000
Total receipts	-
Total payments	23,707

1. The payments are related to Moorebank Units Relocation (MUR) Projects in order for Defence to facilitate the drawdown of monies from the Departmental Appropriation Act (No.2). (*This act is administered by Department of Finance*).

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

5.2: Special Accounts

	Service for Other Entities And Trust Monies Defence Special Account ^{1,5}		Young Endeavour Youth Program Special Account ^{2,5}		Defence Endowments Special Account ^{3,5}		Fedorczenko Legacy Special Account ^{4,5}	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Balance brought forward from previous period	70,953	64,827	1,491	1,375	48	48	169	167
Total increases	53,771	39,056	65	198	1	1	3	4
Available for payments	124,724	103,883	1,556	1,573	49	49	172	171
Decreases:								
Departmental								
Total departmental	-	-	-	-	-	-	-	-
Administered								
Total Administered	(38,197)	(32,930)	(36)	(32)	-	(1)	(4)	(2)
Total Decreases	(38,197)	(32,930)	(36)	(32)	-	(1)	(4)	(2)
Total Balance to be carried forward to next period	86,527	70,953	1,520	1,491	49	48	168	169
Balance represented by:								
Cash held in entity bank accounts	-	-	-	-	-	-	-	-
Cash held in the Official Public Account	86,527	70,953	1,520	1,491	49	48	168	169

Notes

1. **Appropriation: Public Governance, Performance and Accountability Act 2013 section 78.**

- Establishing Instrument: Financial Management and Accountability Determination 2009/15.
- Purpose: This account was created to disburse amounts held on trust or otherwise for the benefit of persons other than the Commonwealth.
- Special account is disclosed on a recoverable GST exclusive basis.
- This account is non-interest bearing.

2. **Appropriation: Public Governance, Performance and Accountability Act 2013 section 78.**

- Establishing Instrument: Financial Management and Accountability Determination 2009/02.
- Purpose: For the receipt and payment of money in connection with the operations and activities of the STS Young Endeavour, as specified by the Young Endeavour Program Board of Management or by the Commonwealth.
- Special account is disclosed on a recoverable GST exclusive basis.
- This account is interest bearing.

Department of Defence NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

5.2: Special Accounts (continued)

3. **Appropriation: Public Governance, Performance and Accountability Act 2013 section 78.**

- Establishing Instrument: Financial Management and Accountability Determination 2009/11.
- Purpose: For expenditure in accordance with the terms provided for in the endowments.
- Special account is disclosed on a recoverable GST exclusive basis.
- This account is interest bearing.

4. **Appropriation: Public Governance, Performance and Accountability Act 2013 section 78.**

- Establishing Instrument: Financial Management and Accountability Determination 2009/13.
- Purpose: For expenditure in relation to the defence of Australia of the residual of the estate of the late Petro Fedorczenko.
- Special account is disclosed on a recoverable GST exclusive basis.
- This account is interest bearing.

5. **Monies held within special accounts:**

Service for Other Entities and Trust Monies Defence Special Account:

Woomera Security Lodgements, Peter Mitchell Trust Fund, Project Q, Metal Storm R&D, Singapore Armed Forces (Army 1), Singapore Armed Forces (Army 2), Global Positioning System, Republic of Singapore Air Force UT 1, Republic of Singapore Air Force UT 2, Explosive Safety Trials, SAF Exercise Infrastructure Damage Cost Recovery, Share Vision CSNE, Emerging Technologies, Accommodation Purchases, P303, Paris, Ex Aussiaing, Pitchpipe 2009, Spurgalls 2, Research Program, SEET (JIC), Doppler Targets, Hercules, Rascaï, FA18 Barrel Testing, Virsuite, OOT Project, Geospatial Intelligence, DHS, CTTSO, US Collaboration and RSAF Oakey Facilities Works.

Young Endeavour Youth Program Special Account:

Young Endeavour Youth Program Special Account and Young Endeavour Youth Program Special Public Fund.

Defence Endowments Special Account:

Parker Trophy, Gowlland Medal, Edward Rodwell Memorial Prize, Joseph Schultz Memorial Prize, C.J. Toohy Memorial Prize, Ronald Syme Trust Prize, General Bridges Memorial Prize Fund, T.J. Stevens Memorial Fund and RAN Training Prizes.

