National Research Council Canada

Annual Report 2010-2011

National Research Council Canada
Conseil national de recherches Canada

Canada

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FINANCIAL STATEMENT DISCUSSION AND ANALYSIS

Introduction

The following Financial Statement Discussion and Analysis (FSD&A) should be read in conjunction with the audited financial statements and accompanying notes for the National Research Council of Canada (NRC) for the fiscal year ended March 31, 2011.

The responsibility for the preparation of the FSD&A rests with the management of NRC. It has been prepared in accordance with the Public Sector Statement of Recommended Practice SORP-1.

The purpose of the FSD&A is to highlight information and provide explanations which enhance the users' understanding of NRC's financial position and results of operations, while demonstrating NRC's accountability for its resources. Additional information on NRC's performance is available in the NRC Departmental Performance Report (DPR).

The FSD&A consists of two distinct segments: Highlights; and Discussion and Analysis. Please note that all financial information presented herein is denominated in Canadian dollars, unless otherwise indicated.

Special note regarding forward-looking statements

The words "estimate", "will", "intend", "should", "anticipate", and similar expressions are intended to identify forward-looking statements. These statements reflect assumptions and expectations of NRC, based on its experience and perceptions of trends and current conditions. Although NRC believes the expectations reflected in such forward-looking statements are reasonable, they may prove to be inaccurate, and consequently NRC's actual results could differ materially from expectations set out in this FSD&A. In particular, the risk factors described in the "Risks and Uncertainties" section of this report could cause actual results or events to differ materially from those contemplated in forward-looking statements.

Statement of Management Responsibility Including Internal Control Over Financial Reporting

The NRC financial statements include a Statement of Management Responsibility Including Internal Control Over Financial Reporting, which outlines that the responsibility for the integrity and objectivity of the financial statements and information contained therein rests with management. The Statement has been changed in 2010-11 to include that, in addition to management's assertion that a system of financial management and internal controls is in place, management is also responsible for maintaining an effective system of internal control over financial reporting and that an annual assessment of the effectiveness of the system is completed. This change was put in place with the implementation of the *Treasury Board Policy on Internal Control*. A description of how the system of internal controls is designed and maintained and monitored is also made available.

2010-2011 Highlights

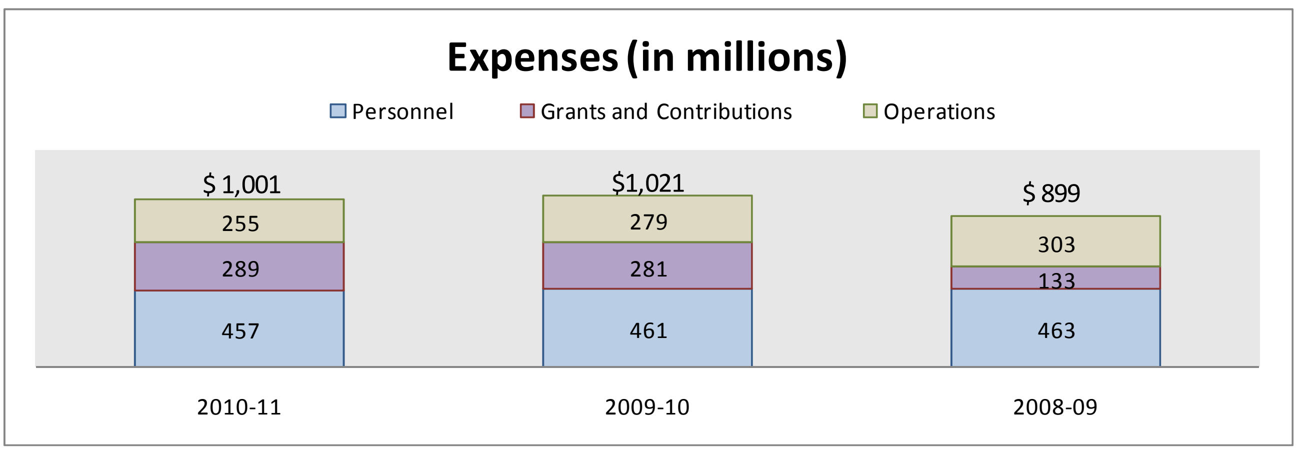
Financial Highlights

NRC's 2010-11 Financial Statements were influenced by a number of factors, including Canada's Economic Action Plan and expenditure restraint measures. These factors also played a role in the 2009-10 financial results, and help to explain some of the financial account variances from year-to-year, and contributed to changes in NRC's Net Cost of Operations and Equity position, which decreased by $32.1 million and increased by $26.7 million in 2010-11, respectively.

Statement of Operations

Expenses: NRC incurred total expenses of $1.001 billion in 2010-11, down slightly from 1.021 billion in 2009-10 but higher than $899 million incurred in 2008-09. 2010-11 and 2009-10 expenses are similar, and both are significantly higher than 2008-09 due to Canada's Economic Action Plan (CEAP). Introduced in January 2009, the CEAP was the Government's response to a deep global recession. The CEAP has delivered billions of dollars in stimulus for the economy to protect Canadian jobs and income as well as ensure a prosperous economy of tomorrow. NRC received and spent $142.5 million in additional appropriations in 2010-11 to support scientific research and development activities performed by Canadian organizations, of which $140.3 million was spent on contributions with the remainder spent on personnel and operational costs. (NRC also received funds for the modernization of federal laboratories and for the remediation of contaminated sites from the CEAP, but these expenditures had little impact on the Statement of Operations.)

The following chart illustrates NRC's total expenses categorized by major expense, over the past three fiscal years:



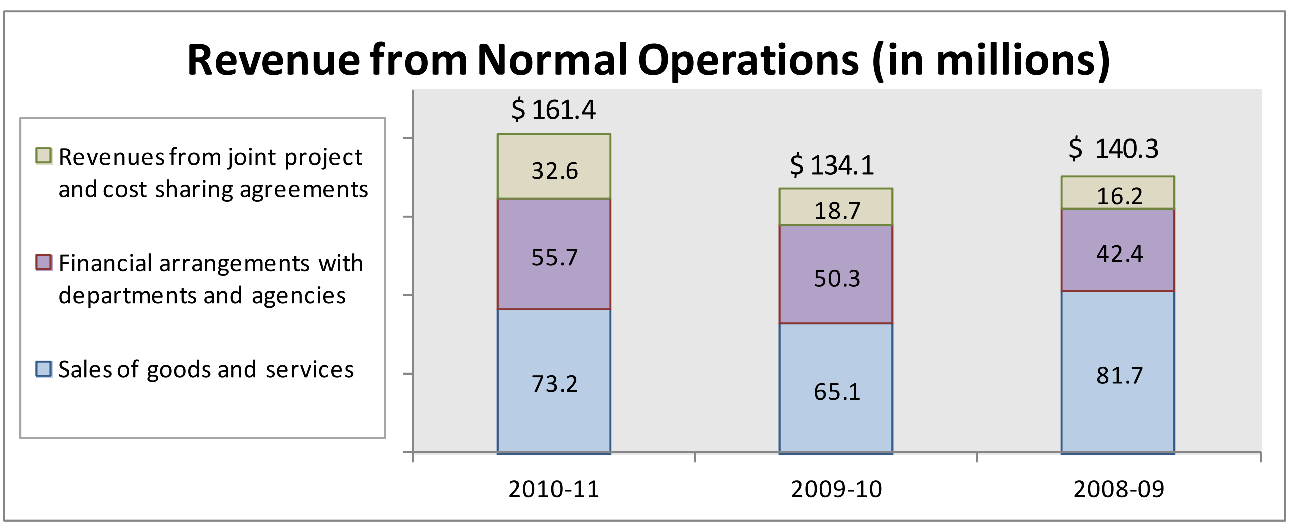
- ***Personnel:*** NRC's total expenses, as detailed in the Notes to the Financial Statements, are made up of 46% (45% in 2009-10) in salaries and employee benefits, which represent NRC's most significant cost driver. Salaries and employee benefits were $457 million in 2010-11, down from $461 million in 2009-10. Several factors explain the $4 million (or 1%) decrease. The most significant were a $10.6 million increase to the charge for future employee severance benefits and a $1.6 million increase in vacation leave accruals, offset by a $7.1 million of decrease in salary costs due to fewer full time equivalent (FTE) personnel, a $5.4 million decrease in NRC's share of the Government's overall cost of employee benefits such as employer provided pension contributions and health and dental insurance, and a $3.0 million decrease as a result of increased capitalized salary costs relating to construction of capitalized assets.

- ***Grants and Contributions:*** NRC made total net grants and contributions of $289 million in 2010-11, as compared to $281 million in 2009-10 and $133 million in 2008-09. Canada's Economic Action Plan (CEAP) provided NRC with additional funds in both 2009-10 and 2010-11 to support small and medium-sized enterprises with their innovation efforts through the NRC Industrial Research Assistance Program (NRC-IRAP). $142.8 million of additional Grants and Contributions funding was made available through the CEAP in 2010-11 ($144.1 million in 2009-10). This investment will help the Government build a competitive advantage for Canada based on excellence in science and technology. With this support, SMEs are better equipped to perform R&D, commercialize new products and processes, and access global markets.
- **Operations:** NRC's operational costs (excluding salaries and employee benefits) decreased by $24 million from $279 million in 2009-10 to $255 million in 2010-11. The decrease in costs is mainly attributable to professional and special services which decreased by $7.6 million, bad debt expense which decreased by $5.6 million, and transportation and communication which decreased by $4.4 million. The decrease in operational costs is forecast to be maintained for upcoming years given NRC's implementation of cost management measures within these areas.

Further details on expense variations are explained in the Financial Analysis section.

Revenue: Revenue is important to NRC, not only as a means of financing its operating and capital expenditures, but also because it is an indicator of the value that NRC provides to its clients and collaborators. It keeps NRC at the forefront of private sector technology trends and developments. NRC earned total revenues of $169.8 million in 2010-11, a $11.3 million increase from the $158.5 million earned in 2009-10. A $13.9 million increase in revenues from joint project and cost sharing arrangements was primarily due to NRC meeting its contractual obligations for revenue that was previously deferred. There was also a $11.9 million decrease in financial arrangements with other government departments, a decrease mainly caused by a $16.8 million financial arrangement with Industry Canada being funded through appropriations in 2010-11 and a $6 million increase in revenue from services of a non-regulatory nature.

NRC revenues, adjusted for non-recurring interdepartmental transactions, provide a more accurate representation of NRC's normal operations. NRC revenues from normal operations increased by $27.3 million in 2010-11 from 2009-10. Sales of goods and services to external parties increased by $8.1 million ($8.5 million decrease from 2008-09). Financial arrangements with other government departments and agencies, and revenues from joint project and cost sharing agreements also both increased, by $5.4 million and $13.9 million respectively ($13.3 million and $16.4 million increases respectively from 2008-09).



Sales of goods and services include services of a non-regulatory nature, sales of goods and information products, rights and privileges, as well as revenue derived from the lease and use of property. The increase in sales of goods and services is attributable to many factors, including the effect of the slow but steady recovery from the global economic downturn and an increased focus on revenue generating activities throughout NRC. Revenue increases occurred at many of NRC's Institutes / Branches / Programs (IBP) to varying degrees, including a $2.2 million increase at NRC's Institute for Aerospace Research (NRC-IAR) due to several large new projects at both the Aerodynamics Laboratory and Gas Turbine Laboratory and a $1.2 million increase at NRC's Centre for Surface Transportation Technology (NRC-CSTT) mainly due to increased sales at its rail division.

The $5.4 million increase in financial arrangements with other government departments and agencies was due to increased revenue at several IBPs including $2.7 million at NRC's Canada Institute for Scientific and Technical Information (NRC-CISTI) due to a new ongoing contract with Health Canada and a $1.2 million increase at NRC-IAR from new projects with the Department of National Defence. Increased revenues from joint project and cost sharing agreements are due to increases at several IBPs including a $1.1 million increase at NRC's Steacie Institute for Molecular Sciences (NRC-SIMS) and a $1.0 million increase at NRC's Industrial Materials Institute (NRC-IMI).

Further details on revenues are found in the Financial Analysis section.

Discontinued Operations: As part of the Strategic Review conducted in 2008, the Research Press program at NRC's Canada Institute for Scientific and Technical Information (NRC-CISTI) was privatized in September 2010. All revenues and expenses relating to Research Press are excluded from the Statement of Operations for fiscal year 2010-11 and 2009-10 and are included instead on a net basis as Discontinued Operations. 2010-11 discontinued operations include $7.2 million of revenues and $7.9 million of expenses ($11.1 million and $11.2 million respectively in 2009-10).

Statement of Financial Position

Assets: NRC's total assets signify its ability to provide future services for Canadians. NRC had total assets of $820.4 million as at March 31, 2011, up slightly from $816.9 as at March 31, 2010. NRC's largest single component of assets is tangible capital assets (detailed below), which represent $573.7 million or 70% of the total ($579.1 million or 71% of the total as at March 31, 2010). Other significant assets include $197.3 million ($197.4 million as at March 31, 2010) Due from Consolidated Revenue Fund (the amount of cash that NRC is entitled to withdraw from the federal government treasury) and Accounts Receivable valued at $25.8 million ($18.9 million as at March 31, 2010).

- ***Tangible Capital Assets:*** NRC's infrastructure is an important element for the successful delivery of its mandate. Re-investments in tangible capital assets are crucial. As many of NRC's most significant tangible capital assets continue to age, NRC's recapitalization program is important to ensuring NRC continues to be able to meet the needs of its clients. In 2010-11, NRC acquired and/or constructed $62.3 million in tangible capital assets, down from $66.9 million in 2009-10 and $62.6 million in 2008-09. The total amount of annual amortization, transfers, disposals, and write-offs were greater than tangible capital asset acquisitions, producing a decline in the total net book value of tangible capital assets over the past three years. NRC's largest components of tangible capital investments are research buildings and facilities as well as machinery, equipment and furniture. Combined, they account for over 84% of the cost (77% of the net book value) of tangible capital investments.

Further details on tangible capital asset acquisitions are provided in the Financial Analysis section.

Liabilities: Accounts payable and accrued liabilities of $139.3 million as at March 31, 2011($144.3 million as at March 31, 2010) are NRC's largest liabilities. The largest components are amounts owing to suppliers and contributions payable ($108.6 million), payables to other Federal Government departments and agencies ($21.3 million) and accrued salaries and employee benefits ($8.2 million). NRC also has a $63.7 million deferred revenue liability ($79.5 million as at March 31, 2010) representing revenue that has been collected but not yet earned, and $71.1 million of liabilities relating to employee future benefits ($69 million as at March 31, 2010). Vacation pay and compensatory leave represents a $38.5 million liability for NRC ($43 million as at March 31, 2010).

Equity of Canada: NRC's equity of Canada as at March 31, 2011 was $507.5 million, up from $480.8 million as at March 31, 2010 and $491.4 million as at March 31, 2009. This amount illustrates NRC's net resources (financial and non-financial) that will be used to provide future services for Canadians.

Supplementary Highlights

Canada's Economic Action Plan: The effects of Canada's Economic Action Plan (CEAP) can be felt across the scientific research and development community in both financial and non-financial terms. Over $157 million in CEAP funding was made available to NRC in both 2010-11 and 2009-10.

Funding of $145 million was made available to NRC-IRAP from the federal government in 2010-11 ($146 million in 2009-10) to stimulate wealth creation for Canada. NRC-IRAP provides financial assistance, along with technical and business advisory services to small and medium-sized enterprises (SMEs) across Canada to help them develop technologies for competitive advantage. This increased funding provided NRC-IRAP with the financial means to assist over 1,600 new clients in 2010-11 and 1,700 new clients in 2009-10. These new clients represent a four-fold increase over the amount of new funded clients in 2008-09.

CEAP funding of $10.4 million was made available in 2010-11 for the modernization of federal labs ($8.7 million in 2009-10). Details on the projects funded under this initiative can be found in the Tangible Capital Assets discussion of the Financial Analysis section. $2.5 million of CEAP funds were made available to accelerate the Federal Contaminated Site Action Plan in 2010-11 ($2.4 million in 2009-10).

NRC's Strategic Direction: Under the leadership of NRC's new President, a new strategic direction for the organization was developed by NRC's management team in 2010-11. NRC intends to be a purposeful outcome based organization.

NRC's new strategy identifies six major areas of focus to improve direction and accountability within the organization. These are natural resources, environment, health costs, security, community infrastructure, and industry competitiveness. NRC will contribute to Canadian issues and challenges associated with those themes through "programs". Decisions about program and capital investment will ensure that programs align with strategy. Specialized infrastructure and expertise to help industry in targeted areas where there is a need for such support will also be provided.

NRC's new flagship programs will be an important way for NRC to explain and demonstrate its capabilities and the benefits it provides for Canada. The flagship programs will be inspiring, large in scale and provide substantial public benefit. Four flagships are under development:

1. Printable electronics – a new globally competitive electronics industry that will be viable in Canada.
2. Resilient Wheat – develop a profitable strain of wheat that is highly tolerant to environmental and climate stress.
3. Industrial Biomaterials – a Canadian based value chain that replaces imported products with economical high performance materials.
4. Creating value from CO_2: algal carbon conversion – reduce 20% of CO_2 emissions from large Canadian point source emitters through production and conversion of algae to value added products.

