# CANEX

Consolidated Financial Statements
**March 31, 2011**
(in thousands of Canadian dollars)

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January 31, 2012

## Independent Auditor's Report

**To the Non-Public Property Board**

We have audited the accompanying consolidated financial statements of CANEX, which comprise the consolidated balance sheet as at March 31, 2011 and the consolidated statements of earnings and comprehensive income, accumulated other comprehensive loss and retained earnings, and cash flows for the year then ended, and the related notes including a summary of significant accounting policies.

**Management's responsibility for the consolidated financial statements**

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

**Auditor's responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of CANEX as at March 31, 2011 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

**Other matter**

The consolidated financial statements of CANEX for the year ended March 31, 2010 were audited by another auditor who expressed an unqualified opinion on those consolidated financial statements on June 18, 2010.

PricewaterhouseCoopers LLP[1]

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[1] Chartered accountant auditor permit No. 18865

# CANEX

Consolidated Balance Sheet

**As at March 31, 2011**

(in thousands of Canadian dollars)

| | 2011<br>$ | 2010<br>$ |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | 9,635 | 7,611 |
| Due from Canadian Forces Central Fund (note 4) | 26,114 | 27,307 |
| Account and accrued receivables | 2,427 | 1,308 |
| Inventory | 18,745 | 18,413 |
| Prepaid expenses | 255 | 230 |
| | 57,176 | 54,869 |
| **Property and equipment** (note 5) | 30,948 | 26,190 |
| | 88,124 | 81,059 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | 7,650 | 8,498 |
| Current portion of loans payable (note 6) | 3,469 | 2,009 |
| | 11,119 | 10,507 |
| **Loans payable** (note 6) | 22,009 | 16,239 |
| | 33,128 | 26,746 |
| **Equity** | | |
| **Contributed capital** | 23,280 | 23,280 |
| **Accumulated other comprehensive loss** | (3,172) | (3,252) |
| **Retained earnings** | 34,888 | 34,285 |
| | 54,996 | 54,313 |
| | 88,124 | 81,059 |

Refer to the accompanying notes to the consolidated financial statements.

**Approved by**

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## CANEX

Consolidated Statement of Earnings and Comprehensive Income

**For the year ended March 31, 2011**

(in thousands of Canadian dollars)

| | 2011<br>$ | 2010<br>$ |
|---|---|---|
| **Sales** | 141,493 | 153,880 |
| **Cost of merchandise sold** | 110,252 | 117,664 |
| **Gross profit** | 31,241 | 36,216 |
| **Other revenue** (notes 7 and 10) | 11,001 | 10,843 |
| | 42,242 | 47,059 |
| **Operating expenses** | | |
| Payroll and benefits | 19,703 | 19,943 |
| Other operating expenses | 13,137 | 13,184 |
| Amortization of property and equipment | 3,582 | 3,329 |
| Interest on loans payable (note 6) | 873 | 570 |
| Levies (note 8) | 350 | 370 |
| | 37,645 | 37,396 |
| **Earnings before royalties and contributions** | 4,597 | 9,663 |
| **Royalties and contributions** (note 10) | (3,994) | (4,554) |
| **Net earnings for the year** | 603 | 5,109 |
| **Change in unrealized gains (losses) on translation of self-sustaining foreign operations** | 80 | (5,232) |
| **Comprehensive income (loss)** | 683 | (123) |

Refer to the accompanying notes to the consolidated financial statements.

# CANEX

Consolidated Statement of Accumulated Other Comprehensive Loss and Retained Earnings

**For the year ended March 31, 2011**

(in thousands of Canadian dollars)

| | 2011<br>$ | 2010<br>$ |
|---|---|---|
| **Accumulated other comprehensive income (loss)** | | |
| **Accumulated other comprehensive income (loss) – Beginning of year** | (3,252) | 1,980 |
| Change in unrealized gains (losses) on translation of self-sustaining foreign operations | 80 | (5,232) |
| **Accumulated other comprehensive loss – End of year** | (3,172) | (3,252) |
| **Retained earnings** | | |
| **Retained earnings – Beginning of year** | 34,285 | 29,176 |
| **Net earnings for the year** | 603 | 5,109 |
| **Retained earnings – End of year** | 34,888 | 34,285 |

Refer to the accompanying notes to the consolidated financial statements.