Fedorczenko Legacy Special Account:

Fedorczenko.

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PEOPLE AND RELATIONSHIPS

This section describes our relationship with key people.

6.1: Key Management Personnel Remuneration

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of Defence, directly or indirectly. This definition has narrowed in comparison to the definition of Senior Management applied in the 2015-16 financial statements. According to AASB 124 and Department of Finance guidance, the key management personnel of Defence are considered to be the:

- i) Minister for Defence;
- ii) Minister for Defence Industry;
- ii) Minister for Defence Personnel;
- iv) Secretary and Chief of the Defence Force (CDF); and
- v) Direct reports to Secretary and CDF (Group Heads and Service Chiefs).

Key management personnel remuneration is reported in the table below.

	2017	2016 ¹
	\$	\$
Short-term employee benefits	6,913,570	7,286,496
Post-employment benefits	1,316,081	1,338,949
Long-term benefits	785,433	758,491
Termination benefits	-	-
Total key management personnel remuneration expenses²	9,015,084	9,383,936

The total number of key management personnel that are included in the above table are 15 (2015-16: 18).

Notes

1. In the financial statements for the period ended 30 June 2016, Defence was required to disclose Senior Management Personnel Remuneration in accordance with section 27 of the Financial Reporting Rule that existed at that time. Senior Management were defined as the senior executive of the Department. For comparative purposes, the disclosure in the financial statements for the period ended 30 June 2016 was as follows:

	2016
	\$
Short-term employee benefits	
Salary	63,459,634
Performance bonus	174,779
Other	19,073,362
Total short-term employee benefits	82,707,775
Post-employment benefits	
Superannuation	15,170,961
Total post-employment benefits	15,170,961
Other long-term benefits	
Annual leave	6,282,712
Long-service leave	2,177,158
Total other long-term benefits	8,459,870
Termination benefits	11,284,152
Total senior management personnel remuneration	117,622,758

The total number of senior management personnel that are included in the above table are 395.

2. The above key management personnel remuneration excludes the remuneration and other benefits of the Minister for Defence, Minister for Defence Industry and Minister for Defence Personnel. The remuneration and other benefits of the Minister for Defence, Minister for Defence Industry and Minister for Defence Personnel are set by the Remuneration Tribunal and are not paid by the Department of Defence.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

6.2: Related Party Disclosures

Related party relationships:

Defence is an Australian Government controlled entity. Related parties to this entity are:

- i) Key Management Personnel (as detailed in Note 6.1);
- ii) Spouse or domestic partners of (i);
- iii) Children or dependents of (i); and
- iv) Entities, individually or jointly, controlled by the above individuals.

Transactions with related parties:

Given the breadth of Government activities, related parties may transact with the government sector in the same capacity as ordinary citizens. Such transactions include the payment or refund of taxes, receipt of a Medicare rebate or higher education loans. These transactions have not been separately disclosed in this note.

No transactions with related parties occurred during the financial year.

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For the period ended 30 June 2017

MANAGING UNCERTAINTIES

This section analyses how Defence manages financial risk within its operating environment.

7.1: Contingent Liabilities and Assets

7.1A: Contingent liabilities and assets

	Claims for damages / costs		Total	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Contingent Assets				
Balance from previous period	5,477	7,208	5,477	7,208
New	2,246	1,898	2,246	1,898
Re-measurement	15,987	(3,629)	15,987	(3,629)
Assets realised	-	-	-	-
Rights expired	(540)	-	(540)	-
Total contingent assets	23,170	5,477	23,170	5,477
Contingent Liabilities				
Balance from previous period	94,939	24,993	94,939	24,993
New	1,191	48,529	1,191	48,529
Re-measurement	(37,264)	25,945	(37,264)	25,945
Liabilities realised	(5,572)	(4,528)	(5,572)	(4,528)
Obligations expired	-	-	-	-
Total contingent liabilities	53,294	94,939	53,294	94,939
Net contingent assets (liabilities)	(30,124)	(89,462)	(30,124)	(89,462)

Quantifiable Contingencies

Contingent Assets: At 30 June 2017, the Schedule of Contingencies contains 11 (2015-16: 19) instances of non-remote, quantifiable contingent assets in respect of claims by the Department valued at \$23.2m (2015-16: \$5.5m). The Department is expecting to succeed in its claims. The estimated figure is determined by conducting an objective analysis of the probable amounts owing to the Department.