Governance: NRC has implemented a number of initiatives to improve corporate governance in keeping with the broad government goal of improved management, accountability and transparency in the public sector.

An organizational-wide business planning process serves as a crucial mechanism for making both financial and non-financial decisions. NRC was successful in balancing its 2010-11 budget despite important financial pressures. Salary and operating budget reductions were imposed on institutes, programs and corporate branches, some programs and projects were cancelled or delayed, and additional revenue targets were imposed.

NRC also put into place an Investment Planning process during 2010-11 to set priorities and allocate resources. Two distinct types of projects fall under this new process – projects related to the management of science or research, and projects related to NRC's research capability such as corporate management initiatives and projects related to real property (buildings, facilities), Information technology/Information management, or scientific equipment. Investment in NRC buildings was given particular attention in investment planning for 2011-12 – NRC set aside $14 million for recapitalization projects on NRC buildings.

This new process helps ensure that NRC complies with the Treasury Board Policy on Investment Planning. It focuses on governance, management controls and improving capacity and places an emphasis on NRC-wide management, to help ensure scarce resources are invested in areas where they will help NRC achieve its objectives. It also promotes clear accountability of managing projects. During 2010-11, applications were submitted for 103 different investment projects over 5 years, of which 29 were approved for funding in fiscal year 2011-12.

In accordance with the policy requirements, NRC has produced three linked deliverables:

1. A five-year Investment Plan (IP) identifying investments in assets, acquired services and projects;
2. An Organizational Project Management Capacity Assessment (OPMCA); and
3. Project Complexity and Risk Assessments (PCRAs) for all projects over $1M to be undertaken within the planning period.

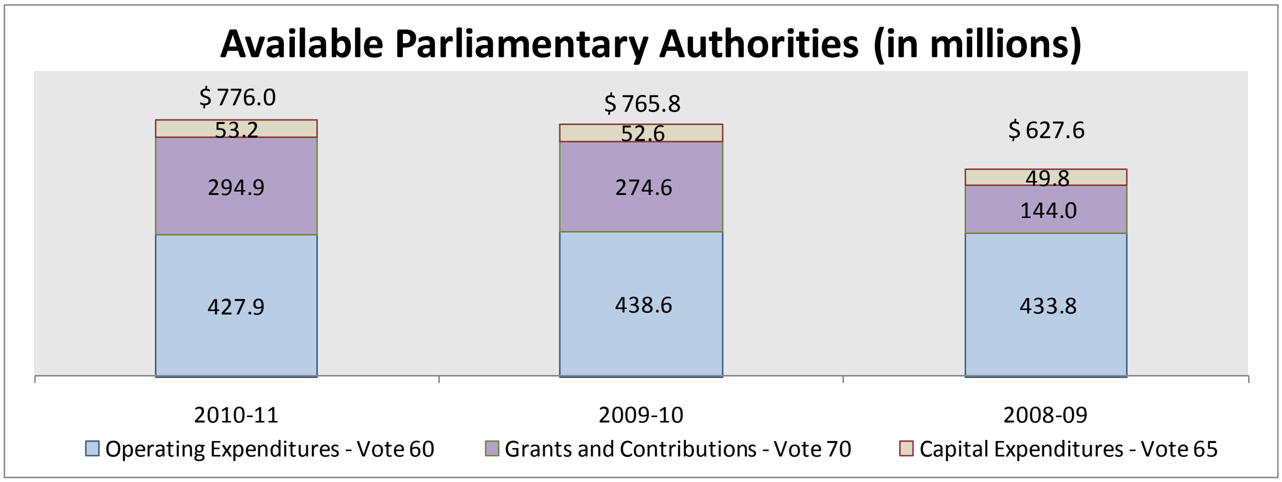
Financial management is an essential component of good governance and has substantial influence on corporate values and culture. During 2010-11, a focus was made to improve compliance with financial policy and procurement procedures. This included the development of procurement guides for users as well as testing of transactions to ensure compliance with financial and procurement policies.

Discussion and Analysis

Uncertainties

NRC funds the majority of its salary, operating and capital expenditures from parliamentary appropriations. The non-salary portion of this funding is fixed, with no indexing for price increases. As a result, the actual funding for NRC, in terms of buying power, has been declining over the past decade. Furthermore, with the exception of funds received from Canada's Economic Action Plan in 2010-11 and 2009-10, NRC's parliamentary appropriations have decreased over previous years.

The following chart illustrates NRC's parliamentary appropriations over the past three fiscal years, including the Main Estimates, the Supplementary Estimates, Transfers, Adjustments and Warrants but excludes statutory appropriations (Spending of revenues pursuant to paragraph 5 (1) e of the National Research Council Act, Contributions to employee benefit plans, Spending proceeds from the disposal of surplus Crown assets, Collection agency fees and Losses on foreign exchange).



In 2010-11, available parliamentary authorities increased by $10.2 million, from $765.8 million in 2009-10 to $776.0 million. While Grants and Contributions funding increased by $20.3 million, $16.8 million of the increase relates to NRC's administration of Industry Canada's Community Adjustment Fund (CAF). In 2009-10, CAF funding was received through revenue as a financial arrangement rather than through parliamentary authorities. Excluding CAF funding, NRC's available parliamentary appropriations decreased by $6.6 million, primarily due to a $10.7 million reduction in Operating Expenditure funding. Available Parliamentary Authorities in both 2009-10 and 2010-11 are significantly higher than 2008-09 due to funding received from Canada's Economic Action Plan. Without these elements, NRC's available parliamentary authorities would have been at $618.6 million ($625.8 million in 2009-10) with $42.8 million in capital expenditures ($43.9 million in 2009-10), $152.1 million in grants and contributions ($147.1 million in 2009-10), and $423.2 million in operating expenditures ($434.8 million in 2009-10).

NRC owns and manages 181 specialized buildings and facilities across Canada that comprise approximately 556,000 square meters of space. It also has an equipment and informatics base of $615.1 million in cost, with $188.2 million in net book value ($609.7 million in cost, with $199 million in net book value in 2009-10). NRC's capacity to fund the upgrade or replacement of these assets from its appropriations is limited. However, through its 5 year investment plan, NRC is investing funds to maintain its buildings and laboratories to existing conditions.

Sunsetting Funding: In order to ensure value for money, a Government of Canada practice is to provide funding for new initiatives on a sunsetting basis. Rather than providing a permanent increase in the NRC allotment, the government allocates funding for specified purposes for a limited period of time with the option for renewal. Renewal is conditional on various factors, including performance, achieving desired objectives, linkages to priorities, and availability of funds.

Although NRC funding is not necessarily provided on an ongoing basis, new government-approved initiatives, such as the establishment of technology cluster sites in communities across Canada, often entail ongoing commitments from NRC such as maintenance of new facilities and new staff salaries. There is also an expectation by the communities that support these new initiatives, and in some cases invest in them, that they will exist beyond the original funding window. These challenges add complexity to planning, budgeting and operations.

Currently, NRC has numerous initiatives and projects funded on a sunsetting basis, examples of which include the following:

- Canada's Economic Action Plan: The Economic Action Plan was implemented as a two-year program designed to stimulate Canada's Economy during a severe global economic downturn. Over $157 million in funding was made available to NRC in both 2010-11 and 2009-10. 2010-11 was the final year that NRC will receive funding.

- Technology Cluster Initiatives: Since its inception in 2000-01, NRC has received over $620 million in funding for technology cluster initiatives. The funding for NRC's technology cluster initiatives is set to expire at the end of 2011-12. NRC's technology cluster initiatives play a key role in activities that support the integration of players in Canada's innovation system. They nurture the growth of local scientific and innovative capability that drives dynamic and competitive industries; and also help to address challenges inherent in the current Canadian industrial structure (predominance of SMEs).

- TRIUMF: The current contribution agreement with TRIUMF (Canada's National Laboratory for Particle and Nuclear Physics) expires at the end of 2014-15 and will provide $177 million in funding over the next four years. Since 1976, NRC has provided over $1 billion in funding to TRIUMF, with $45 million provided in 2010-11.

- Genomics R&D Initiatives: The Genomics R&D Initiatives (GRDI) is a federal program that coordinates genomics R&D in 6 federal departments and agencies to support their mandates, public policy objectives and key national interest in human health, agriculture and food safety, environment and natural resources management. In 2008-09, NRC and 5 other federal government departments received approval to renew the GRDI for total funding until 2010-11 of $59.7 million. NRC's portion is $18 million ($6 million in each of 2008-09, 2009-10, and 2010-11). At present time there is no formal approval in place to renew the initiatives. However, they are part of the Government of Canada Fiscal Framework, and renewal is anticipated.

Foreign Currency: NRC purchased $43.1 million CDN in goods and services in foreign currencies in 2010-11 ($56.3 million in 2009-10), which exposes NRC to an element of risk due to fluctuations in foreign exchange. The most significant amount of purchases in foreign currencies is completed in US dollars (94% in 2010-11). Due to the strength of the CDN dollar over the US dollar in 2010-11, NRC's $39.8 million in US dollar purchases cost $3.8 million CDN dollars less than that same spending would have cost at the 2009-10 exchange rate.

In addition, NRC had $38 million CDN in foreign currency receipts in 2010-11, of which $37.3 million (98%) was received in US currency, compared to $31 million out of $33.4 million (93%) received in 2009-10. The $36.6 million in US dollar receipts in 2010-11 were able to offset 92% (59% in 2009-10) of the $39.8 million in US dollar disbursements.

Revenue: NRC activities generate revenues which can be reinvested in operations. NRC has steadily increased its external sources of funding since the early 1990s. The portion of NRC's operating and capital expenditures funded from external sources of income was roughly 11% in 1991-92. This percentage climbed to 22% in 2010-11, approximately the same as the average over the previous five fiscal years.

NRC's Centre for Surface Transportation Technology (NRC-CSTT) and NRC's Canadian Hydraulics Centre (NRC-CHC) rely primarily on external sources of revenue to fund their operations. In addition, NRC's largest institute – NRC's Institute for Aerospace Research (NRC-IAR) – generates external revenue to fund 48% of its operations. Significant downturns in the industries or federal departments that these groups support could impact NRC's ability to continue operations at current levels.

As part of its organizational strategy, NRC is looking to further increase external revenue in future years.

Financial Analysis

The following is an analysis that explains the meaning of main items appearing on the financial statements, significant variances, and financial trends.

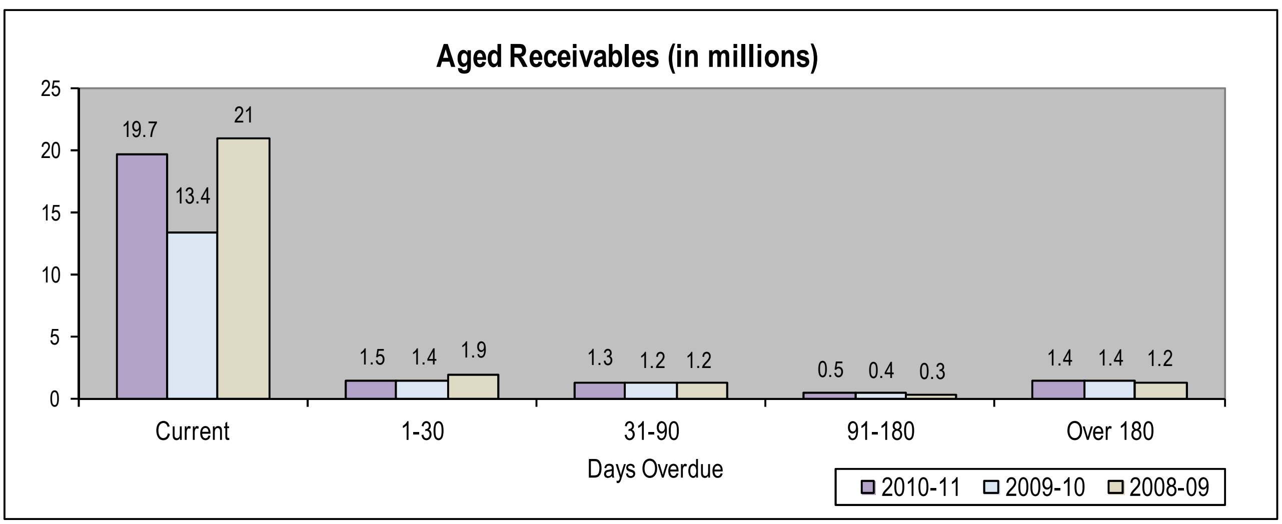
Assets

Due from the Consolidated Revenue Fund (CRF): This account represents the amount of cash that NRC is entitled to withdraw from the federal government treasury. This includes cash to discharge liabilities for which NRC has already received an appropriation, as well as revenue received but not spent. NRC's due from the CRF was $197.3 million as at March 31, 2011, down from $197.4 million as at March 31, 2010. Changes in the composition of the balance include a $3 million increase in accounts receivable from other government departments and a $0.5 million decrease in specified purpose account deferred revenue, partially offset by a $2.3 million increase in revenue available for use in subsequent years and a net $1.1 million increase in accounts payable eligible for payment from the CRF.

Accounts Receivable: Accounts receivable and advances totalled $25.8 million as at March 31, 2011, a $6.9 million increase from 2010. Details can be found in Note 4 to the financial statements.

Receivables from external parties: NRC had accounts receivable with external clients worth $19.2 million as at March 31, 2011 and a corresponding allowance for doubtful accounts of $682 thousand ($15.4 million and $856 thousand as at March 31, 2010), a favourable amount considering the total value of NRC's external revenues. The $3.8 million increase in accounts receivable from external parties is consistent with the higher level of revenue generated from total sales of goods and services in the year.

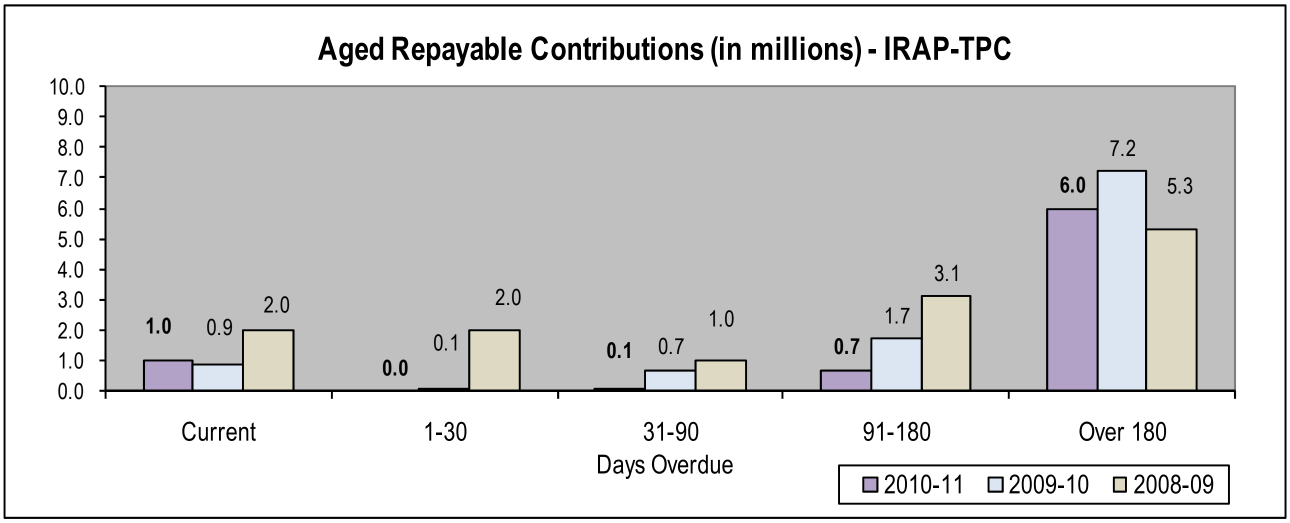
Aged Accounts Receivable: The graph below shows the aged accounts receivable from external parties, other government departments, and employee advances, but does not include repayable contributions under the IRAP-TPC program, which are shown separately. In 2010-11, 92% (90% in 2009-10 and 94% in 2008-09) of accounts receivable are aged 90 days or below indicating that NRC is able to collect on its operating receivables in a timely manner.



NRC-IRAP TPC Repayable Contributions

The NRC-IRAP Technology Partnerships Canada (TPC) program has been administered by NRC on behalf of Industry Canada since 1998. This program provides conditionally repayable contributions to small and medium-sized enterprises (SMEs) to support the pre-commercialization phase of their technology development. This conditional repayment program in most cases requires quarterly repayments of the contribution based on a percentage of the recipient's gross revenue. Although no new contributions have been made since 2008-09, the wind down phase will require the collection of the repayable contributions over the next several years as per repayable contribution agreements in place and conditions therein.