# CANEX

Consolidated Statement of Cash Flows

**For the year ended March 31, 2011**

(in thousands of Canadian dollars)

| | 2011<br>$ | 2010<br>$ |
|---|---|---|
| **Cash flows from** | | |
| **Operating activities** | | |
| Net earnings for the year | 603 | 5,109 |
| Items not affecting cash | | |
| Amortization of property and equipment | 3,582 | 3,329 |
| Loss on disposal of property and equipment | 23 | 55 |
| | 4,208 | 8,493 |
| Net change in non-cash operating working capital items (note 13) | (1,131) | (8,889) |
| | 3,077 | (396) |
| **Investing activities** | | |
| Purchase of property and equipment | (8,396) | (3,242) |
| Proceeds on disposal of property and equipment | 22 | 2 |
| | (8,374) | (3,240) |
| **Financing activities** | | |
| Issuance of loans payable | 9,447 | 9,222 |
| Repayment of loans payable | (2,217) | (2,068) |
| | 7,230 | 7,154 |
| **Effect of exchange rate on foreign currency translation adjustment** | 91 | (5,562) |
| **Net cash inflow (outflow)** | 2,024 | (2,044) |
| **Cash and cash equivalents – Beginning of year** | 7,611 | 9,655 |
| **Cash and cash equivalents – End of year** | 9,635 | 7,611 |
| Cash and cash equivalents comprise: | | |
| Cash | 7,252 | 6,451 |
| Short-term investments | 2,383 | 1,160 |
| | 9,635 | 7,611 |
| **Supplemental cash flow information** | | |
| Interest paid on loans payable | 873 | 570 |

Refer to the accompanying notes to the consolidated financial statements.

(in thousands of Canadian dollars)

## 1 Basis of organization

The Canadian Forces Exchange System ("CANEX") is a division of the Canadian Forces Personnel and Family Support Services ("CFPFSS"), operating under the authority of the Chief of the Defence Staff in his Non-Public Property ("NPP") capacity. Responsibility for directing the affairs of CANEX rests with the Non-Public Property Board.

Morale and Welfare ("MW") Programs is the term used to describe those activities of the Canadian Forces designed to contribute to the morale and well-being of Canadian Forces personnel and their families, and which are normally supported by both public and non-public resources. CANEX is included in these activities.

The level of public support provided to CANEX is outlined in Chapter 5 of the Department of National Defence ("DND") Manual A-PS-110-001/AG-002, "Public Support of Personnel Support Programs", and under Treasury Board Directive No. 689194, which states in part that:

> "A reasonable level of goods, services and recreation facilities should be available to Canadian Forces personnel in their area of service. Where the levels are inadequate, the Department's responsibility, as an employer, to ensure their availability, where practical and desirable, may be discharged through a system of non-public fund organizations."

The DND provides direct and indirect public support to CANEX based on the location of the Bases, Wings and Units. Bases, Wings and Units are classified as remote, rural, semi-urban or urban, with each classification having a specified level of DND public fund support, the decision on the locations where CANEX will operate as well as investment propositions.

As at March 31, 2011, the Canadian Forces Central Fund ("CFCF") had committed to an amount of $1,669 (2010 – $1,428) in work in progress relating to a new location or improvement of the current location. Rights and obligations are transferred to CANEX once the project is completed and generates operating revenue.

In Canada, business consists of merchandising operations at Canadian Forces Bases, Wings and Units operating under the name CANEX. In Germany, similar businesses are operated at the NATO Air Base at Geilenkirchen ("NATO Air Base") under the name NATEX, in accordance with the concession contract ("NATEX contract") between CANEX and the NAEWF E-3A Component headquarters. CANEX also operates an automotive sales transaction office in Germany under the name AMSTO.

CANEX distributes profits to the Bases, Wings and Units at which CANEX operates. NATEX distributes profits to the NATO Air Base in accordance with the NATEX contract.

(in thousands of Canadian dollars)

## 2 Summary of significant accounting policies

### Future accounting changes – New accounting framework

The Canadian Institute of Chartered Accountants ("CICA") has issued a new accounting framework applicable to Canadian private enterprises. Effective for fiscal years beginning on January 1, 2011, private enterprises will have to choose between International Financial Reporting Standards ("IFRS") and Canadian generally accepted accounting principles ("GAAP") for private enterprises, whichever suits them best. Early adoption of these standards is permitted. CANEX currently plans to adopt the new accounting standards for private enterprises for its fiscal year beginning on April 1, 2011; however, the impact of this transition has not yet been determined.