Contingent Liabilities: At 30 June 2017, the Schedule of Contingencies contains 14 (2015-16: 19) instances of non-remote, quantifiable contingent liabilities in respect of claims on the Department valued at \$53.2m (2015-16: \$94.9m). The estimated figure is determined by conducting an objective analysis of the probable amount payable for all the matters managed by firms engaged by Defence through the Attorney General's Legal Services Multi Use List and those being handled in-house by Defence Legal Division. However, the exact amount payable under those claims is uncertain. The Department is defending the claims or is trying to resolve them by recourse to alternative dispute resolution measures.

Unquantifiable Contingencies

Contingent Assets: At 30 June 2017 Defence had 8 (2015-16: 6) instances of unquantifiable non-remote contingent assets.

Contingent Liabilities: At 30 June 2017 Defence had 40 (2015-16: 36) instances of unquantifiable non-remote contingent liabilities.

Land decontamination, site restoration and decommissioning of Defence assets: Defence has made financial provision for the future estimates involved in land decontamination, site restoration and decommissioning of Defence assets where a legal or constructive obligation has arisen. For those decontamination, restoration and decommissioning activities for which there is no legal or constructive obligation, the potential costs have not been assessed and are unquantifiable. Where there is a possible legal or constructive obligation, but the potential cost could not be quantified, the obligations have been assessed as unquantifiable contingencies. It was not possible to estimate the amounts of any eventual payments or receipts that may have eventuated in relation to these claims.

Costs associated with the Royal Commission into Institutional Responses to Child Sexual Abuse have not been assessed and are considered unquantifiable at this time. It is currently not possible to estimate the amounts of any eventual payments that may eventuate in relation to any such claims.

Quantifiable Remote Contingencies

Remote Contingent Assets: At 30 June 2017 Defence had 3 (2015-16: 1) instances of quantifiable remote contingent assets valued at \$0.790m (2015-16: \$0.05m).

Remote Contingent Liabilities: At 30 June 2017 Defence had 1,462 (2015-16: 1,409) instances of quantifiable remote contingent liabilities valued at \$5,269m (2015-16: \$5,416m).

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

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7.1: Contingent Liabilities and Assets (continued)

Unquantifiable Remote Contingencies

Contingent Assets: At 30 June 2017 Defence had 1 instance of unquantifiable remote contingent assets (2015-16: nil).

Contingent Liabilities: At 30 June 2017 Defence had 27 instances of unquantifiable remote contingent liabilities (2015-16: 23).

Accounting Policy

Contingent liabilities and contingent assets are not recognised in the statement of financial position but are disclosed in the relevant schedules and notes. They may arise from uncertainty as to the existence of a liability or asset, or represent an existing liability or asset in respect of which settlement is not probable or the amount cannot be reliably measured. Contingent assets are disclosed when settlement is probable but not virtually certain, and contingent liabilities are disclosed when settlement is greater than remote.

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

7.2: Financial Instruments

		2017 \$'000	2016 \$'000
7.2A: Categories of financial instruments			
Financial Assets			
Cash and cash equivalents	3.1A	88,823	47,597
Loans and receivables:			
Trade and other receivables		402,464	462,561
Total Financial Assets		<u>491,287</u>	<u>510,158</u>
Carrying amount of financial assets		<u>491,287</u>	<u>510,158</u>
Financial Liabilities			
At amortised cost:			
Suppliers		2,304,285	2,263,290
Other payables		131,907	111,429
Finance leases		1,549,237	1,534,423
Total Financial Liabilities at Amortised Cost		<u>3,985,429</u>	<u>3,909,142</u>
Carrying amount of financial liabilities		<u>3,985,429</u>	<u>3,909,142</u>

Accounting Policy

Financial Assets

Defence classifies its financial assets in the following categories;

- a) financial assets at fair value through profit or loss;
- b) held-to-maturity investments;
- c) available-for-sale financial assets; and
- d) loans and receivables

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. Financial assets are recognised and derecognised upon trade date.