The NRC-IRAP TPC program supports small start-up firms, whose future success is often entirely dependent on one technology. Failure to bring the technology to market, at times, can result in the firm ceasing operations. The NRC-IRAP TPC accounts receivable as at March 31, 2011 was $7.8 million ($10.6 million as at March 31, 2010) with a corresponding allowance for doubtful accounts of $5.7 million ($8.6 million as at March 31, 2010). The large allowance, as well as the fact that a majority of IRAP-TPC receivables are aged greater than 180 days (see graph below), highlight the high-risk nature of the program. However, in spite of this risk, NRC has received repayments amounting to approximately 37% of contributions disbursed as at March 31, 2011 (33% as at March 31, 2010). With 188 projects still being administered (215 as at March 31, 2010), this percentage is expected to increase over the next decade.



Equity Investments: As part of its mandate to promote industrial innovation in Canada, NRC provides financial assistance to firms through access to equipment, intellectual property and incubation space in its laboratories and Industrial Partnership Facilities. NRC has on occasion taken an equity position in a company in return for assistance provided. NRC divests of equity investments by taking into account the interests and market liquidity of the company involved.

The full value recorded on the statement of financial position reflects NRC's investment in publicly traded companies as its shares in privately held corporations are deemed to have no market value. NRC's equity investments increased from $252 thousand to $472 thousand in 2010-11 following the conversion of a public company's debt owing to NRC into equity. NRC also sold shares in a private company, realizing a gain of $133 thousand.

The following table provides an overview of NRC's 2010-11 equity holdings and disposal transactions.

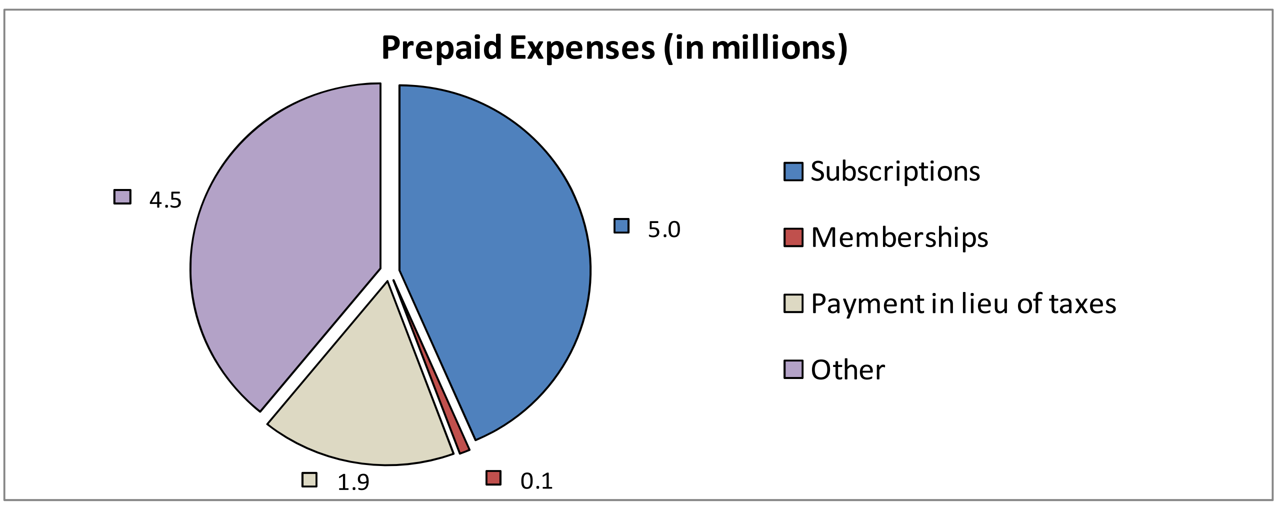
Company	Opening balance ($)	Book value of equity investments acquired, sold or written off during the year ($)	Closing balance ($)	Market value of publicly traded equity investments ($)	Proceeds from sale of equity investments ($)	Gain on sale of equity investments ($)
Privately held Corporations	13	(11)	2	n/a	132,679	132,668
Chemaphor Inc.	252,061	-	252,061	144,935	-	-
Omnitech Consultant Group Inc	1	(1)	-	-	-	-
Cequence Energy Ltd.	1	-	1	13,309	-	-
PharmaGap Inc.	-	219,889	219,889	122,879	-	-
Total	**252,076**	**219,877**	**471,953**	**281,123**	**132,679**	**132,668**

NRC's intention is to eventually liquidate the remaining equity positions, when conditions permit.

Endowment Fund Investments: The Holmes Endowment Fund is an investment bequeathed to NRC in July 1994. Up to two-thirds of the endowment fund's yearly net income is used to finance the H.L. Holmes award. The award covers a one- or two-year period and provides the opportunity to Canadian post-doctoral students to study at world famous graduate schools or research institutes under outstanding researchers. In 2010-11, NRC provided a grant totalling $97 thousand to the recipient of the 2009 NRC H.L. Holmes Award. The recipient is using the total award of $198 thousand to fund two years of collaborative research at the Harvard Medical School in Cambridge, Massachusetts to explore cellular processes leading to cholera, a severe diarrheal disease that afflicts or kills many in developing countries.

The endowment fund had a fair market value of $4.8 million on March 31, 2011 ($4.7 million as at March 31, 2010). The investments within the portfolio had an average effective return of 4.7%. The endowment fund is presented at an amortized cost of $4.6 million ($4.5 million as at March 31, 2010) on the Statement of Financial Position and not at fair value.

Prepaid Expenses: NRC's prepaid expenses as at March 31, 2011 were $11.5 million ($10.3 million as at March 31, 2010). The increase of $1.2 million is mainly attributable to an increase in scientific journal subscriptions within the NRC Canada Institute for Scientific and Technical Information (NRC-CISTI), which increased from $4.3 million to $5 million. Subscriptions form the primary component of NRC's prepaid expenses. Canada's science library subscribes to many of the world's major scientific and technical journals and databases.



Other prepaid expenses include various items such as software license and maintenance, travel and conference reservations, rental fees and security deposits.

Tangible Capital Assets: NRC's tangible capital asset net book value has decreased from $579.1 million in 2009-10 to $573.7 million in 2010-11. Total tangible capital asset acquisitions totalled $62.3 million, amortization totalled $67.2 million, and net assets transferred, disposed or written-off were $0.4 million.

Acquisitions

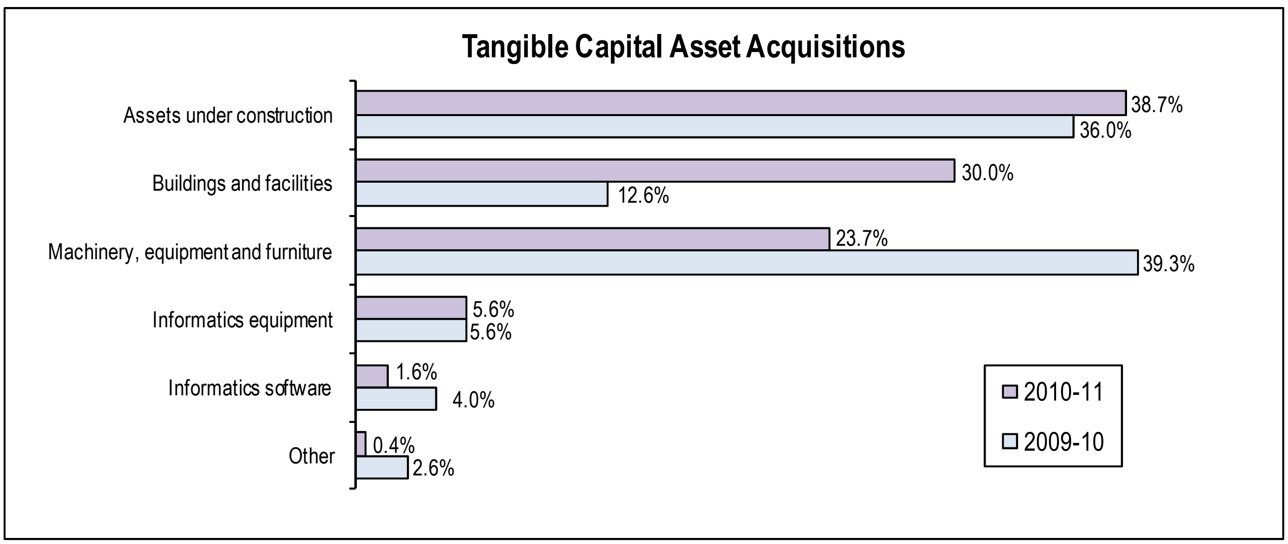
Additions to Tangible Capital Assets totalled $62.3 million in 2010-11, including $10.1 million financed from funding received for the modernization of federal laboratories through Canada's Economic Action Plan. This is a slight decrease from the $66.9 million spent in 2009-10. Of the $62.3 million in tangible capital asset additions, $24.1 million or 39% relate to spending on assets under construction as at March 31, 2011. The remaining balance is primarily made up of investments in NRC buildings and facilities ($18.7 million or 30%) as well as machinery and equipment ($14.8 million or 24%).

The following represents significant tangible capital assets expenditures in 2010-11:

- The recapitalization and deferred maintenance work completed in 2010-11 includes: upgrades to laboratories and equipment, replacement of windows, roofing material, building exteriors, electrical and mechanical systems. Two significant projects include a $2.6 million investment at NRC's Institute for Aerospace Research (NRC-IAR) in exterior recladding to extend the life of a building and a $1.5 million investment at NRC's Institute for National Measurement Standards (NRC-INMS) to retrofit a steam condensate line to extend its life and provide new connections.
- NRC-IAR invested $3.7 million for a total project cost of $4.9 million for the construction of an Icing System in Thompson Manitoba. This Icing System is integrated into an Engine Test Facility owned by a Joint Venture made up of Pratt and Whitney Canada and Rolls Royce Canada, and operated under contract by MDS Aero Test. NRC maintains ownership and operating responsibility for the Icing System and will be paid for its use by the Joint Venture. This facility supports the testing and certification of gas turbine engines in icy conditions. Participation in this facility meets multiple NRC objectives including contributing to the economic viability of northern communities, enhanced air transportation safety by providing access to an economical and sustainable test facility, and contributing to the competitiveness of Canadian industry in aerospace, a key industry sector.
- NRC-IAR invested $1.7 million in a test facility to support a large high pressure and high temperature combustion project. This is a key asset for industry to test and develop low emission gas turbines, and generates revenue for NRC through rentals of the test facility. Construction of this asset is expected to be completed during the 2011-12 fiscal year.
- NRC's Industrial Materials Institute (NRC-IMI) spent $2.3 million to purchase and install a Dieffenbacher DYG 2500/2100 AS Compression Press with Active Parallel Levelling System for use at the Magna-NRC Composites Centre of Excellence. The press will be used to support multiple research projects encompassing the compression moulding and forming of many composite materials and is a key asset for NRC-IMI, the Composites Centre and the NRC Biosourced Industrial Materials Manufacturing (NBIMM) initiative. Construction of this asset is expected to be completed during the 2011-12 fiscal year.
- NRC-IMI spent $2.2 million to replace an exterior wall due to problems with the original construction in 1982. This new wall will increase the useful life of the building.
- NRC's National Institute for Nanotechnology (NINT) invested $1.9 million in 2010-11 toward a $4.3 million project to build an equipment room and renovate existing floor space to meet the requirements of new equipment being installed as part of the Hitachi Microscopy Products Centre (HEMIC) initiative, a $14M collaboration expected to speed up commercialization of NINT microscope innovations.

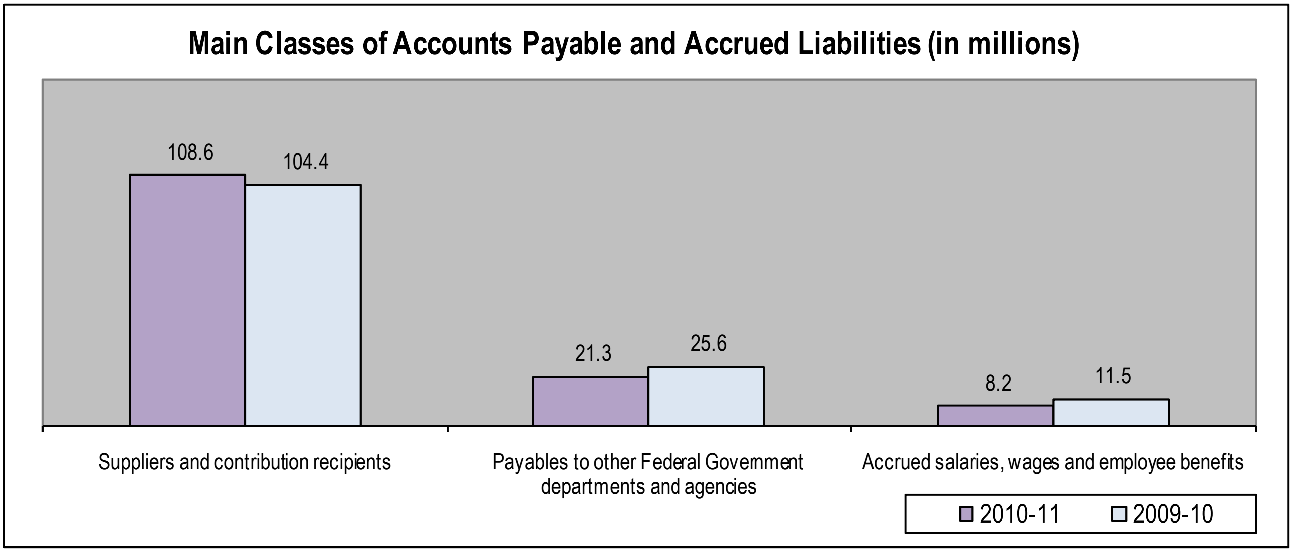
- NRC's Institute for Microstructural Sciences (NRC-IMS) invested $1.2 million on a SPTS Ii2L model Inductively Coupled Plasma (ICP) etch tool. The Canadian Photonics Fabrication Centre (CFPC) at NRC-IMS fabricates a variety of lasers, detectors and modulators for a large number of external clients. The fabrication process involves a dry etching process under vacuum. The new ICP etch tool will provide improved Etch process uniformity and control, reduced down time, and increased dry etch capacity in the largest segment of CPFC's activities. Construction of this asset is expected to be completed during the 2011-12 fiscal year.
- NRC spent $1.0 million to upgrade its DDC building control systems for improved energy management and building performance at many facilities across NRC.
- NRC's Institute for Chemical Process and Environmental Technology (NRC-ICPET) invested $900 thousand to construct the Analytical High Resolution Transition Electron Microscope as part of a specialized $4 million facility to meet current leading edge research requirements for imaging and analytical characterization of organic and inorganic materials. Construction of this asset is expected to be completed during the 2011-12 fiscal year.

The following diagram depicts NRC's distribution of tangible capital asset acquisitions over the last two fiscal years.



Liabilities

Accounts Payable and Accrued Liabilities: NRC's accounts payable and accrued liabilities as at March 31, 2011 were $139.3 million ($144.3 million as at March 31, 2010). The decrease of $5 million is mainly due to a decrease in payables to other government departments and lower accrued salaries and employee benefits, partially offset by an increase in payables to suppliers. The following graph shows the three largest categories of accounts payable and accrued liabilities.

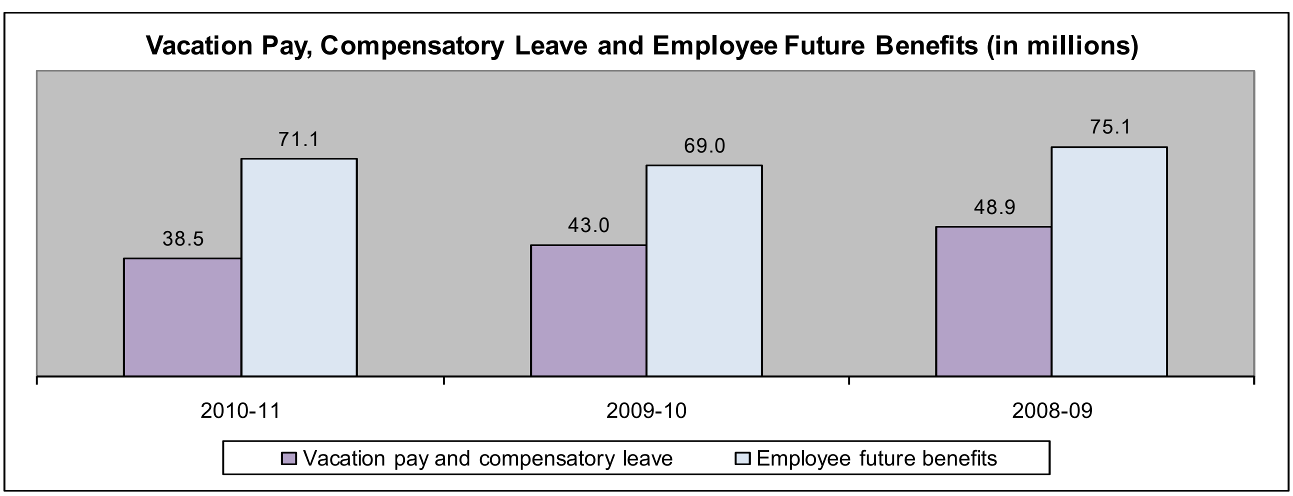


The $4.2 million increase in payables to suppliers and contribution recipients is due to increased amounts owing to external suppliers at year-end. The $4.3 million decrease in payables to other Federal Government departments and agencies is the result of higher payables in 2009-10 related to NRC's portion of employee benefits following the payment of retroactive salaries in 2009-10.