These consolidated financial statements have been prepared in accordance with Canadian GAAP. As CANEX is an NPP enterprise carrying on a business, these consolidated financial statements have been prepared on the same basis as a private company and include the following significant accounting policies.

### Financial presentation

These consolidated financial statements include the sales, cost of sales, operating expenses, assets and liabilities of CANEX, NATEX and AMSTO. These entities are collectively referred to as CANEX for the purposes of these consolidated financial statements. All significant transactions and balances between these entities have been eliminated.

### Revenue recognition

Revenue from the sale of merchandise is recorded upon acceptance by the customer. CANEX records revenue from sales under its credit plan when the customer takes possession of the merchandise and collectibility is assured. Credit plan balances are transferred annually to the CFCF (note 4). Concession and administrative fees are recognized each period in accordance with the terms of the agreements.

### Cash and cash equivalents

Cash and cash equivalents include cash and short-term investments with original maturities of three months or less. CANEX uses both the CFCF banking facility and local banking arrangements.

### Inventory

Inventory, which is composed of retail products, is recorded at the lower of cost and net realizable value less normal profit margins, as determined by the retail method and the cost method for inventory based on departmental details. Cost is substantially determined using average cost. Net realizable value is the estimated selling price less the estimated costs necessary to make the sale.

(in thousands of Canadian dollars)

**Property and equipment**

Property and equipment are recorded at cost and are amortized on a straight-line basis over their estimated useful lives at the following rates:

| | |
|---|---|
| Buildings | 5% |
| Motor vehicles and computer equipment | 24% |
| Point of sale system | 17% |
| Fixtures and equipment | 12% |
| Building improvements | 9% |

Construction in progress is amortized when the asset is substantially complete.

**Impairment of property and equipment**

Property and equipment are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value. No impairment loss was recorded for the years ended March 31, 2011 and 2010.

**Income taxes**

CANEX is an unincorporated Crown NPP entity and is therefore not subject to income taxes in Canada or Germany. Accordingly, no provision for income taxes has been recorded in these consolidated financial statements.

**Foreign currency translation**

CANEX's reporting currency and functional currency is the Canadian dollar. The functional currency of NATEX and AMSTO is the euro. NATEX and AMSTO are considered self-sustaining foreign operations.

NATEX and AMSTO's monetary assets and liabilities have been translated into Canadian dollars at the rates of exchange prevailing at the balance sheet date. NATEX and AMSTO's revenues and expenses are translated at the average rate of exchange for the year. Gains and losses resulting from translation of the accounts of NATEX and AMSTO are recorded in comprehensive income.

**Financial instruments**

CANEX has made the following classifications:

- Cash and cash equivalents are classified as financial assets held for trading and measured at fair value.
- Due from CFCF and account and accrued receivables are classified as loans and receivables and recorded at amortized cost using the effective interest rate method.

(in thousands of Canadian dollars)

- Accounts payable and accrued liabilities and loans payable are classified as other liabilities and measured at amortized cost using the effective interest rate method.

**Use of estimates**

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Actual results could differ from those estimates. The significant estimates included in these consolidated financial statements relate to valuation of account and accrued receivables, inventory valuation, useful lives of property and equipment, and accrued liabilities.

## 3 Capital disclosures

CANEX's main objectives when managing capital are to safeguard CANEX's ability to continue as a going concern and to distribute profits to Bases, Wings and Units at which CANEX and NATEX operate. These profits are to be distributed to the Canadian Forces Bases, Wings and Units to finance a wide variety of social and recreational programs for the benefit of military personnel and their dependants.

In the management of capital, CANEX includes equity and loans payable in the definition of capital. As at March 31, 2011, CANEX has $80,474 (2010 – $72,561) in capital.

CANEX manages its capital structure and makes adjustments due to changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, CANEX may adjust the amount of its debt. CANEX does not have any externally imposed capital requirements.

## 4 Amount due from Canadian Forces Central Fund

The CFCF, which provides banking services and financial assistance to NPP activities at Bases, Wings and Stations as well as to CANEX, is a separate entity under the directional responsibility of the NPP Board, which also has ultimate responsibility for CANEX. The amount due from the CFCF is non-interest bearing and due on demand with the exception of $12,197 (2010 – $12,157) which bears interest at a rate of prime plus 0.25% per annum and is due on demand. Interest earned in the year ended March 31, 2011 amounted to $772 (2010 – $311) and is included in other revenue.