(a) Effective Interest Method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised on an effective interest rate basis except for financial assets that are recognised at fair value through profit or loss.

(b) Loans and Receivables

Trade receivables, loans and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'.

Receivables for goods and services are generally receivable within the short term and are measured at their nominal amounts less any allowance for impairment. The collectability of receivables is assessed periodically with allowances made for doubtful debts when there is objective evidence that Defence will not be able to collect the debt. No allowance is made for Australian Government, foreign government and employee debts as they are normally deemed to be collectable unless there is objective evidence to the contrary. Long term receivables are discounted to the present value using the effective interest method.

(c) Impairment of Financial Assets

Financial assets are assessed for impairment at the end of each reporting period.

Financial assets held at amortised cost - if there is objective evidence that an impairment loss has been incurred for loans and receivables or held to maturity investments held at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount is reduced by way of an allowance account. The loss is recognised in the Statement of Comprehensive Income.

Department of Defence

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

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Accounting Policy (Continued)

Financial Liabilities

Financial liabilities are classified as either financial liabilities 'at fair value through profit or loss' or other financial liabilities. Financial liabilities are derecognised upon trade date.

(a) Financial Liabilities at Fair Value Through Profit or Loss

Financial liabilities at fair value through profit or loss are initially measured at fair value. Subsequent fair value adjustments are recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability.

(b) Other Financial Liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. These liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on the financial liability.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Defence's supplier and other payables are generally payable within the short term and are recognised at the amount of cash or cash equivalents required to settle the liability. Liabilities are recognised to the extent that the goods or services have been received (and irrespective of having been invoiced).

Financial Risk Management

Under relevant legislation and Australian Government policy, Defence is restricted from entering into borrowings, some investments and entering into derivative transactions to offset risk exposure. As such, Defence's exposure to risk is primarily related to credit risk on trade receivables and foreign currency risk in relation to payments to overseas suppliers of goods and services received. However, this exposure is minimal in terms of the operations of Defence as Defence is subject to a no win/no loss funding arrangement for foreign exchange gains and losses.

Defence is also exposed to some contract price escalation risk. This risk exposure is due to the difference in the basis on which Defence is funded for price escalations from government to the price escalation clauses embedded within the contracts. The risk of increased cost is managed by Defence to ensure exposure to the Australian Government is minimised.

Derecognition of Financial Assets and Liabilities

Financial assets are derecognised when the contractual rights to the cash flows from the financial assets expire or the assets with the associated risks and rewards are transferred to another entity. Financial liabilities are derecognised when the obligation under the contract is discharged, cancelled or has expired.

	2017 \$'000	2016 \$'000
7.2B: Net gains or losses on financial assets		
Loans and receivables		
Exchange gains/(loss)	(3,299)	(107)
Impairment reversal/(impairment)	(4,940)	(130)
Net gain/(loss) on loans and receivables	<u>(8,239)</u>	<u>(237)</u>
Net gain/(loss) on financial assets	<u>(8,239)</u>	<u>(237)</u>

There is no interest income from financial assets not at fair value through the net cost of services.

7.2C: Net gains or losses on financial liabilities

At amortised cost

Exchange gains/(loss)	(4,527)	(18,517)
Interest expense	(104,561)	(94,351)
Net gain/(loss) financial liabilities - at amortised cost	<u>(109,088)</u>	<u>(112,868)</u>
Net gain/(loss) on financial liabilities	<u>(109,088)</u>	<u>(112,868)</u>

There is no interest expense from financial liabilities not at fair value through the net cost of services.

Department of Defence
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7.3: Administered - Financial Instruments

Details of the significant accounting policies and methods adopted, including the criteria for recognition and the basis for measurement in respect of each class of financial asset and financial liability are disclosed in Note 7.2A Financial Instruments.