NRC's accrued salaries represents salary earned by personnel as at March 31, 2011 for which they have not received payment. The decrease of $3.3 million in comparison with the previous year is primarily explained by a decrease in the allowance recorded for termination benefits, partially offset by an increase of one day worked by NRC employees for which they had not yet been paid as at March 31, 2011.

NRC's contaminated site liabilities have decreased by $1.8 million due to restoration costs incurred by NRC in the remediation of contaminated sites previously accrued. While NRC's remaining liability is only $80 thousand, work on restoration and management of existing sites will continue in 2011-12 with funding provided by the Government through the Accelerated Federal Contaminated Sites Action Plan.

Vacation Pay and Compensatory Leave: After many years of steadily increasing vacation pay and compensatory leave liabilities, the amount decreased in each of the past two fiscal years, including a $4.5 million decrease in 2010-11 and a decrease of $5.9 million in 2009-10. The decrease is a result of additional restrictions imposed on carry-over conditions in recent collective bargaining agreements and management oversight activities taken to manage outstanding vacation liabilities.



Employee Future Benefits: Employee future benefits represent an allowance for severance benefits payable to employees upon termination of employment with the public service. The allowance for employee future benefits is established at year end based on the total annual salary cost of NRC's indeterminate employees. The increase of $2.1 million results from a 0.52% increase in the rate used by Government Departments to estimate and accrue their portion of the allowance as well as a slight increase due to the natural rise in employment wages applicable to NRC's continuing workforce.

Deferred Revenue: Deferred revenue totalled $63.7 million as at March 31, 2011, compared to $79.5 million in 2010, and is broken down in Note 9 of the financial statements.

Contributions Related to Leased Tangible Capital Assets

Deferred revenue for contributions related to leased tangible capital assets result from tangible capital assets provided to NRC under a lease agreement with monetary consideration below fair market value. The contributions related to leased tangible capital assets is associated with leases of facilities for $1 per year with the University of Western Ontario to accommodate NRC's Industrial Materials Institute (NRC-IMI) and NRC's Institute for Research Construction (NRC-IRC), the University of Alberta to accommodate NRC-NINT, and the University of Prince Edward Island to accommodate NRC's Institute for Marine Biosciences (NRC-IMB).

When new capital leases are recognized, NRC will establish a non-financial tangible capital asset as well as corresponding deferred revenue equal to the fair market value of the capital lease. Over time and as the asset is used, NRC recognizes equal amounts of amortization and revenue (lease inducement revenue). As a result, no impact occurs on NRC's net cost of operations or its Equity of Canada. As at March 31, 2011 this balance was $48.0 million ($50.6 million as at March 31, 2010). The balance decreased by $2.6 million in the current year to account for revenue recognized in accordance with the useful life of the related asset.

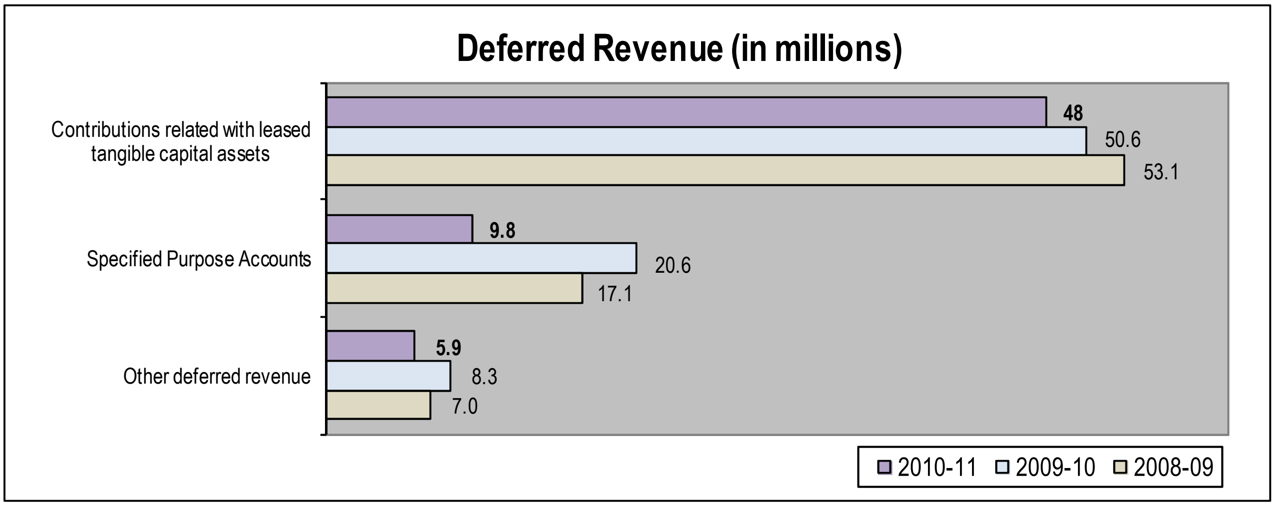
Specified Purpose Accounts

NRC undertakes collaborative work with clients for the mutual benefit of both parties. Funding provided by the collaborator is placed in a Specified Purpose Account (SPA) and used over the duration of the project. Amounts remaining in the SPA at year-end are recorded as deferred revenue as the funds will be expended in the coming year(s) on the project. At the end of 2010-11, this amount totalled $9.8 million ($20.6 million as at March 31, 2010), representing a decrease of 52% over the previous year. This decrease is primarily the result of work being completed on projects for which the revenue was deferred in previous years.

Other

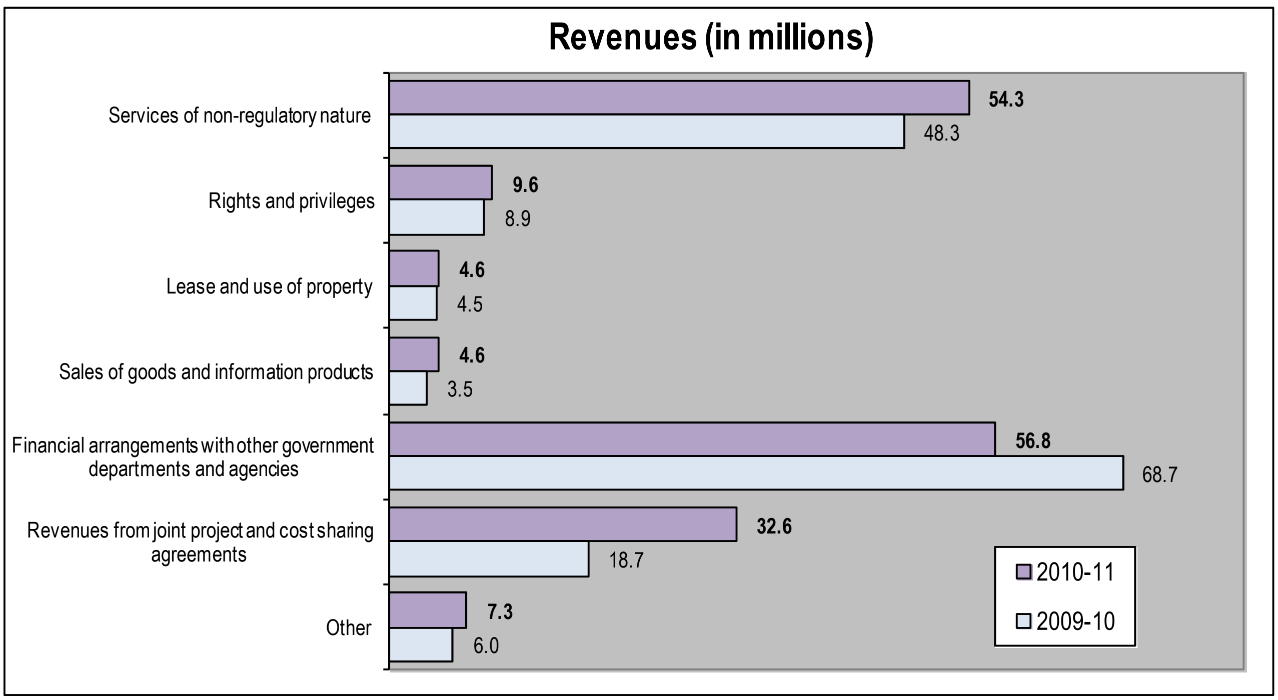
NRC had other deferred revenues of $5.9 million as at March 31, 2011 ($8.3 million as at March 31, 2010). NRC-CISTI's Research Press operation, which was privatized in September 2010, accounted for $4.7 million of the 2009-10 balance. This decrease is partially offset by a number of deferred revenue increases, including $0.9 million of deferred revenue for a project at NRC-HIA, $0.8 million of increased deferred revenue on percentage of completion contracts at NRC-IRC, and $0.8 million of deferred revenue at NRC-NINT relating to grant money to help fund an expansion project taking place during the 2011-12 fiscal year.

The other main component of "other" deferred revenue is deferred conference and seminar registration fees. NRC conducts many conferences and seminars which often require registration many months in advance of the conference date. Receipts from registration are recorded as deferred and recognized when the conference takes place. Deferred revenue from conference and seminar registration decreased by $0.1 million as of March 31, 2011.



Revenues

NRC's total revenues were $169.8 million in 2010-11, compared to $158.5 million in 2009-10. Recent trends in revenue components are shown in the following chart.



Services of a Non-Regulatory Nature: In 2010-11, 33% or $54.3 million (30% or $48.3 million in 2009-10) of NRC revenues were generated from services of a non-regulatory nature, which primarily consists of research services provided directly to industry and academic clients. As discussed in the Highlights section the $6 million increase is due to increases at many IBPs, most significantly a $2.2 million increase at NRC's Institute for Aerospace Research (NRC-IAR) due to several large new projects at both the Aerodynamics Laboratory and Gas Turbine Laboratory and a $1.2 million increase at NRC's Centre for Surface Transportation Technology (NRC-CSTT) mainly due to increased sales at its rail division.

Rights and Privileges: Royalty revenue is earned from companies that license the rights to use NRC technologies. Royalties are typically based on a percentage of the licensee's sales. In 2010-11, NRC generated $9.6 million in royalties, up slightly from $8.9 million in 2008-09. The main contributor of revenue earned from this income stream is NRC's Institute for Biological Sciences (NRC-IBS) which generated over $5 million in royalties.

Sales of Goods and Information Products: As part of its goal to disseminate scientific and technical information of importance to industry, NRC has publications and certified reference materials that it sells to clients. Total sales of goods and information products totalled $4.6 million in 2010-11, as compared to $3.5 million in 2009-10. The largest component of revenue derived from the sale of goods and information products are sales of codes, most significantly National Model Building Codes by NRC's Institute for Research in Construction (NRC-IRC).

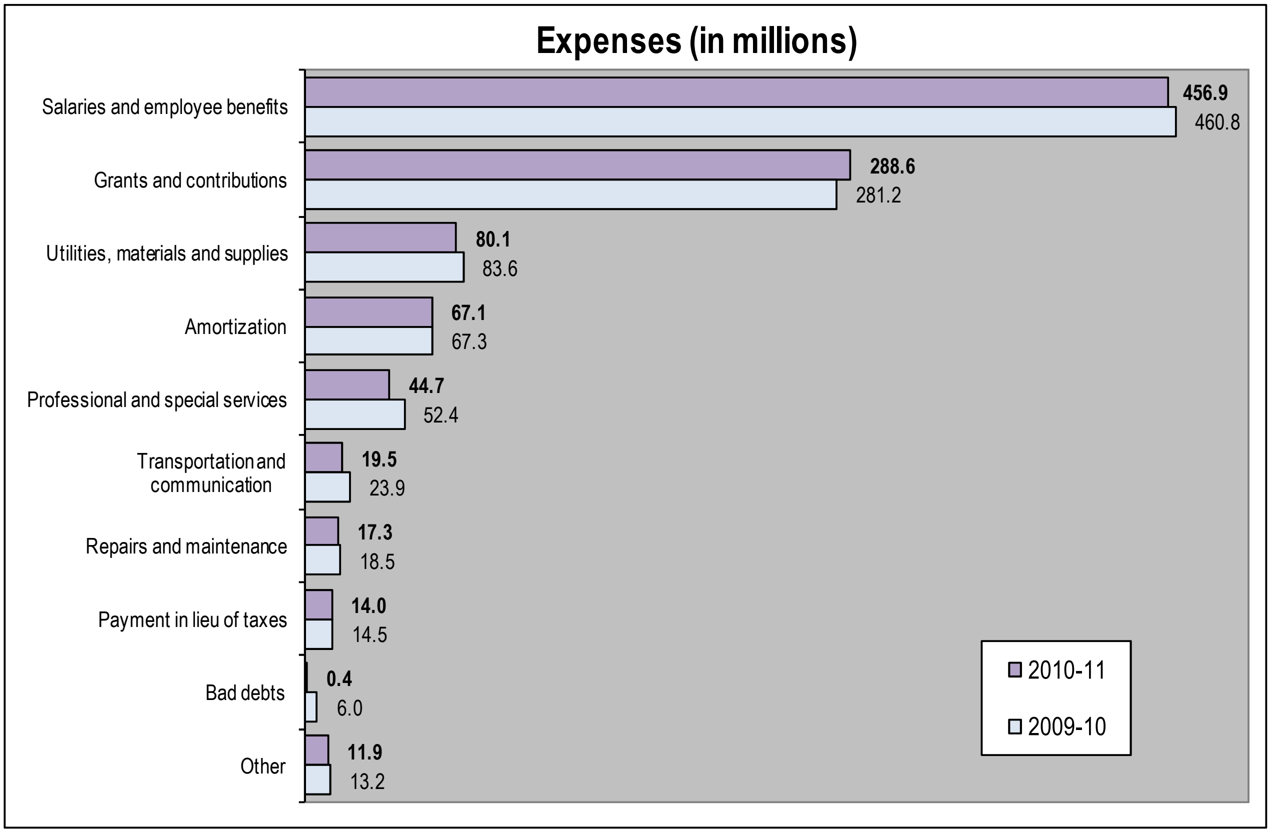
Lease and Use of Property: Facilitating access to NRC researchers and facilities is an important part of technology transfer at NRC. To this end, NRC provides laboratory space to companies on a commercial basis, often as part of a collaboration or technology transfer agreement. Revenue from lease and use of property amounted to $4.6 million in 2010-11, compared to $4.5 million in 2009-10. The year over year consistency demonstrates NRC's ability to continuously attract external stakeholders to utilize NRC facilities, laboratories and research equipment.

Financial Arrangements with Other Government Departments and Agencies: NRC undertakes research and administers funding on behalf of other federal government departments through NRC programs. The incremental costs associated with this work are reimbursed to NRC. In 2010-11, the amount of work undertaken for other government departments was significant, totalling $56.8 million ($68.7 million in 2009-10). When excluding the effect of transfer payment programs administered by NRC on behalf of Industry Canada (CAF and TPC), which decreased by $17.3 million in 2010-11, financial arrangements with other government departments and agencies have increased by $5.4 million. As discussed in the Highlights section, significant factors behind this increase include a $2.7 million increase at NRC-CISTI due to a new ongoing contract with Health Canada for shared library services, and a $1.2 million increase at NRC-IAR from new projects with the Department of National Defence. Revenue at NRC-CSTT decreased by $2.4 million due to a decrease in revenue from the Department of National Defense, its largest client. This decrease was offset by increases of $0.3-$0.7 million at 6 other IBPs.

Revenues from Joint Project and Cost Sharing Agreements: NRC receives income in the course of collaborative research projects that involve cost sharing arrangements for work that is likely to lead to new expertise or technology. In 2010-11, collaborative funding across all sectors at NRC earned $32.6 million ($18.7 million in 2009-10). Revenue from joint research projects are recognized on a percentage of completion basis. Consequently, revenues fluctuate as NRC resources are dedicated and used to deliver the terms set out in each agreement. As such, the increase achieved in 2010-11 on revenues from joint projects and cost sharing agreements demonstrate NRC's progress and additional resources dedicated to such projects over the previous fiscal year.

Expenses

As noted in the Highlights section, NRC's expenses decreased slightly from $1.021 billion in 2009-10 to $1.001 billion in 2010-11. The two major categories of expenses are salaries and employee benefits (46% of total expenses in 2010-11 and in 2009-10) and grants & contributions (29% of total expenses in 2010-11, 28% in 2009-10).