(in thousands of Canadian dollars)

The CFCF assumes all trade payables from CANEX for consideration at their fair value. In addition, the risk and rewards of receivable collection related to the credit plan and other trade receivables are assumed by the CFCF for consideration at their fair value. All credit plan balances and other trade receivables and all trade payables are assumed by the CFCF at fair value, with a 1% fee charged to CANEX by the CFCF for credit losses on the receivables balance. On an annual basis, the fee charged will be evaluated based on the actual credit loss for the preceding year. Any amount charged as part of the fee in excess of actual credit losses can be returned to CANEX. Fees charged in the year ended March 31, 2011 amounted to $1,122 (2010 – $565).

## 5 Property and equipment

| | | | **2011** | **2010** |
|---|---|---|---|---|
| | **Cost** $ | **Accumulated amortization** $ | **Net** $ | **Net** $ |
| Buildings | 32,041 | 14,802 | 17,239 | 12,893 |
| Motor vehicles and computer equipment | 2,028 | 1,778 | 250 | 251 |
| POS system | 2,820 | 2,178 | 642 | 849 |
| Fixtures and equipment | 11,422 | 8,466 | 2,956 | 2,868 |
| Building improvements | 25,434 | 16,174 | 9,260 | 8,748 |
| Construction in progress | 601 | - | 601 | 581 |
| | 74,346 | 43,398 | 30,948 | 26,190 |

## 6 Loans payable

Loans payable, held by the CFCF, bear interest at a fixed rate of 4% (2010 – 4%) per annum and are unsecured. Principal repayments over the next five years and thereafter are as follows:

| | $ |
|---|---|
| 2012 | 3,469 |
| 2013 | 1,981 |
| 2014 | 1,894 |
| 2015 | 1,865 |
| 2016 | 1,628 |
| Thereafter | 14,641 |
| | 25,478 |
| Less: Current portion | 3,469 |
| Long-term portion | 22,009 |

(in thousands of Canadian dollars)

## 7 Other revenue

Other revenue consists primarily of concession fees at Bases, Wings and Units across Canada and administrative fees for the Home Heating Oil and Insurance programs.

## 8 Levies

Levies are paid to the Canadian Forces Personnel Assistance Fund at a rate of 0.15% of total sales. Levies on AMSTO revenue are paid to the CFCF at a rate of 20% of revenue earned by AMSTO.

## 9 Pension plan

Substantially all CANEX employees are eligible to be members of the Non-Public Funds Employees Pension Plan (the “Plan”). The Plan is a defined benefit pension plan which provides retirement benefits relating to contributions and years of service. In the year ended March 31, 2011, CANEX contributed $941 (2010 – $1,005) to the Plan. Plan contributions are included in payroll and other benefits.

## 10 Related party transactions

**Royalties and contributions**

In the year ended March 31, 2011, CANEX paid royalties of $3,113 (2010 – $3,120) to Canadian Forces Bases, Wings and Units. In Canada, royalties consist of CANEX’s contribution to the per capita CANEX/SISIP Morale and Welfare grant and a direct distribution of 1.5% of total sales plus 30% of net concession revenues, with the exception of CFB Suffield and CFB Wainwright. Royalties at these two Bases are based on 5% of total sales plus 30% of net concession revenues.

In the year ended March 31, 2011, NATEX contributed $881 (2010 – $1,434) to the NATO Air Base. NATEX’s contributions are based on various percentages of consumer sales, in accordance with the NATEX contract.

**Department of National Defence**

In the year ended March 31, 2011, the DND contributed $2,490 (2010 – $2,382) to CANEX towards payroll costs, travel and supplies. All amounts received are recorded against the corresponding operating expense in the consolidated statement of earnings.

The DND provides certain facilities and land. It also pays for and provides other services on behalf of, and at no cost to, CANEX. These services include payment in lieu of taxes and the use of legal, environmental and other advisory services. The fair value of the facility and services provided to CANEX by the DND has not been determined and has not been recorded in the consolidated financial statements.

(in thousands of Canadian dollars)

**Canadian Forces Personnel and Family Support Services ("CFPFSS")**

The CFPFSS provides accounting, information technology, and human resources services to CANEX. These transactions occurred in the normal course of operations and are recorded in other operating expenses at the exchange amount of $2,855 for the year ended March 31, 2011 (2010 – $2,855). This is the amount of consideration established and agreed to by the related parties and represents management's best estimate of fair value.