		2017	2016
		\$'000	\$'000
7.3A: Categories of financial instruments			
Financial Assets			
Cash and cash equivalents		-	-
Loans and receivables:			
Receivables	4.1B	<u>572,385</u>	<u>588,444</u>
Total		<u>572,385</u>	<u>588,444</u>
Available for sale:			
Investment - Defence Housing Australia	4.1C	<u>2,573,475</u>	<u>2,474,029</u>
Investment - Small Portfolio bodies	4.1C	<u>89,198</u>	<u>89,734</u>
Total		<u>2,662,673</u>	<u>2,563,763</u>
Carrying amount of financial assets		<u>3,235,058</u>	<u>3,152,207</u>
Financial Liabilities			
At amortised cost:			
Other payables	4.3A	<u>6,427</u>	<u>8,262</u>
Total		<u>6,427</u>	<u>8,262</u>
Carrying amount of financial liabilities		<u>6,427</u>	<u>8,262</u>
7.3B: Net gains or losses on financial assets			
Loans and receivables			
Interest revenue		25,866	26,479
Impairment		(143)	(72)
Exchange gains/(loss)		<u>(154)</u>	<u>148</u>
Net gain/(loss) on loans and receivables		<u>25,569</u>	<u>26,555</u>
Available for sale			
Dividend revenue	4.1B	<u>39,585</u>	<u>62,719</u>
Net gain/(loss) available for sale		<u>39,585</u>	<u>62,719</u>
Net gain/(loss) on financial assets		<u>65,154</u>	<u>89,274</u>
7.3C: Net gains or losses on financial liabilities			
There was no net gain / (loss) from financial liabilities.			

Department of Defence
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

For the period ended 30 June 2017

7.4: Fair Value Measurements

The following disclosures provide an analysis of assets and liabilities that are measured at fair value. The remaining assets and liabilities disclosed in the statement of financial position do not apply to the fair value hierarchy.

The different levels of the fair value are detailed below:

- Level 1: Quote prices (unadjusted) in the active market for identical assets or liabilities that the entity can access at measurement date.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: Unobservable inputs for an asset or liability.

Accounting Policy

In estimating the fair value of an asset or a liability, Defence uses market-observable data to the extent it is available. For level 2 and 3 inputs, Defence engages third party qualified valuers and internal experts to establish the appropriate valuation techniques and inputs to the models to ensure the valuation are in line with AASB 13.

The Asset Accounting branch reviews all reports received from third party valuers and internal experts to ensure unobservable inputs used align with Defence's own assumptions and understanding of the market. This review includes investigation of significant fluctuations in the fair value of the assets and liabilities and that the report includes sufficient information to ensure compliance with AASB 13.

Defence deems transfers between levels of fair value hierarchy to have occurred when there has been a change to the inputs to the fair value measurement (for instance from observable to unobservable and vice versa) and the significance that the changed input has in determining the fair value measurement.

		Fair value measurements at the end of the reporting period	
		2017	2016
		\$'000	\$'000
7.4A: Fair Value Measurements			
Non-financial assets - Recurring fair value			
Land	3.2A	5,335,942	5,505,638
Buildings	3.2A	12,156,276	12,135,434
Specialist Military Equipment	3.2A	58,572,944	56,217,433
Infrastructure	3.2A	5,874,047	5,630,439
Plant and Equipment	3.2A	2,286,663	2,111,345
Heritage and Cultural	3.2A	607,285	623,102
Total Non-financial assets - Recurring fair value		84,833,157	82,223,391
Financial liabilities - Recurring fair value			
Employee provisions	3.5A	2,627,662	2,705,095
Total financial liabilities - Recurring fair value		2,627,662	2,705,095
Non financial liabilities - Recurring fair value			
Restoration, decontamination and decommissioning	3.5B	1,166,051	1,286,184
Total Non-financial liabilities - Recurring fair value		1,166,051	1,286,184
Assets not measured at fair value in the statement of financial position¹			
Cash and cash equivalents	3.1A	88,823	47,597
Trade and other receivables	3.1B	1,005,919	1,406,929
Inventories	3.2B	6,775,387	6,729,988
Intangibles	3.2A	749,190	794,155
Prepayments	3.2C	1,909,787	2,874,690
Total assets not measured at fair value in the statement of financial position		10,529,106	11,853,359
Liabilities not measured at fair value in the statement of financial position¹			
Other provisions	3.5C	51,693	29,193
Suppliers	3.3A	2,304,285	2,539,881
Other payables and personal benefits	3.3B, 3.3C	347,845	252,899
Finance lease payables	3.4A	1,549,237	1,534,423
Total liabilities not measured at fair value in the statement of financial position		4,253,060	4,356,396

¹ These items carrying amounts equate to their approximate fair values.