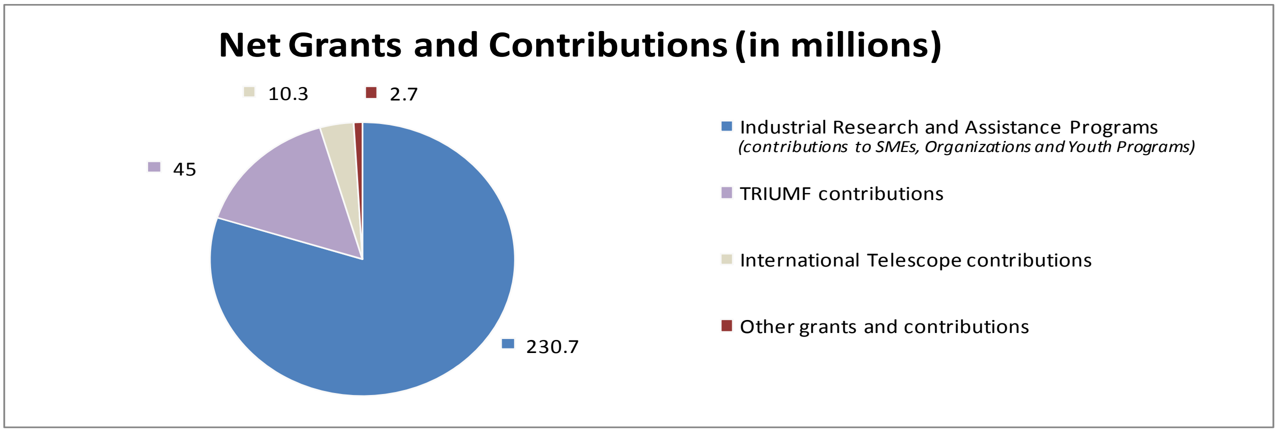


Salaries and Employee Benefits: Salaries and employee benefits include such costs as gross salaries and wages, overtime pay, retroactive salary adjustments, employee entitlements and allowances, severance pay, pension and medical benefits. Total NRC salaries and employee benefits have decreased by $3.9 million in 2010-11, from $460.8 million in 2009-10 to $456.9 million in 2010-11. As discussed in the Highlights section, the main causes of this decrease include a $10.6 million increase to the charge for future employee severance benefits which was offset by a $5.4 million decrease in NRC's share of the Government's overall cost of employee benefits such as employer provided pension contributions and health and dental insurance, and a $3.0 million decrease as a result of an increased amount of capitalized salary costs relating to construction of capitalized assets. The remainder of the decrease is the result of decreased salary expenses due to fewer full time equivalent employees (FTEs) compared to 2009-10 (primarily term, casual and student employees) following budget reductions.

Grants and Contributions*:* Grants and contributions increased by $7.4 million, from $281.2 million in 2009-10 to $288.6 million in 2010-11. The increase is mainly due to adjustments made in 2009-10 in IRAP TPC repayable contributions, causing a net increase of $5 million to contributions expense in 2010-11.

The greatest component of NRC Grants and Contribution expenses relates to the NRC-IRAP program. NRC-IRAP provides grants to Canadian SMEs, Organizations and Youth Programs to stimulate wealth creation for Canada through technology by enhancing innovation and commercialization capacity. As noted in the Highlights section, grants and contributions were significantly higher in both 2009-10 and 2010-11 compared to previous years due to $143 million of additional funding received through Canada's Economic Action Plan.

The following chart illustrates NRC's net grants and contributions categorized by major program.



Utilities, Materials and Supplies: Utilities, materials and supplies include expenditures such as electricity, natural gas, serial renewals, electronic data processing (EDP) equipment with cost under $5,000, fuel, software, laboratory equipment and laboratory products. Utilities, material and supply costs decreased by $3.5 million from $83.6 million in 2009-10 to $80.1 million in 2010-11. The decrease is due to reduced spending in several areas including laboratory equipment and parts and electronic supplies.

Amortization: Tangible capital assets are expected to yield benefits over several accounting periods. As such, NRC's use of these assets to provide services is recognized as an expense on a straight-line basis over the estimated useful life of each asset class. This expense, which was $67.1 million in 2010-11 ($67.3 million in 2009-10), is referred to as amortization.

Professional and Special Services: Professional and special services decreased by $7.6 million in 2010-11, from $52.3 million in 2009-10 to $44.7 million. Main causes for this 15% decrease include $3.1M of reduced engineering services, primarily due to the completion of a large revenue contract at NRC-HIA, reduced spending on consultants by $3.7 million, as well as a $1 million reduction in legal, patent and copyright services.

Transportation and Communication: Transportation and communication expenses decreased by $4.4 million in 2010-11, from $23.9 million in 2009-10 to $19.5 million. The 18% decrease is mainly attributable to NRC's effort of reducing travel costs. In addition to travel restrictions imposed internally, the 2009 Federal Budget imposed a two year travel expenditure ceiling, capped at 2008-09 levels, on all federal departments and agencies. The decrease in transportation and communication spending is expected to remain at lower levels in the future.

Repairs and Maintenance: NRC has a significant amount of capital investments, such as buildings, facilities, and research equipment. The repair and maintenance costs incurred of $17.3 million in 2010-11 ($18.5 million in 2009-10) represent expenditures related to the maintenance of these assets. The decrease of $1.2 million or 6% is mainly due to reduced laboratory repair costs.

Bad Debts: NRC's decrease in bad debt expense of $5.6 million ($6 million in 2009-10 and $0.4 million in 2010-11) was mainly attributable to the NRC-IRAP TPC program (refer to Accounts Receivable discussion above).

In 2010-11, there were fewer IRAP TPC clients invoiced as a result of the gradual winding down of the program and there was an increase in the number of "negotiated exit" arrangements with IRAP TPC clients that were in financial hardship. These arrangements resulted in reductions to both the accounts receivable and bad debt expenses relating to this program.

Other: Other expenses of $11.9 million ($13.2 million in 2009-10) include, but are not limited to rental charges of $4.6 million ($4.8 million in 2009-10), award costs of $2.7 million ($3.1 million in 2009-10), and information costs of $2.2 million ($2.5 million in 2009-10).

NRC · CNRC

Financial Statements

National Research Council Canada

March 31, 2011

Auditor General of Canada
Vérificateur général du Canada

INDEPENDENT AUDITOR'S REPORT

To the National Research Council of Canada and the Minister of Industry

Report on the Financial Statements

I have audited the accompanying financial statements of the National Research Council of Canada, which comprise the statement of financial position as at 31 March 2011, and the statement of operations, statement of equity of Canada and statement of cash flow for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the National Research Council of Canada as at 31 March 2011, and the results of its operations and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

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Report on Other Legal and Regulatory Requirements

In my opinion, the transactions of the National Research Council of Canada that have come to my notice during my audit of the financial statements have, in all significant respects, been in accordance with the *Financial Administration Act* and regulations, the *National Research Council Act* and regulations and the by-laws of the National Research Council of Canada.

John Apt, CA
Principal
for the Auditor General of Canada

22 February 2012
Ottawa, Canada

National Research Council Canada

Statement of Management Responsibility Including Internal Control Over Financial Reporting

Responsibility for the integrity and objectivity of the accompanying financial statements for the year ended March 31, 2011, and all information contained in these statements rests with the management of the National Research Council Canada (NRC). These financial statements have been prepared by management in accordance with Treasury Board accounting policies, which are based on Canadian generally accepted accounting principles for the public sector.

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

Management is also responsible for maintaining an effective system of internal control over financial reporting designed to provide reasonable assurance that financial information is reliable, that assets are safeguarded and that transactions are properly authorized and recorded in accordance with the *Financial Administration Act* and other applicable legislation, regulations, authorities and policies.

Management seeks to ensure the objectivity and integrity of data in its financial statements through careful selection, training, and development of qualified staff; through organizational arrangements that provide appropriate divisions of responsibility; through communication programs aimed at ensuring that regulations, policies, standards, and managerial authorities are understood throughout NRC; and through conducting an annual assessment of the effectiveness of the system of internal control over financial reporting.

An assessment for the year ended March 31, 2011 was completed in accordance with the *Treasury Board Policy on Internal Control* and the results and action plans are summarized in annex.

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

The effectiveness and adequacy of NRC's system of internal control is reviewed by the work of internal audit staff, who conduct periodic audits of different areas of NRC's operations, and by the NRC Departmental Audit Committee, which oversees management's responsibilities for maintaining adequate control systems and the quality of financial reporting, and which recommends the financial statements to the President.

The Office of the Auditor General, the independent auditor for the Government of Canada, has expressed an opinion on the fair presentation of the financial statements of NRC which does not include an audit opinion on the annual assessment of the effectiveness of NRC's internal controls over financial reporting.

John R. McDougall, P.Eng.
President

Michel Piché, M.P.A., CMA, CIA
Vice-President, Corporate Management
and Chief Financial Officer

Ottawa, Canada
February 22, 2012

National Research Council Canada
Statement of Financial Position
as at March 31

(in thousands of dollars)	**2011**	**2010**
ASSETS		
Financial Assets		
Due from the Consolidated Revenue Fund	197,300	197,426
Accounts receivable and advances (Note 4)	25,806	18,892
Inventory for resale	2,192	3,001
Equity investments (Note 5)	472	252
Endowment fund investments (Note 6)	4,631	4,515
	230,401	224,086
Non-Financial Assets		
Prepaid expenses	11,498	10,344
Inventory for consumption	4,757	3,409
Tangible capital assets (Note 7)	573,723	579,084
	589,978	592,837
TOTAL ASSETS	**820,379**	**816,923**
LIABILITIES AND EQUITY OF CANADA		
Liabilities		
Accounts payable and accrued liabilities (Note 8)	139,331	144,332
Vacation pay and compensatory leave	38,531	43,032
Deferred revenue (Note 9)	63,731	79,507
Lease obligation for tangible capital assets (Note 10)	213	277
Employee future benefits (Note 11)	71,099	69,004
	312,905	336,152
Equity of Canada	507,474	480,771
TOTAL LIABILITIES AND EQUITY OF CANADA	**820,379**	**816,923**

Contingent liabilities (Note 12)
Contractual obligations (Note 13)
Net debt indicator (Note 14)

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

John R. McDougall, P.Eng.
President

Michel Piché, M.P.A., CMA, CIA
Vice-President, Corporate Management
and Chief Financial Officer

Ottawa, Canada
February 22, 2012

National Research Council Canada
Statement of Operations
for the year ended March 31

(in thousands of dollars)	**2011**	**2010**
Expenses		
Manufacturing Technologies	177,531	183,576
Information and Communication Technologies (ICT) and Emerging Technologies	92,599	90,882
Industrial Research Assistance	288,983	290,101
Health and Life Sciences Technologies	141,336	139,536
Energy and Environmental Technologies	53,631	55,997
National Science and Technology Infrastructure	103,509	109,215
Scientific, Technical and Medical Information	27,013	37,982
Internal Services	116,029	114,150
Total Expenses	1,000,631	1,021,439
Revenues		
Manufacturing Technologies	76,014	65,204
Information and Communication Technologies (ICT) and Emerging Technologies	20,425	11,519
Industrial Research Assistance	1,206	18,584
Health and Life Sciences Technologies	32,381	25,152
Energy and Environmental Technologies	17,721	14,524
National Science and Technology Infrastructure	10,413	7,866
Scientific, Technical and Medical Information	3,959	5,286
Internal Services	7,666	10,347
Total Revenues	169,785	158,482
Net Cost from Continuing Operations	830,846	862,957
Net Cost from Discontinued Operations (Note 19)	723	68
Net Cost of Operations	**831,569**	**863,025**

Segmented Information (Note 16)

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

National Research Council Canada
Statement of Equity of Canada
for the year ended March 31

(in thousands of dollars)	**2011**	**2010**
Equity of Canada, beginning of year	480,771	491,370
Net cost of operations	(831,569)	(863,025)
Net cash provided by Government	825,029	809,673
Change in due from the Consolidated Revenue Fund	(126)	8,130
Services provided without charge by other government departments and agencies (Note 15)	33,369	34,623
Equity of Canada, end of year	507,474	480,771

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

National Research Council Canada
Statement of Cash Flow
for the year ended March 31

(in thousands of dollars)	**2011**	**2010**
Operating Activities		
Net cost of operations	831,569	863,025
Non-cash items		
Amortization of tangible capital assets	(67,203)	(67,879)
Gain on sale of equity investments	133	2,969
Net loss on disposal of tangible capital assets	(1,247)	(2,221)
Services provided without charge by other government departments and agencies(Note 15)	(33,369)	(34,623)
Other	1,190	143
Variations in Statement of Financial Position		
Increase (decrease) in accounts receivable and advances	6,914	(7,779)
(Decrease) increase in inventory for resale	(809)	820
Increase in equity investment	220	-
Increase in endowment fund investments	116	96
Increase (decrease) in prepaid expenses	1,154	(1,756)
Increase in inventory for consumption	1,348	554
Decrease (increase) in liabilities	23,247	(6,209)
Cash used in operating activities (including discontinued operations)	763,263	747,140
Capital Investing Activities		
Acquisitions of tangible capital assets	62,283	66,867
Acquisitions not affecting cash and transfers to inventory for resale	-	(676)
Proceeds from disposal of tangible capital assets	(384)	(282)
Cash used in capital investing activities	61,899	65,909
Investing Activities		
Proceeds from sale of equity investments	(133)	(3,376)
Cash provided in investing activities	(133)	(3,376)
Net cash provided by Government of Canada	825,029	809,673

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

National Research Council Canada
Notes to Financial Statements
Year ended March 31, 2011

1. Authority and Objectives

The National Research Council Canada (NRC) exists under the *National Research Council Act* and is a departmental corporation named in Schedule II of the *Financial Administration Act*. The mission of NRC is to work with clients and partners to provide strategic research, scientific and technical services to develop and deploy solutions to meet Canada's current and future industrial and societal needs.

In delivering its mandate, NRC reports under the following program activities:

- Manufacturing Technologies: Multidisciplinary research and development in consultation with industry, universities, government departments and other key innovation players to improve the global competitiveness of Canadian industry by transforming knowledge and innovation into real economic value and by transferring technologies into industrial solutions for the marketplace.
- Information and Communication Technologies (ICT) and Emerging Technologies: Mobilizes, collaborates and partners with key university, government and private sector players and forms major research collaborations to develop integrated research solutions in the areas of information and communications technologies and emerging technologies.
- Industrial Research Assistance: Provides a range of technical and business-oriented advisory services, as well as financial support for small and medium-sized Canadian businesses engaged in research and development of technological innovations to augment their capacity and capability to innovate, commercialize and generate significant economic activity for Canadian Industry.
- Health and Life Science Technologies: Mobilizes and partners with key university, government and private sector players and forms major research collaborations to develop integrated research solutions for complex health and related life science issues.
- Energy and Environmental Technologies: In partnership with other government departments, universities and industry, brings together the knowledge and expertise needed to make an impact on areas of critical importance to Canada in environmental and sustainable energy.
- National Science and Technology Infrastructure: Manages national science and engineering facilities and infrastructure critical to research, development and innovation by Canadian scientific and technological communities.
- Scientific, Technical and Medical Information: Operates and maintains the national science library, specifically holding the national collection of Scientific, Technical and Medical information, to facilitate knowledge discovery, cross discipline research, innovation and commercialization.
- Internal Services: Groups of activities and resources administered to support the needs of programs and other corporate obligations of the organization. Includes only those activities and resources that apply across the organization and not to those provided specifically to a program.

2. Summary of Significant Accounting Policies

These financial statements have been prepared in accordance with Treasury Board accounting policies stated below, which are based on Canadian generally accepted accounting principles for the public sector. The presentation and results using the stated accounting policies do not result in any significant differences from Canadian generally accepted accounting principles, except as disclosed in Note 14 - Net Debt Indicator.