In the year ended March 31, 2011, the CFPFSS contributed $200 (2010 – $200) to CANEX as a Corporate Procurement and Discount Program Subsidy. This contribution has been recorded in other revenue.

## 11 Contingencies

From time to time, CANEX is involved in claims in the normal course of business. Management assesses such claims and where considered likely to result in a material exposure and where the amount of the claim is quantifiable, provisions for loss are made based on management's assessment of the likely outcome. CANEX does not provide for claims that are considered unlikely to result in a significant loss, claims for which the outcome is not determinable or claims where the amount of the loss cannot be reasonably estimated. Any settlement or awards under such claims are provided for when reasonably determinable.

## 12 Financial instruments and risk management

CANEX, through its financial assets and financial liabilities, is exposed to the following risks from its use of financial instruments: credit risk, liquidity risk, interest rate risk, and currency risk. The following analysis provides a measurement of risks as at March 31, 2011.

**Credit risk**

Credit risk refers to the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

CANEX provides credit to its customers through its credit plan. CANEX has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks. As at March 31, 2011, no financial instruments are past due or impaired (note 4).

The credit risk on cash and cash equivalents is limited because the counterparties are chartered banks with high credit ratings assigned by national credit rating agencies.

**Liquidity risk**

Liquidity risk refers to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

(in thousands of Canadian dollars)

CANEX manages liquidity risk by maintaining adequate banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows, and matching the maturity profiles of financial assets and financial liabilities. CANEX uses both the CFCF banking facility and local banking arrangements.

**Interest rate risk**

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

CANEX's financial assets which are exposed to interest rate risk consist of cash and cash equivalents invested at short-term interest rates and the amount due from CFCF (note 4).

The loans payable bear interest at fixed rates. Consequently, the loans payable only have a fair value exposure and are not exposed to cash flow fluctuations (note 6). The interest-bearing temporary investments included in cash and cash equivalents have a limited exposure to interest rate risk due to their short-term maturity.

**Currency risk**

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

CANEX earns certain revenue and incurs certain expenses in currencies other than its functional currencies and is therefore subject to foreign currency risk. Included in other operating expenses is a foreign exchange loss of $46 (2010 – gain of $325).

The carrying amounts of CANEX's foreign currency-denominated financial assets and financial liabilities as at March 31, 2011 are as follows:

| | Current assets | | | | Current liabilities | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| | € | $ | € | $ | € | $ | € | $ |
| NATEX | 10,610 | 14,623 | 10,844 | 14,897 | 665 | 916 | 860 | 1,182 |
| AMSTO | 8,795 | 12,121 | 8,447 | 11,604 | 3,269 | 4,506 | 3,421 | 4,699 |

**Fair value**

a) Establishing fair value

The fair value of amount due from CFCF, account and accrued receivables, and accounts payable and accrued liabilities approximate their carrying amounts in the consolidated financial statements due to the relatively short period to maturity of these financial instruments.

The fair value of the loans payable is comparable to their book value given their competitive terms and conditions.

(in thousands of Canadian dollars)

b) Fair value hierarchy

Financial instruments recorded at fair value on the consolidated balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 – Valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – Valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and
- Level 3 –Valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

CANEX's financial instruments recorded at fair value are cash and cash equivalents. Fair values reflect valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).

For the year ended March 31, 2011, there were no significant transfers of amounts between levels.

## 13 Net change in non-cash operating working capital items

| | **2011**<br>**$** | **2010**<br>**$** |
|---|---|---|
| Due from CFCF | 1,193 | (9,006) |
| Account and accrued receivables | (1,116) | 145 |
| Inventory | (316) | 1,097 |
| Prepaid expenses | (25) | 423 |
| Accounts payable and accrued liabilities | (867) | (1,548) |
| | (1,131) | (8,889) |

(in thousands of Canadian dollars)

## 14 Segmented information

Included in the consolidated financial statements of CANEX are the results of operations for NATEX and AMSTO. The financial information for NATEX and AMSTO is summarized as follows:

| | **2011** **$** | **2010** **$** |
|---|---|---|
| Total assets | 29,535 | 29,875 |
| Sales and other revenue | 26,040 | 37,886 |
| Net earnings | 39 | 1,403 |

## 15 Comparative figures

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