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7.5: Administered - Fair Value Measurements

Accounting Policy

The following tables provide an analysis of the assets and liabilities that are measured at fair value. The remaining assets and liabilities disclosed in the statement of financial position do not apply the fair value hierarchy.

The different levels of the fair value are detailed below:

- Level 1: Quote prices (unadjusted) in the active market for identical assets or liabilities that the entity can access at measurement date.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: Unobservable inputs for an asset or liability.

Administered investments are valued using the net assets valuation approach.

		Fair value measurements at the end of the reporting period	
		2017	2016
		\$'000	\$'000
7.5A: Administered Fair value measurements			
Financial assets			
Administered Investment	4.1C	<u>2,662,673</u>	<u>2,563,763</u>
Total Financial Assets		<u>2,662,673</u>	<u>2,563,763</u>
Assets not measured at fair value in the statement of financial position¹			
Trade and other receivables	4.1B	<u>572,385</u>	<u>588,444</u>
Prepayments	4.2A	<u>240,452</u>	<u>203,121</u>
Total assets not measured at fair value in the statement of financial position		<u>812,837</u>	<u>791,565</u>
Liabilities not measured at fair value in the statement of financial position¹			
Other payables	4.3A	<u>6,427</u>	<u>8,262</u>
Total liabilities not measured at fair value in the statement of financial position		<u>6,427</u>	<u>8,262</u>

¹ These items carrying amounts equate to their approximate fair values.

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OTHER INFORMATION

8.1: Assets Held in Trust

	2017 \$'000	2016 \$'000
Young Endeavour Youth Program Public Fund (Trust)		
Monetary assets held in trust were also disclosed in 5.2 Special Accounts in the table titled "Young Endeavour Youth Program Special Account" (Special Public Money).		
<i>Purpose of trust arrangement:</i>		
<i>To create a capital fund for the purpose of furthering youth development initiatives to make specific acquisitions and to support the Young Endeavour Youth Scheme through sail training for young Australians.</i>		
The fund is listed as a deductible gift recipient.		
Total amount held at the beginning of the reporting period	1,360	1,274
Other receipts	53	88
Total credits	1,413	1,362
Payment made to suppliers	(33)	(2)
Total debits	(33)	(2)
Total amount held at the end of the reporting period	1,380	1,360
Peter Mitchell Trust Fund (Trust)		
Monetary assets held in trust were also disclosed in 5.2 Special Accounts in the table titled "Services for Other Entities and Trust Monies" (Special Public Money).		
<i>Purpose of trust arrangement:</i>		
<i>To disburse amounts held on trust or otherwise for the benefit of a person other than the Commonwealth.</i>		
Total amount held at the beginning of the reporting period	1	3
Other receipts	6	3
Total credits	7	6
Payment made to suppliers	(3)	(5)
Total debits	(3)	(5)
Total amount held at the end of the reporting period	4	1
Fedorczenko Legacy Fund Special Account (Trust)		
Monetary assets held in trust were also disclosed in 5.2 Special Accounts in the table titled "Fedorczenko Legacy Special Account" (Special Public Money).		
<i>Purpose of trust arrangement:</i>		
<i>For expenditure in relation to the defence of Australia of the residual of the estate of the late Petro Fedorczenko.</i>		
Total amount held at the beginning of the reporting period	169	167
Other receipts	3	4
Total credits	172	171
Payment made to suppliers	(4)	(2)
Total debits	(4)	(2)
Total amount held at the end of the reporting period	168	169

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8.2: Restructuring

8.2A: Departmental restructuring

	2017	Defence Materiel Organisation
	\$'000	2016¹
		\$'000
FUNCTIONS ASSUMED		
Assets recognised		
Cash and cash equivalents	-	(32,619)
Trade and other receivables	-	575,441
Property, plant and equipment	-	4,732
Intangibles	-	6
Prepayments	-	2,909,916
Total assets recognised	-	3,457,476
Liabilities recognised		
Suppliers	-	1,417,301
Unearned income	-	1,091,018
Grants	-	859
Other payables	-	232,726
Employee provisions	-	156,310
Other provisions	-	1,073
Total liabilities recognised	-	2,899,287
Net assets recognised²	-	558,189
Less DMO appropriation receivable not transferred to Defence	-	(113,623)
Net contribution by owners	-	444,566