Significant accounting policies are as follows:

a) Parliamentary authorities

NRC is financed mainly by the Government of Canada through Parliamentary authorities. Financial reporting of authorities provided to NRC do not parallel financial reporting according to generally accepted accounting principles since authorities are primarily based on cash flow requirements. Consequently, items recognized in the Statement of Operations and the Statement of Financial Position are not necessarily the same as those provided through authorities from Parliament. Note 3 provides a reconciliation between the bases of reporting.

b) Net Cash Provided by Government

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

c) Amounts due from/to the CRF

Amounts due from/to the CRF are the result of timing differences at year-end between the time when a transaction affects authorities and when it is processed through the CRF. Amounts due from the CRF represent the net amount of cash that NRC is entitled to draw from the CRF without further authorities to discharge its liabilities.

d) Revenues

- Receipts are deposited to the Consolidated Revenue Fund. Under the NRC Act, money received by NRC through the conduct of its operations is respendable in the current or in subsequent years.
- Revenues are recognized in the year in which the underlying transaction or event occurred that gave rise to revenue.
- Funds received for which NRC has an obligation to other parties for the provision of goods, services or the use of assets in the future are recorded as deferred revenue.
- Contributions of leased tangible capital assets are deferred and amortized as Lease inducement revenue on the same basis as the related depreciable tangible capital assets.

e) Expenses

- Expenses are recorded on an accrual basis.
- Grants are recognized in the year in which the conditions for payment are met. In the case of grants which do not form part of an existing program, the expense is recognized when the Government announces a decision to make a non-recurring transfer, provided the enabling legislation or authorization for payment receives parliamentary approval prior to the completion of the financial statements.
- Contributions are recognized in the year in which the recipient has met the eligibility criteria or fulfilled the terms of a contractual transfer agreement, provided that the transfer is authorized and a reasonable estimate can be made.
- Vacation pay and compensatory leave are accrued as the benefits are earned by employees under their respective terms of employment.
- Services provided without charge by other government departments and agencies for accommodation, employer contributions to the health and dental insurance plans, audit of NRC's financial statements, legal services and workers' compensation are recorded as operating expenses at their estimated cost and credited directly to equity.

f) Employee future benefits

i) Pension Benefits

Eligible employees participate in the Public Service Pension Plan, a multiemployer plan administered by the Government of Canada. NRC's contributions to the Plan are charged to expenses in the year incurred and represent NRC's total obligation to the Plan. Current legislation does not require NRC to make contributions for any actuarial deficiencies of the Plan.

ii) Severance Benefits

Employees are entitled to severance benefits under labour contracts or conditions of employment. These benefits are accrued as employees render the services necessary to earn them. The obligation relating to the benefits earned by employees is calculated using information derived from the results of the actuarially determined liability for employee severance benefits for the Government as a whole.

g) Accounts receivable

Accounts receivable are stated at the lower of cost and net recoverable value; a valuation allowance is recorded for receivables where recovery is considered uncertain.

h) Conditionally repayable contributions

Conditionally repayable contributions are contributions that, all or part of which become repayable, if conditions specified in the contribution agreement come into effect. Accordingly, they are not recorded on the Statement of Financial Position until the conditions specified in the agreement come into effect, at which time they are recorded as a receivable and a reduction in transfer payment expenses. An estimated allowance for uncollectibility is recorded where appropriate.

i) Contingent liabilities

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

j) Environmental liabilities

Environmental liabilities reflect the estimated costs related to the management and remediation of environmentally contaminated sites. Based on management's best estimates, a liability is accrued and an expense recorded when the contamination occurs or when NRC becomes aware of the contamination and is obligated, or is likely to be obligated to incur such costs. If the likelihood of NRC's obligation to incur these costs is not determinable, or if an amount cannot be reasonably estimated, the costs are disclosed as contingent liabilities in the notes to the financial statements.

k) Inventories

Inventory for resale and for consumption is recorded at the lower of cost (using the average cost method) or net realizable value. The cost is charged to operations in the year in which the items are sold or used.

l) Equity investments

Equity investments include shares in public and privately-held companies. Equity investments are typically obtained as a result of debt settlement negotiations or as a result of non-monetary transactions (where financial assistance at better-than-market conditions was provided to firms through access to intellectual property, equipment and incubation space in laboratories). If the estimates of the non-monetary transactions cannot be determined, the equity investments are initially recorded at a nominal value. Otherwise they are initially recorded at fair value based on market prices. If the fair value of equity investments becomes lower than the book value and this decline in value is considered to be other than temporary, the equity investments are written down to fair value.

m) Endowment fund investments

Endowments consist of donations subject to externally imposed restrictions stipulating that the resources be maintained permanently. Income from the investment of endowments may only be used for the purposes established by the donors.

Endowments are recognized as an asset when the amount to be received can be reasonably estimated and ultimate collection is reasonably assured.

Funds received for endowments are invested in bonds and are carried at amortized cost. The premium or discount determined at the time of acquisition is amortized until the security’s maturity. Fair value of bonds is based on market prices.

n) Foreign currency transactions

Transactions involving foreign currencies are translated into Canadian dollar equivalents using rates of exchange in effect at the time of those transactions. Monetary assets and liabilities denominated in a foreign currency are translated into Canadian dollars using the rate of exchange in effect at year end. Gains and losses resulting from foreign currency transactions are included in the applicable line on the Statement of Operations according to the activities to which they relate. Net gains and losses relating to the sale of goods or services denominated in a foreign currency are included in revenues. Net gains and losses relating to the purchase of goods or services denominated in a foreign currency are included in expenses. Contractual obligations may contain foreign currencies that are translated into Canadian dollar equivalents using the rate of exchange in effect at March 31, 2011.

o) Tangible capital assets

Acquired tangible capital assets and leasehold improvements having an initial cost of $5,000 or more are recorded at their acquisition cost. Contributed tangible capital assets are recorded at market value at the date of contribution. NRC does not capitalize intangibles, works of art and historical treasures that have cultural, aesthetic or historical value. Assets acquired under tangible capital leases are initially recorded at the lower of the present value of the minimum lease payments at the inception of the lease or fair value. Tangible capital assets held for sale are recorded at the lower of their carrying value or fair value less cost to sell and no amortization is recorded.

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

Asset Class	Amortization Period
Land	Not applicable
Buildings and facilities	25 years
Works and infrastructure	25 - 40 years
Machinery, equipment and furniture	10 years
Informatics equipment	5 years
Informatics software	5 years
Vehicles	7 years
Aircraft	15 - 30 years
Leasehold improvements	Lesser of the remaining term of the lease or useful life of the improvement
Leased tangible capital assets	In accordance with asset class

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

Where NRC enters into land leases at a nominal value, the transaction is considered as a non-monetary transaction and is recorded at fair value. Fair value of the transaction is based on market prices. If the estimates of the non-monetary transactions cannot be determined, the amount of the transaction is recorded at a nominal value.

p) Measurement uncertainty

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in the financial statements. At the time of preparation of these statements, management believes the estimates and assumptions to be reasonable. The most significant items where estimates are used are percentage of completion on revenue from the provision of services, contingent liabilities, contaminated site liabilities, the liability for employee severance benefits, the allowance for doubtful accounts, the fair value of non-monetary transactions related to leased tangible capital assets and the useful life of tangible capital assets. Actual results could significantly differ from those estimated. Management's estimates are reviewed periodically and, as adjustments become necessary, they are recorded in the financial statements in the year they become known.

q) Asset retirement obligations

Liabilities are recognized for statutory, contractual or legal obligations, when incurred, associated with the retirement of tangible capital assets when those obligations result from the acquisition, construction, development or normal operation of the assets. The obligations are measured initially at fair value, determined using present value methodology, and the resulting costs capitalized into the carrying amount of the related asset. In subsequent periods, the liability is adjusted for the accretion of discount and any changes in the amount or timing of the underlying future cash flows. The capitalized asset retirement cost is depreciated on the same basis as the related asset and the discount accretion is included in determining the results of operations.

3. Parliamentary Authorities

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

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

(in thousands of dollars)	**2011**	**2010**
Net Cost of Operations	831,569	863,025
Adjustments for items affecting net cost of operations but not affecting authorities (including discontinued operations):		
Revenues	176,959	169,627
Amortization of tangible capital assets	(67,203)	(67,879)
Financial arrangements with other government departments and agencies	(57,978)	(70,266)
Services provided without charge by other government departments and agencies(Note 15)	(33,369)	(34,623)
Specified purpose accounts expenses	(20,856)	(16,491)
Decrease in salary accrual	4,532	8,978
Decrease in vacation pay and compensatory leave	4,501	5,904
Refunds of previous year's expenditures	3,180	1,362
(Increase) decrease in employee future benefits	(2,095)	6,071
Cost of goods sold	(1,732)	(696)
Loss on disposal of tangible capital assets	(1,247)	(2,221)
Other	1,064	596
(Increase) decrease in accrued liability	(431)	309
Decrease in inventory	(430)	(9)
Decrease in litigation claim expense accrual	375	675
Decrease (increase) in contaminated sites liabilities	203	(30)
Bad debt expense	(136)	(689)
Total items affecting net cost of operations but not affecting authorities (including discontinued operations)	5,337	618
Adjustments for items not affecting net cost of operations but affecting authorities:		
Acquisitions of tangible capital assets and additions to assets under construction	60,801	65,565
Inventory purchases	2,777	1,204
Contaminated sites remediation reducing the liability	1,597	2,299
Increase (decrease) in prepaid expenses	1,154	(1,756)
Decrease in lease obligations for tangible capital assets	63	59
	66,392	67,371
Current year authorities used	903,298	931,014

b) Reconciliation of Parliamentary authorities provided and used

(in thousands of dollars)	**2011**	**2010**
Parliamentary appropriations provided:		
Vote 60 – Operating expenditures	427,947	438,567
Vote 65 – Capital expenditures	53,192	52,597
Vote 70 – Grants and contributions	294,888	274,579
Statutory amounts:		
Revenues pursuant to paragraph 5(1)(e) of the *National Research Council Act*	123,255	155,956
Contributions to employee benefit plans	63,681	67,902
Proceeds from the disposal of surplus Crown assets	594	441
Collection agency fees	25	27
Less:		
Revenues available for use in future years	(48,316)	(46,009)
Lapsed authorities:		
Frozen allotments - Operating	(4,327)	(8,075)
Frozen allotments - Capital	(3,198)	(1,388)
Frozen allotments - Grants and Contributions	(410)	-
Unexpended authorities - Grants and Contributions	(3,581)	(3,543)
Unexpended authorities - Capital	(328)	-
Unexpended authorities - Operating	(124)	(40)
Current year authorities used	903,298	931,014

4. Accounts Receivable and Advances

The following table presents details of NRC's accounts receivable and advances balances:

(in thousands of dollars)	**2011**	**2010**
Receivables from external parties	19,177	15,443
Receivables from other government departments and agencies	5,143	2,309
Employee advances	36	40
	24,356	17,792
Less: allowance for doubtful accounts on receivables from external parties	(682)	(856)
	23,674	16,936
Repayable contributions	7,820	10,586
Less: allowance for uncollectibility	(5,688)	(8,630)
Net repayable contributions	2,132	1,956
Total	25,806	18,892

5. Equity Investments

Equity investments include shares in three publicly held companies (three in 2010) and two privately held companies (thirteen in 2010). These shares were obtained through debt settlement or non-monetary transactions. NRC will consider timely opportunities for divestiture of equity investments by taking into account the interests, market liquidity and expected future growth of the applicable company.

During the year, NRC sold shares for $132,679 ($3,376,391 in 2010) realizing a gain of $132,678 ($2,968,969 in 2010). NRC also received shares in a public company in exchange for debt settlement of $219,889 (nil in 2010). No companies in which NRC holds equity investments were declared bankrupt or inactive during the year (nine in 2010).

As at March 31, 2011, the book value of the equity investments was $471,953 ($252,076 in 2010). The market value of NRC's equity investments in publicly held companies was $281,123 ($171,967 in 2010). The market value of the privately held companies is not determinable.

6. Endowment Fund Investments

This account was established pursuant to paragraph 5(1)(f) of the *National Research Council Act* to record the residue of the estate of the late H.L. Holmes. Up to two thirds of the endowment fund's yearly net income is used to finance the H.L. Holmes award on an annual basis. The award provides the opportunity to post-doctoral students to study at world famous graduate schools or research institutes under outstanding researchers.

(in thousands of dollars)	**2011**	**2010**
Restricted cash and investments, beginning of year	4,515	4,419
Net income from endowment	213	213
Awards granted	(97)	(117)
Restricted cash and investments, end of year	4,631	4,515

The portfolio had an average effective return of 4.70% (5.07% in 2010) and an average term to maturity of 5.18 years as at March 31, 2011 (5.52 years as at March 31, 2010). The fair value of the endowment investments as at March 31, 2011 was $4,775,354 ($4,653,482 in 2010).

7. Tangible Capital Assets

(in thousands of dollars)

	Cost				Accumulated Amortization				Net Book Value	
Tangible capital asset class	Opening balance	Acquisitions	Transfers, disposals and write-offs	Closing balance	Opening balance	Amortization	Transfers, disposals and write-offs	Closing balance	2011 Net book value	2010 Net book value
Land	9,879	-	-	9,879	-	-	-	-	9,879	9,879
Buildings and facilities	655,870	18,711	9,795	684,376	(386,849)	(21,509)	23	(408,335)	276,041	269,021
Works and infrastructure	21,682	110	-	21,792	(14,457)	(654)	-	(15,111)	6,681	7,225
Machinery, equipment and furniture	513,002	14,776	(3,850)	523,928	(335,674)	(34,620)	14,705	(355,589)	168,339	177,328
Informatics equipment	63,628	3,467	(6,015)	61,080	(51,810)	(4,354)	6,786	(49,378)	11,702	11,818
Informatics software	21,767	971	(4,033)	18,705	(13,298)	(2,659)	4,000	(11,957)	6,748	8,469
Vehicles	3,170	49	(184)	3,035	(2,407)	(151)	177	(2,381)	654	763
Aircraft	11,294	66	-	11,360	(9,866)	(118)	-	(9,984)	1,376	1,428
Leasehold improvements	12,808	49	-	12,857	(3,206)	(567)	-	(3,773)	9,084	9,602
Assets under construction	32,961	24,084	(22,181)	34,864	-	-	-	-	34,864	32,961
Leased tangible capital assets	63,700	-	336	64,036	(13,110)	(2,571)	-	(15,681)	48,355	50,590
Total	1,409,761	62,283	(26,132)	1,445,912	(830,677)	(67,203)	25,691	(872,189)	573,723	579,084

When assets under construction are put into use during the fiscal year, they are transferred out of Assets under construction and into the capital asset class to which they relate, from which point on they are amortized as applicable.

Amortization expense for the year ended March 31, 2011 is $67,202,810 ($67,879,472 in 2010).

At March 31, 2011, NRC held eight land lease agreements (eight in 2010) for a nominal annual cost of one dollar with universities. In these instances, NRC owns the building on the leased land. The fair value of the land leases for these non-monetary transactions could not be determined at the inception of the lease therefore they are recorded at a nominal value.

On March 21, 1996, NRC entered into a non-monetary transaction consisting of a lease agreement with the University of Western Ontario for the relocation of the Integrated Manufacturing Technologies Institute (IMTI), whereby leased property was provided to NRC for twenty-five years at a nominal cost of one dollar. Since the inception of the lease agreement, IMTI was restructured under NRC's Industrial Materials Institute (IMI) and NRC's Institute for Research in Construction. NRC has no obligations to the University of Western Ontario other than the relocation of the institute. The property was recorded as a leased tangible capital asset at its fair value of $10,000,000. The annual amortization of $400,000 for the leased tangible capital asset is exactly offset by the amortization of the deferred contribution related to the leased property.

On May 23, 2006, NRC took possession of a new facility and entered into a non-monetary transaction with the University of Alberta. NRC entered into a lease agreement with the University for the housing of NRC's National Institute for Nanotechnology (NINT), whereby leased property is provided to NRC at a nominal cost of one dollar per year. The lease provides a one year term with options to renew on ten sequential occasions, each of the first nine renewals to be for a period of five years and the tenth renewal for a period of four years. The building was recorded as a leased tangible capital asset at its fair value of $44,400,000. The annual amortization of $1,776,000 for the leased tangible capital asset is exactly offset by the amortization of the deferred contribution related to the leased building.

On September 1, 2006, NRC took possession of a new facility and entered into a non-monetary transaction with the University of Prince Edward Island. NRC entered into a lease agreement with the University for the housing of NRC's Institute for Nutrisciences and Health (INH), whereby leased property was provided to NRC at a nominal cost of one dollar per year. The lease provides a nineteen month term with renewal options for seven additional periods of five years, and one additional period of three years and five months (to August 31, 2046). The building was recorded as a leased tangible capital asset at its fair value of $9,300,000. The annual amortization of $372,000 for the leased tangible capital asset is exactly offset by the amortization of the deferred contribution related to the leased building.

8. Accounts Payable and Accrued Liabilities

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

(in thousands of dollars)	**2011**	**2010**
Suppliers and contributions payable	108,612	104,421
Payable to other government departments and agencies	21,271	25,641
Accrued wages and employee benefits	8,248	11,495
Contractor holdbacks	1,036	814
Contaminated site liabilities	80	1,880
Sales tax payable	84	81
Total	139,331	144,332

9. Deferred Revenue

Deferred revenue represents amounts received from external parties for which NRC has a future obligation for the provision of goods, services or the use of assets. Revenue is recognized in the period that goods are delivered or services are provided. A summary of the transactions related to this account are as follows:

(in thousands of dollars)	**2011**	**2010**
Deferred revenue – contributions related to leased tangible capital assets		
Balance, beginning of year	50,590	53,138
Contributions recognized as revenue	(2,548)	(2,548)
Balance, end of year	48,042	50,590
Deferred revenue - specified purpose accounts		
Balance, beginning of year	20,618	17,060
Funds received	21,713	22,271
Revenue recognized	(32,569)	(18,713)
Balance, end of year	9,762	20,618
Deferred revenue - other		
Balance, beginning of year	8,299	6,972
Funds received	4,838	8,868
Revenue recognized	(7,210)	(7,541)
Balance, end of year	5,927	8,299
Total	63,731	79,507

10. Lease obligation for tangible capital assets

NRC has entered into an agreement to lease mechanical test equipment under capital lease with a cost of $336,000 and accumulated amortization of $22,400 as at March 31, 2011 ($336,000 and $0 in 2010). The obligations related to the upcoming years include the following:

(in thousands of dollars)	**2011**	**2010**
2011	-	80
2012	80	80
2013	80	80
2014	80	80
Total future minimum lease payments	240	320
Less: imputed interest (6.11%)	(27)	(43)
Balance of obligations under leased tangible capital assets	213	277

11. Employee Future Benefits

Employees of NRC are entitled to specific benefits on or after termination or retirement, as provided for under various collective agreements or conditions of employment.

a) Pension benefits

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

Both the employees and NRC contribute to the cost of the Plan. The expense amounts to $44,702,888 as at March 31, 2011 ($49,024,953 in 2010), which represents approximately 1.9 times (1.9 times in 2010) the contributions by employees.

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

b) Severance benefits

NRC provides severance benefits to its employees based on eligibility, years of service and final salary. These severance benefits are not pre-funded. Benefits will be paid from future authorities. Information about the severance benefits, measured as at March 31, is as follows:

(in thousands of dollars)	**2011**	**2010**
Accrued benefit obligation, beginning of year	69,004	75,075
Increase (decrease) of the accrued expense for the year	9,845	(965)
Benefits paid during the year	(7,750)	(5,106)
Accrued benefit obligation, end of year	71,099	69,004

12. Contingent Liabilities

Contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. They are grouped into these three categories as follows:

a) Contaminated sites

During 2010-11, NRC completed extensive remediation work at specific contaminated sites. Liabilities are accrued to record the estimated costs related to the management and remediation of contaminated sites where NRC is obligated or likely to be obligated to incur such costs. For 2011, NRC has identified four sites (two sites in 2010) where such action is possible and for which a liability of $79,829 ($1,880,195 in 2010) has been recorded in accrued liabilities. The estimate has been prepared using current market rates and is based on the results of initial testing performed by NRC at suspect sites. NRC has identified one additional site with contaminants exceeding an environmental standard and for which NRC may be responsible to incur remediation costs. This site is still under investigation and NRC is presently unable to determine the amount of the remediation liability, if any. NRC's ongoing efforts to assess contaminated sites may result in additional environmental liabilities related to newly identified sites, or changes in the assessments or intended use of existing sites. These liabilities will be accrued by NRC in the year in which they become likely and are reasonably estimable.

b) Claims and litigation

Claims have been made against NRC in the normal course of operations. Legal proceedings for six claims were pending at March 31, 2011 (eleven in 2010). NRC has no claim that will likely result in a liability (one in 2010) for which no accrued liability ($375,000 in 2010) has been recorded based on NRC's legal assessment of potential liability. NRC has one claim where the outcome is undeterminable (two in 2010). Some of these potential liabilities may become actual liabilities when one or more future events occur or fail to occur. To the extent that the future event is likely to occur or fail to occur, and a reasonable estimate of the loss can be made, an estimated liability is accrued and an expense recorded in the financial statements.

c) Asset Retirement Obligations

As at March 31, 2011 NRC has recognized an asset retirement obligation of $253,000 ($221,000 in 2010) in the financial statements as a result of its legal obligation to retire storage tank systems for petroleum products and allied petroleum products. The undiscounted amount of expected future cash flows required to settle the asset retirement obligation is estimated at $452,000 ($463,000 in 2010). The liability for the expected future cash flows, as reflected in the financial statements, has been discounted at a weighted average of 3.77% (4.74% in 2010) based on the Government of Canada benchmark bonds. This obligation will be settled over the useful lives of the operating assets. The following table summarizes the changes in the asset retirement obligations:

(in thousands of dollars)	**2011**	**2010**
Asset retirement obligations, beginning of year	221	216
Accretion of asset retirement obligations	32	5
Asset retirement obligations, end of year	253	221

Other asset retirement obligations, such as the costs associated with the removal and disposal of asbestos and other designated substances located in NRC buildings have not been recognized in the financial statements due to the fact that they are subject to several uncertainties. NRC generally incurs the cost of removing and disposing regulated substances during major building renovations; consequently the timing and scope of these renovations cannot be reasonably estimated at this time and therefore fair values cannot be reasonably determined. Changes in these assumptions and uncertainties could materially affect NRC's assets and liabilities as well as the resulting amortization and accretion expenses related to the asset retirement obligation.

13. Contractual Obligations

The nature of NRC's activities can result in some large multi-year contracts and obligations whereby NRC will be obligated to make future payments in order to carry out its transfer payment programs or when the services/goods are received. Significant contractual obligations that can be reasonably estimated are summarized as follows:

(in thousands of dollars)	**2012**	**2013**	**2014**	**2015**	**2016 and thereafter**	**Total**
Transfer payments	104,845	55,140	49,561	49,941	1,572	261,059
Operating contracts	18,789	3,291	1,551	307	-	23,938
Total	123,634	58,431	51,112	50,248	1,572	284,997

14. Net Debt Indicator

The presentation of the net debt indicator and a statement of change in net debt is required under Canadian generally accepted accounting principles.

Net debt is the difference between a government's liabilities and its financial assets and is meant to provide a measure of the future revenues required to pay for past transactions and events. A statement of change in net debt would show changes during the period in components such as tangible capital assets, prepaid expenses and inventories. NRC is financed by the Government of Canada through appropriations and respendable revenues and operates within the Consolidated Revenue Fund (CRF), which is administered by the Receiver General for Canada. All cash received by NRC is deposited to the CRF and all cash disbursements made by NRC are paid by the CRF. With the exception of endowment fund investments and receivables from other Federal Government departments, NRC's Financial Assets as well as future appropriations and respendable revenues generated by NRC's operations can be used to discharge existing liabilities.

(in thousands of dollars)	**2011**	**2010**
Liabilities		
Accounts payable and accrued liabilities	139,331	144,332
Vacation pay and compensatory leave	38,531	43,032
Deferred revenue	63,731	79,507
Lease obligation for tangible capital assets	213	277
Employee future benefits	71,099	69,004
	312,905	336,152
Financial Assets		
Due from the Consolidated Revenue Fund	197,300	197,426
Accounts receivable and advances	25,806	18,892
Inventory for resale	2,192	3,001
Equity investments	472	252
Endowment fund investments	4,631	4,515
	230,401	224,086
Net Debt Indicator	82,504	112,066

15. Related Party Transactions

NRC is related as a result of common ownership to all Government departments, agencies, and Crown corporations. NRC enters into transactions with these entities in the normal course of business and on normal trade terms.

a) Common services provided without charge by other government departments and agencies

During the year, NRC received services without charge from other government departments and agencies. These services have been recognized in NRC's Statement of Operations as follows:

(in thousands of dollars)	**2011**	**2010**
Employer's contributions to the health and dental insurance plans provided by Treasury Board	31,830	33,022
Audit of NRC's financial statements provided by the Office of the Auditor General of Canada	614	501
Legal services provided by Justice Canada	486	454
Workers' compensation benefits provided by Human Resources and Skills Development Canada	287	302
Payroll services provided by Public Works and Government Services Canada (Note 18)	-	192
Accommodation provided by Public Works and Government Services Canada	152	152
Total	33,369	34,623

The Government has centralized some of its administrative activities for efficiency, cost-effectiveness purposes and economic delivery of programs to the public. As a result, the Government uses central agencies and common service organizations so that one department performs services for all other departments and agencies without charge. The costs of these services, such as the payroll and cheque issuance services provided by Public Works and Government Services Canada, beginning in 2011 are not included in the Statement of Operations (amount not determinable in 2011, $192,000 in 2010).

b) Other transactions with related parties

(in thousands of dollars)	**2011**	**2010**
Receivable from other government departments and agencies	5,143	2,309
Payable to other government departments and agencies	21,271	25,641
Expenses - Other government departments and agencies	80,156	87,691
Revenues - Other government departments and agencies	57	69

16. Segmented Information

Presentation by segment is based on NRC's program activity architecture (PAA). NRC allocates transactions over the PAA in accordance with stewardship principles, based on the Institutes, Branch or Program (IBP) that is responsible for managing the resource.

The presentation by segment is based on the same accounting policies as described in the Summary of significant accounting policies in note 2. The following table presents the expenses incurred and revenues generated for the main program activities, by major object of expenses and by major type of revenues. The segment results for the period are as follows:

(in thousands of dollars)	Manufacturing Technologies	ICT and Emerging Technologies	Industrial Research Assistance	Health and Life Sciences Technologies	Energy and Environmental Technologies	National Science and Technology Infrastructure	Scientific, Technical and Medical Information	Internal Services	**2011 Total**	**2010 Total**
Expenses										
Salaries and employee benefits	112,620	52,561	49,305	92,862	34,922	33,451	13,204	68,003	456,928	460,831
Grants and contributions	-	-	230,758	-	-	55,752	1,656	431	288,597	281,230
Utilities, materials and supplies	20,918	12,449	1,549	17,774	4,656	2,289	9,166	11,331	80,132	83,632
Amortization	21,096	13,128	137	16,019	7,393	4,435	1,119	3,763	67,090	67,340
Professional and special services	9,629	8,424	1,532	6,057	3,622	3,415	1,076	10,952	44,707	52,348
Transportation and communication	4,976	2,324	3,199	2,612	1,335	1,923	372	2,752	19,493	23,873
Repairs and maintenance	4,859	1,782	207	3,279	1,264	717	295	4,924	17,327	18,483
Payments in lieu of taxes	1,188	554	-	427	77	-	-	11,753	13,999	14,475
Rentals	1,031	661	1,923	197	83	426	51	221	4,593	4,803
Awards	207	528	5	1,732	78	38	3	82	2,673	3,104
Information	412	94	69	84	46	55	44	1,416	2,220	2,453
Cost of goods sold	462	-	-	171	-	1,014	-	55	1,702	608
Net loss (gain) on disposal of capital assets	106	52	21	108	155	(6)	27	175	638	2,221
Bad debts	-	-	278	-	-	-	-	136	414	6,032
Other	27	42	-	14	-	-	-	35	118	6
Total expenses	177,531	92,599	288,983	141,336	53,631	103,509	27,013	116,029	1,000,631	1,021,439
Revenues										
Sales of goods and services										
Services of non-regulatory nature and other fees and charges	27,497	4,109	-	7,475	4,200	7,038	455	3,494	54,268	48,250
Rights and privileges	800	1,809	-	6,389	474	177	-	-	9,649	8,922
Sales of goods and information products	3,476	-	-	622	-	528	-	4	4,630	3,507
Lease and use of property	558	982	-	2,375	262	7	-	445	4,629	4,449
	32,331	6,900	-	16,861	4,936	7,750	455	3,943	73,176	65,128
Financial arrangements with other government departments and agencies	32,224	4,059	1,206	3,735	10,118	1,434	3,480	522	56,778	68,666
Revenues from joint project and cost sharing	11,459	5,405	-	11,785	2,667	1,229	24	-	32,569	18,714
Other	-	4,061	-	-	-	-	-	520	4,581	457
Lease inducement revenue	-	-	-	-	-	-	-	2,548	2,548	2,548
Gain on sale of equity investment	-	-	-	-	-	-	-	133	133	2,969
Total revenues	76,014	20,425	1,206	32,381	17,721	10,413	3,959	7,666	169,785	158,482
Net cost from continuing operations	101,517	72,174	287,777	108,955	35,910	93,096	23,054	108,363	830,846	862,957

17. Financial Instruments

NRC's financial instruments consist of accounts receivable and advances, investments and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that NRC is not exposed to significant interest, currency or credit risk arising from these financial instruments. Unless otherwise disclosed in these financial statements, management estimates that the carrying values of the financial instruments approximate their fair value due to their impending maturity.

18.Change in accounting policy

During the year, NRC adopted a change in accounting policy in order to comply with the revised Treasury Board Accounting Standard (1.2) on preparation of departmental financial statements. This new standard requires that Payroll Services provided without charge by Public Works and Government Services Canada not be recorded as operating expenses. This change is being applied prospectively beginning in fiscal year 2011.

19. Discontinued Operations

On January 1, 2010, approval was made to privatize the Research Press program at NRC's Canada Institute for Scientific and Technical Information (NRC-CISTI) into a newly formed non-profit organization operated by previous employees of NRC-CISTI, effective September 1, 2010. The consideration for the privatization was $1. As part of the privatization, NRC agreed to make cash contributions of up to $2 million in support of the creation of the non-profit organization for expenses incurred up to September 1, 2010. For the fiscal year ended March 31, 2011, total contributions were $1,609,935. This amount is included in Grants and Contribution in continued operations.

As part of the privatization on September 1, 2010, $1,093,759 of inventory was disposed of as there was no further use. The following assets were transferred at their net book value:

Assets	Net book value
Inventory	457,497
Informatics software	606,852
Informatics equipment	2,460

In addition, a non-competitive contract was initiated between NRC and the non-profit entity in the amount of $4 million which is included in revenue below, for the 7 month period September 1, 2010 to March 31, 2011. This was a non-cash transaction and reflects a decrease in the deferred revenue already received in relation to the fiscal year ended March 31, 2011.

The transfer and disposal of capital assets and the revenue received as part of the non-competitive contract are included in the segmented information summarized below.

The following segmented information has been removed from the Statement of Operations and Note 16-Segmented Information as part of the discontinued operations. The net amount is disclosed on the Statement of Operations as the Net Cost from Discontinued Operations:

	2011	2010
Expenses	7,897,000	11,213,000
Revenues	7,174,000	11,145,000
Net	723,000	68,000

In addition to the above information, NRC has entered into a non-competitive lease agreement with the non-profit organization for use of NRC premises of up to 1,810 square meters of space for five years at no charge for the first two years. The third year of the lease agreement is below fair market value with the fourth and fifth years expected to be at fair market value. NRC has also leased the name “NRC – Research Press” to the non-profit organization.

20. Comparative Information

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

Annex to the Statement of Management Responsibility including Internal Control over Financial Reporting

For the fiscal year ended March 31, 2011

Summary of the assessment of effectiveness of the system of internal control over financial reporting and the action plan of the National Research Council (NRC) for fiscal year 2010-2011

Note to the reader

With the new Treasury Board Policy on Internal Control, effective April 1, 2009, departments are required to demonstrate the measures they are taking to maintain an effective system of internal control over financial reporting (ICFR).

As part of this policy, departments are expected to conduct annual assessments of their system of ICFR, establish action plans to address any necessary adjustments, and to attach to their Statement of Management Responsibility, a summary of their assessment results and action plan.

Effective systems of ICFR aim to achieve reliable financial statements and to provide assurance that:

- Transactions are appropriately authorized;
- Financial records are properly maintained;
- Assets are safeguarded from risks such as waste, abuse, loss, fraud and mismanagement; and
- Applicable laws, regulations and policies are complied with.

It is important to note that the system of ICFR is not designed to eliminate all risks, rather to mitigate risk to a reasonable level with controls that are balanced with and proportionate to the risks they aim to mitigate.

The system of ICFR is designed to mitigate risks to a reasonable level based on an ongoing process to identify key risks, to assess effectiveness of associated key controls, and adjust as required, as well as to monitor the system in support of continuous improvement. As a result, the scope, pace and status of departmental assessments of the effectiveness of systems of ICFR will vary from one organization to the other based on risks and taking into account their unique circumstances.

1. Introduction

This document is attached to NRC's *Statement of Management Responsibility Including Internal Control over Financial Reporting* for the year ended March 31, 2011. As required by the new Treasury Board Policy on Internal Control, effective April 1, 2009*, for the first time*, this document provides summary information on the measures taken by NRC to maintain an effective system of internal control over financial reporting (ICFR). In particular, it provides summary information on the assessments conducted by NRC as at March 31, 2011, including progress, results and related action plans, as well as financial highlights pertinent to understanding NRC's unique control environment.

1.1 Authority, Mandate and Program Activities

Detailed information on NRC's authority, mandate and program activities can be found in its Departmental Performance Report and Report on Plans and Priorities.

1.2 Financial highlights

Financial information can be found in NRC's audited Financial Statements, Notes to Financial Statements and Financial Statements Discussion and Analysis for fiscal year 2010-2011. Information can also be found in the Public Accounts of Canada.

NRC has a strong regional presence. There is a centralized finance and accounting function which is located not only in headquarters but also in each Institute, Branch and Program across Canada that initiate, process and/or record a significant portion of the financial transactions.

NRC utilizes SIGMA, an SAP-based software as its primary financial system.

1.3 Service arrangements relevant to financial statements

NRC relies on other organizations for the processing of certain transactions that are recorded in its financial statements, such as:

- Public Works and Government Services Canada (PWGSC) centrally administers the payments of salaries and the procurement of goods and services as per NRC's Delegation of Authority, provides cheque-issuing services, as well as some accommodations on behalf of NRC;
- Treasury Board Secretariat (TBS) provides NRC with information used to calculate accruals and allowances such as the accrued severance liability and the Employee Benefits Plan (EBP), and pays the employer's share of health and dental insurance premiums;
- Department of Justice provides legal services to NRC;
- The Office of the Auditor General (OAG) provides audit services to NRC; and
- Human Resources and Skills Development Canada (HRSDC) pays the employer's portion of Workers' Compensation.

1.4 Material changes in fiscal year 2010-2011

The following significant changes within NRC that are relevant to the financial statements occurred in fiscal year 2010-2011:

- Under Canada's Economic Action Plan announced by the Minister of Finance, NRC received additional funding for the modernization of federal laboratories, for the Federal Contaminated Sites Action Plan and for contributions to support various research and development projects. This initiative has had a significant and temporary increase in activity for the NRC in both fiscal year 2009-2010 and 2010-2011. Refer to the Departmental Performance Report for details;

- A new President was appointed in April 2010 and a new Chief Financial Officer (CFO) was appointed in the 4th quarter on an acting basis, with an indeterminate appointment in fiscal year 2011-2012;

- The introduction of monthly forecast updates to replace quarterly budget reviews in order to provide more timely financial information;

- The implementation of an investment planning process to integrate prioritization planning and resource allocation; and

- Under the leadership of NRC's new President, a new strategic plan for NRC was developed with implementation to begin during the 2011-2012 fiscal year.