¹ As a result of the First Principles Review, the Defence Materiel Organisation (DMO) was delisted and reintegrated into the Department of Defence on 1 July 2015. The activities undertaken by DMO prior to 1 July 2015 were absorbed into Defence's operations from that date.

² The net book value of assets and liabilities were transferred from DMO to Defence for no consideration on 1 July 2015. These values, as noted above, are the same as those reported in the financial statements for DMO for the year ended 30 June 2015.

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8.3: Compliance with Statutory Conditions for Payments from the Consolidated Revenue Fund

Section 83 of the Constitution provides that no amount may be paid out of the Consolidated Revenue Fund except under an appropriation made by law. The Department of Finance provided information to all agencies in 2011 regarding the need for risk assessments in relation to compliance with statutory conditions on payments from special appropriations, including special accounts. Defence reported the possibility of this being an issue for the agency in Note 29 Appropriations Table C to the 2010-11 financial statements and undertook to investigate the issue during 2011-12.

As a result of that investigation, legislation was amended by the *Financial Framework Legislation Amendment Act (No. 2) 2012* (FFLA Act No. 2) with effect from 1 July 2012. The amendments ensured that all benefits paid under certain Acts with a special appropriation would not be subject to Section 83 breaches in the future. That is, the FFLA Act No. 2 amended the *Defence Forces Retirement Benefits Act 1948*, *Defence Forces Retirement and Death Benefits Act 1973*, *Military Superannuation and Benefits Act 1991* and *Military Superannuation and Benefits Act 1991 - Retention Benefits* to ensure that overpayments that may be made would be covered by the appropriation provided by those Acts.

Legislation to address the same issue for the *Defence Force (Home Loans Assistance) Act 1990* and the *Defence Home Ownership Assistance Scheme Act 2008* has not progressed at this stage. It should be noted that both schemes have provisions that allow for the recovery of an overpayment. However, at the time when all legislation was being assessed for potential section 83 breaches it was considered that the current recovery provisions were not broad enough to meet future section 83 breaches. Defence or Department of Finance has been unable to secure a place on the parliamentary program due to the low priority Government has placed on the proposed amendments. That is it is unlikely that this matter will be addressed by legislative amendment in the near future. Therefore, if reporting of such breaches is still required Defence will continue to report on potential section 83 breaches for those schemes.

The following table shows the legislation, risk assessment, remedial action and number of potential breaches for the two remaining statutory schemes that still require legislation to address potential Section 83 breaches.

Legislation / Authority to pay ¹	Risk assessment progress as at 30 June 2017 ²	Remedial action taken or proposed ³	Potential Breaches ⁴		
			No.	Value \$'000	Recovered \$'000
<i>Defence Force (Home Loans Assistance) Act 1990</i>	Completed	LP	2	1	1
<i>Defence Home Ownership Assistance Scheme Act 2008</i>	Completed	LP,SM	299	209	205
<i>Services for Other Entities and Trust Moneys - Defence Special Account s20 FMA Act Det 2009/15</i>	Completed	SM	1	6,047	6,047

¹ **Legislation**

Amounts paid under each legislation are disclosed in Note 5.1C Special Appropriations and Note 5.2 Special Accounts.

² **Risk assessment**

Defence has undertaken an assessment of the inherent level of risk of a breach. Legislation marked as "Completed" has undergone internal assessment by business area.

³ **Remedial action taken or proposed**

L=legislative change; S=systems change; P=planned; M=made

⁴ **Potential breaches**

This is a potential issue that still exists for two Defence home loan schemes which will be addressed at a time to be confirmed by Government legislation. Amounts reported have been derived by analysing data on recovery of overpayments and other identified risk areas for 2016-17. Business processes are in place to ensure that identified overpayments are recovered. The numbers and amounts represent the overpayments made during 2016-17.