2. NRC's control environment relevant to ICFR

NRC recognizes the importance of senior management leadership in ensuring that staff at all levels understand their roles in maintaining effective systems of ICFR and are well equipped to exercise these responsibilities effectively and in ensuring that risks are well managed through a responsive and risk-based control environment that enables continuous improvement and innovation.

2.1 Key positions, roles and responsibilities

Below are NRC's key positions and committees with responsibilities for maintaining and reviewing the effectiveness of its system of ICFR.

President – NRC's President, as Accounting Officer, assumes overall responsibility and leadership for the measures taken to maintain an effective system of internal control. In this role, the President is advised by the Departmental Audit Committee and the Senior Executive Committee.

Chief Financial Officer (CFO) – NRC's CFO reports directly to the President and provides leadership for the coordination, coherence and focus on the design and maintenance of an effective and integrated system of ICFR, including its annual assessment.

Vice-Presidents – NRC's senior managers in charge of program delivery are responsible for maintaining and reviewing effectiveness of their system of ICFR falling within their mandate.

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

Departmental Audit Committee (DAC) – The DAC is an advisory committee that provides objective views on NRC's risk management, control and governance frameworks to the President. It is comprised of three external members and it reviews NRC's Corporate Risk Profile, NRC's audited financial statements and its system of internal control, including internal and external audit reports and the assessment and action plans related to the system of ICFR.

Senior Executive Committee (SEC) – As NRC's central decision-making body, SEC reviews, approves and monitors the Corporate Risk Profile and NRC's system of internal control, including the assessment and action plans related to the system of ICFR. It is comprised of the senior NRC managers and is chaired by the President.

Council – The role of Council is to provide advice to senior management on the operations and performance of NRC. The Council is chaired by the President.

Council Finance Committee – The role of the Council Finance Committee is to provide advice and recommendations to Council regarding the results of the current year budget reviews and initial budget allocations, the financial situation arising from NRC's multi-year plans, NRC's investment plan, and other matters that may have a significant impact on NRC's financial sustainability.

Financial Oversight Committee – The main function of the committee is to review and provide overall advice on risk assessments related to account verification processes and to review quality assurance results, including internal control assessments.

Contract Review Committee – This committee is responsible for the review and/or challenge of proposed contracts to ensure that contracting policies are followed, that prudence and probity are being exercised, and that the contracting process is open, fair and competitive.

2.2 Key measures taken by NRC

NRC has a comprehensive internal control framework over financial management. This framework follows the expenditure management process of the Federal government.

NRC's funding is controlled through a centralized budgeting and commitment control process in its integrated financial system. Contracts and contribution agreements are the subject of a rigorous approval process. NRC's practices emphasize segregation of duties and common, systematized business processes across all institute, branches and programs

NRC's expenditures are approved at the expenditure initiation, the performance certification and payment approval stages. Payments are subject to a quality control process that tailors verification processes to risk. Controls over payments are regularly tested for continued and consistent effectiveness.

Financial results are continually monitored through a monthly department-wide financial reporting process validated at each level of management and approved by senior management.

NRC's control environment also includes a series of measures to equip its staff adequately to manage risks through raising awareness, providing appropriate knowledge and tools as well as developing skills. The most relevant measures are:

- An established governance structure and strategic direction through the Senior Executive Committee, supported by an advisory Council, and the Departmental Audit Committee;
- A Conflict of Interest Office under the President, that provides guidance and direction to employees and managers as set out in the NRC's Conflict of Interest Policy, TBS Values and Ethics Code for Public Service, Statement of Ethical Values and the NRC Values;
- A Strategic Planning Branch that coordinates and supports department-wide planning, including integrated business planning, risk management, environmental scanning, and preparation of the corporate risk profile approved by the Senior Executive Committee;
- A division within the Finance Branch and CFO portfolio dedicated to internal control over financial reporting;
- Regular reporting of financial performance and annual performance agreements which clearly set out financial management responsibilities;
- Training program and communications in core areas of financial management;
- Regularly updated delegated authorities matrix;
- Policies and procedures regarding disciplinary measures in cases of delegation of authority infractions;
- Secure financial systems to achieve security and integrity of financial data processing, including restricted system access to administrative support based on authorizations and pre-defined roles, that limit access to specific job requirements and meet segregation of incompatible duties principles;
- Documentation of main business processes and related key risk and control points to support the management and oversight of its system of ICFR;
- A cascading certification process was introduced, in fiscal year 2005-2006, requiring accountable managers and executives to attest annually to the reliability of the financial information in their area of responsibility;
- A complete range of human resources, financial and contracting policies tailored to NRC's control environment, communicated to all levels and supported by formal training sessions;
- A multi-year risk-based internal audit plan;
- Transfer payment recipient risk management framework supported by a documented due diligence and authority based business process, mandatory training, and a continuous quality assurance review; and

- Security Guidelines related to the overall security program including elements of information and personnel security.

3. Assessment of NRC's system of ICFR

3.1 Assessment baseline

NRC's financial statements have been audited by the OAG since fiscal year 2005-2006. Whether it is to support the control-based audit requirements or those of the Policy on Internal Control, an effective system of ICFR aims to provide reasonable assurance that:

- Transactions are appropriately authorized;
- Financial records are properly maintained;
- Assets are safeguarded; and
- Applicable laws, regulations and policies are complied with.

Over time, this includes an assessment of the **design** and **operating effectiveness** of the system of ICFR leading to an **ongoing monitoring program** and continuous improvement of NRC's system of ICFR.

Design effectiveness means:

- Documentation and assessment of entity level controls;
- Documentation and assessment of the Information Technology (IT) controls;
- Documentation of the key processes and related applications to the main accounts;
- Identification, documentation and assessment of key risk and control points throughout these processes;
- Walkthroughs of processes, applications and controls to ensure they are in place and operate as documented;
- Alignment of controls against the risks they are intended to mitigate; and
- Remediation to make any adjustments required, including any retest of design effectiveness.

Operating effectiveness means:

- Development of a risk-based testing plan to identify the key controls to be tested over a defined period of time, including the selection of locations, the test-period as well as the method and frequency of testing;
- Documentation of results of testing; and
- Remediation to make any adjustments required, including any retest of operating effectiveness.

An ***ongoing monitoring program*** means:

- All key roles with respect to the ongoing monitoring of the effectiveness of ICFR are defined;
- A systematic integrated approach to monitoring is in place, including periodic risk-based assessments;

- Engagement on assessment plans, results and progress with the Departmental Audit Committee and other relevant committees;
- Timely remediation and related retesting; and
- Appropriate communication and training of staff.

3.2 Assessment method at NRC

In proceeding with its preparation for the review of its system of ICFR, NRC has taken measures to assess its system of ICFR. NRC followed best practices in the area of internal control frameworks over financial reporting and formally documented its financial management control framework.

NRC identified the following key processes for assessment, taking into consideration its significant financial statements accounts, materiality, risk and other NRC specific factors, including new information available from recent audits and evaluations:

1. Entity level controls;
2. General IT controls; and
3. Business process level controls:
    - Procurement, payables and payments;
    - Transfer payments;
    - Capital assets;
    - Inventory;
    - Payroll administration ;
    - Revenue management;
    - Financial closing and reporting; and
    - Financial resource management.

For the three levels of control, NRC has undertaken the following measures:

3.2.1 Entity level controls:

NRC documented and assessed its entity level controls by using the Committee of Sponsoring Organizations (COSO) questionnaire. NRC then proceeded to identify and assess the key controls that mitigate the risks of not achieving the objectives of the system of internal control.

NRC also performed a fraud risk assessment with the objective of identifying the extent to which NRC is exposed to fraud and potential areas of vulnerability, missing or weak controls. The fraud risk assessment is intended to serve as a management tool to support managers in fulfilling their responsibility to be aware of, consider, and mitigate the risk of fraud.

3.2.2 General IT controls:

NRC documented and assessed the operating effectiveness of the general IT controls, which included a review of access to programs and data, program changes, computer operations and program development for financially relevant systems. The assessment was based on the Control Objectives for Business related Information Technology (COBIT) standards.

3.2.3 Business process level controls:

For each key business process and sub-process, NRC completed the following ***design effectiveness assessment*** steps:

- Gathered information pertaining to processes and locations, risks and controls relevant to ICFR, including appropriate policies and procedures;
- Prioritized the processes and sub-processes based on a risk assessment to focus the documentation on higher risk areas;
- Developed business process documentation using standard process maps (narrative and flowcharts);
- Validated all process maps with business process owners and verified that the documented processes corresponded to actual practices;
- Identified financial statements assertions (objectives), risks and key controls, and assessed residual risk;
- Ensured appropriate alignment of each key control with the risks they aim to mitigate;
- Identified, described and prioritized key control deficiencies;
- Developed a detailed action plan to address required key control deficiencies remediation (e.g. developed recommendations, prioritized deliverables, assigned ownership and accountabilities for remediation work).

NRC developed risk-based testing plans to assess the operating effectiveness of key controls and completed the following ***operating effectiveness assessment*** steps:

- Developed a risk-based testing strategy that identified key controls to be tested over a defined period of time, including the selection of locations, the test-period as well as the method and frequency of testing;
- Tested the key controls for the transactions selected, to determine if these were operating as intended;
- Summarized the results and identified any gaps or weaknesses; and
- Reported on the results and recommended remediation actions to address gaps or weaknesses.

3.3 Ongoing monitoring program at NRC

NRC developed ongoing monitoring plans and executed the review of acquisition card transactions, low/medium-risk payment transactions and contribution agreement files on a continuous basis.

NRC started monitoring revenue files during fiscal year 2010-2011 with the objective of gathering evidence on the effectiveness of certain elements of the revenue management internal control framework and for compliance with policies and procedures.

NRC has also been engaging with the Departmental Audit Committee and the Council Finance Committee on assessment plans, results and progress on a regular basis since January 2010.

4. NRC's assessment results

As at fiscal year ended March 31, 2011, NRC completed the testing of design effectiveness, as well as the testing of operating effectiveness on a risk-based approach, and is in the process of implementing remediation actions as required. The following summarizes key assessment results, from the design and operating effectiveness testing completed by NRC to date.

4.1 Entity level controls

The assessment of NRC's entity level controls concluded that key controls were operating effectively. However, improvement opportunities with regard to the following elements of the application of segregation of duties controls were found:

- Certain employees have been granted unapproved SIGMA access with conflicting roles per the established management approval process; and
- A need for increased monitoring for employees with approved SIGMA access with conflicting roles.

4.2 General IT controls

The assessment of the general IT controls concluded that most key controls were operating effectively. However, some weaknesses were found in the IT environment and necessary improvements were identified in the following areas:

- Improved management approval and formal review process for user access;
- Improved monitoring of privilege access to SIGMA and the associated databases;
- A need for effective segregation of duties in the change management process and appropriate access to the development environment; and

- A need for greater audit trails relative to various IT controls, such as resolution of batch error logs, completed back-up log, evidence of testing on network change request forms, physical access reports and evidence that back-ups are taken off-site.

4.3 Business process controls

4.3.1 Design effectiveness of key controls

NRC assessed the design effectiveness of key controls between 2009 and 2011. The results from the design effectiveness testing identified remediation requirements, which have been or are being pursued in the following key areas:

- Capital assets: Greater clarity of roles and responsibilities between the financial accounting and the material management processes, and an improved challenge function and quality assurance over capital assets processes to ensure the completeness of costs and an appropriate capitalization date for the capitalization of assets under construction;

- Revenue: Standardization of business processes across various locations and increased monitoring of revenue files; and

- Adjusting journal entries: Enhance existing monitoring and review processes for adjusting journal entries.

4.3.2 Operating effectiveness of key controls

In fiscal year 2010-2011, NRC assessed the operating effectiveness of key controls, which identified that most key controls tested were functioning properly. However, improvement opportunities with regard to the operating effectiveness of key financial controls were found in the following areas:

- Transfer payments: Application of established Section 33 account verification procedures was not applied consistently for low or medium risk contribution agreement claim payments;

- Capital assets: Some capital asset acquisitions were not recorded with the correct capitalization date, correct amount and / or not properly classified as an asset under construction;

- Inventory: Physical access was not sufficient to safeguard some inventory for resale; and

- Revenue: Testing results validated weaknesses identified at the design effectiveness assessment step. As a result, the following remediation requirements have been identified: a need for increased training and communication of certain elements of revenue management practices such as properly documented costing and pricing decisions, improvement in project management practices, and greater clarity in the area of revenue recognition practices.

Testing results have been shared with management and the business process owners. Necessary remediation measures are currently being implemented or planned to be implemented by NRC.

4.4 Ongoing monitoring program

NRC created a dedicated Financial Monitoring Division responsible for managing the documentation and testing of key financial controls, as well as for managing an integrated risk-based approach for the ongoing assessment of NRC's ICFR. This unit monitors any required remedial actions to its entity level, general IT and business processes controls based on lessons learned from the annual assessments, routine monitoring activities and the results of internal and external audits. This includes ensuring that there is a program in place that raises awareness and understanding of NRC's system of ICFR at all levels, and ensures that employees have the knowledge, skills and tools required to carry out their responsibilities.

The results from the routine monitoring activities identified remediation requirements, which have been or are being pursued in the following key areas:

- Low/medium risk payment transactions: Testing showed compliance with existing policies. However, certain transactions lacked sufficient documentation to support expenditure initiation authorization and, for some transactions, the appropriate procurement process was not followed;

- Acquisition card transactions: Testing showed compliance with existing policies. However, some cardholders did not protect the acquisition card number in accordance with NRC policies; and

- Contribution agreement files: Testing showed compliance with existing policies and business processes. However, some documentation risks were found where some files did not contain evidence of sufficient documentation per established NRC practices.

All findings stated above were communicated to management and stakeholders. Necessary remediation measures are currently being implemented by NRC.

5. NRC's action plan

5.1 Progress as of March 31, 2011

During fiscal year 2010-2011, NRC has continued to make significant progress in assessing and improving its key controls. Below is a summary of the main progress made by NRC. Remediation action taken to date has been aligned in terms of priorities following an assessment of risk.

NRC has completed the following work:

- Completion of the documentation, design and operating effectiveness testing of all key processes and controls on a risk-based approach;

- Completion of formal documentation of NRC's Financial Management Framework;

- Communication and institution of management actions for circumstances where a policy, regulation or authority has been contravened;

- Review of the application of standards, development of tools and delivery of training for capitalization of assets of under construction and related eligible expenses;
- Increased monitoring of payments where the appropriate procurement process may not have been followed; and
- Developed an approach which links the delegated financial signing authority matrix with a quick reference document in order to clarify contracting policies, authorities and processes.

NRC has substantially advanced the following work:

- Review of the roles and responsibilities for the monitoring requirements of the capital assets management processes and implementation of the required additional monitoring;
- Implementation of remediation actions to address gaps between the NRC and the government of Canada payroll administration framework;
- Implementation of a continuous revenue file monitoring plan;
- Development of a management action plan resulting from the fraud risk assessment;
- Control of access to IT programs and data, IT program changes, backup and recovery of data, and improved audit trail relative to various IT controls;
- Updated documentation and consistent application of Accounts Payable processes to reflect expected quality assurance requirements; and
- Strengthening and standardization of the processes and procedures to maintain master vendor and customer records.

NRC has commenced or partially completed the following work:

- Streamlining, strengthening and standardization of key controls between NRC's Institutes which initiate processes and/or record a significant portion of NRC's revenues; and
- Reporting and monitoring strategy for conflicting roles in the financial system.

5.2 Action plan for the next fiscal year and future years

The action plan for fiscal year 2011-2012 and subsequent years is to develop and implement a formalized ongoing monitoring program of the effectiveness of NRC's system of ICFR. This includes monitoring and testing of the operating effectiveness of key financial internal controls, periodic follow-up reviews of entity level and general IT controls, tracking the status of management action plans in response to audit and other recommendations, and reviewing and testing the effectiveness of new controls.

By end of fiscal year 2011-2012, NRC plans to:

- Continue remediation of the remaining adjustments identified as high priorities;

- Integrate new key controls as required by any adjustments to its business process and other control levels related to substantive NRC organization changes, including the management of timely testing and remediation as appropriate;
- Fully develop its ongoing monitoring plans which will include:
  - Updates of business processes, entity level and general IT controls documentation;
  - Updates of risk assessments;
  - Development of a three year risk-based monitoring plan for the selection of accounts and locations, the test-period as well as the method and frequency of testing; and
  - Development of additional ongoing monitoring routines based on risk (including results from fraud risk assessment and other assessments).
- Continue the ongoing monitoring of the operating effectiveness of its ICFR and report the results of this activity in this annex yearly;
- Document additional sub-processes identified as lower risk.

Future years:

In fiscal year 2012-2013 and thereafter, NRC will ensure the ongoing monitoring of key controls based on risk. The senior management at NRC is committed to sustaining and continuously improving its sound framework of effective ICFR, including ongoing monitoring to ensure that the key controls meet the expectations of management and stakeholders and appropriately mitigate associated risks.