

CANEX

Consolidated Financial Statements
March 31, 2013
(in thousands of Canadian dollars)



November 21, 2013

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, 2013 and the consolidated statements of loss, retained earnings and cash flows for the year then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

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 accounting standards for private enterprises, 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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PwC refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.



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, 2013 and the results of its operations and its cash flows for the year then ended in accordance with Canadian accounting standards for private enterprises.

PricewaterhouseCoopers LLP¹

¹ CPA auditor, CA, public accountancy permit No. A116819

CANEX

Consolidated Balance Sheet

As at March 31, 2013

(in thousands of Canadian dollars)

	Note	2013 \$	2012 \$
Assets			
Current assets			
Cash and cash equivalents		8,312	10,298
Due from Canadian Forces Central Fund	3	26,862	24,327
Account and accrued receivables		1,601	1,188
Inventory		17,474	17,757
Prepaid expenses		262	155
		<u>54,511</u>	<u>53,725</u>
Property and equipment	4, 12	<u>26,985</u>	<u>30,147</u>
		<u>81,496</u>	<u>83,872</u>
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		7,990	7,615
Current portion of loans payable	5	<u>2,132</u>	<u>2,131</u>
		10,122	9,746
Asset retirement obligation	12	755	740
Loans payable	5	<u>20,174</u>	<u>21,690</u>
		<u>31,051</u>	<u>32,176</u>
Equity			
Contributed capital		23,280	23,280
Deferred loss on currency exchange		(4,481)	(3,992)
Retained earnings		<u>31,646</u>	<u>32,408</u>
		<u>50,445</u>	<u>51,696</u>
		<u>81,496</u>	<u>83,872</u>

Approved by the Non-Public Property Board

Refer to the accompanying notes to the consolidated financial statements.

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Consolidated Statement of Loss For the year ended March 31, 2013

(in thousands of Canadian dollars)

	Note	2013 \$	2012 \$
Sales		132,187	135,321
Cost of merchandise sold		103,869	106,538
Gross profit		28,318	28,783
Other revenue	3, 6, 9	10,766	9,633
		39,084	38,416
Operating expenses			
Payroll and benefits		18,835	19,019
Other operating expenses		12,467	13,085
Amortization of property and equipment	12	3,598	3,563
Interest on loans payable	5	925	942
Levies	7	314	318
		36,139	36,927
Earnings before royalties and contributions		2,945	1,489
Royalties and contributions	9	(3,707)	(3,969)
Net loss for the year		(762)	(2,480)

Refer to the accompanying notes to the consolidated financial statements.

CANEX**Consolidated Statement of Retained Earnings****For the year ended March 31, 2013**

(in thousands of Canadian dollars)

	2013	2012
	\$	\$
Retained earnings – Beginning of year	32,408	34,888
Net loss for the year	<u>(762)</u>	<u>(2,480)</u>
Retained earnings – End of year	<u>31,646</u>	<u>32,408</u>

Refer to the accompanying notes to the consolidated financial statements.

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Consolidated Statement of Cash Flows For the year ended March 31, 2013

(in thousands of Canadian dollars)

	Note	2013 \$	2012 \$
Cash flows provided by (used in)			
Operating activities			
Net loss for the year		(762)	(2,480)
Items not affecting cash			
Amortization of property and equipment		3,598	3,563
Loss on disposal of property and equipment		15	38
		<u>2,851</u>	<u>1,121</u>
Net change in non-cash operating working capital items	14	<u>(2,385)</u>	<u>4,093</u>
		<u>466</u>	<u>5,214</u>
Investing activities			
Purchase of property and equipment		(502)	(2,382)
Proceeds on disposal of property and equipment		6	238
		<u>(496)</u>	<u>(2,144)</u>
Financing activities			
Issuance of loans payable		667	2,556
Repayment of loans payable		(2,167)	(4,213)
		<u>(1,500)</u>	<u>(1,657)</u>
Effect of exchange rate on foreign currency translation adjustment		<u>(456)</u>	<u>(750)</u>
Net cash inflow during the year		(1,986)	663
Cash and cash equivalents – Beginning of year		<u>10,298</u>	<u>9,635</u>
Cash and cash equivalents – End of year		<u>8,312</u>	<u>10,298</u>
Cash and cash equivalents comprise:			
Cash		7,224	7,533
Short-term investments		1,088	2,765
		<u>8,312</u>	<u>10,298</u>
Supplemental cash flow information			
Interest paid on loans payable		925	942

Refer to the accompanying notes to the consolidated financial statements.

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Notes to Consolidated Financial Statements

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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 (CDS) in his Non-Public Property (NPP) capacity. Responsibility for directing the affairs of CANEX rests with the Director of General Personnel and Family Support Services as delegated by the CDS.

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.

As at March 31, 2013, the Canadian Forces Central Fund (CFCF) had committed to an amount of \$3,738 (2012 – \$2,916) 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 royalties to the Bases, Wings and Units at which CANEX operates. NATEX distributes royalties to the NATO Air Base in accordance with the NATEX contract.

2 Summary of 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.

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Notes to Consolidated Financial Statements

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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 collectability is assured. Credit plan balances are transferred annually to the CFCF (note 3). 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. The cost method for inventory is substantially determined using average cost. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs necessary to make the sale, which correspond to the direct cost of the inventory.

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 completed.

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, 2013 and 2012.

Asset retirement obligation

Asset retirement obligations relate to estimated future costs to remove underground motor fuel storage tanks and are based on CANEX's prior experience in removing these fuel tanks, the fuel tanks' estimated useful life, external estimates and governmental regulatory requirements. A discounted liability is recorded for the fair

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value of an asset retirement obligation with a corresponding increase to the carrying value of the related long-lived asset at the time an underground storage fuel tank is installed. To determine the initial recorded liability, the future estimated cash flows would be discounted at a rate representing the CFCF banking facility and local banking arrangement rates, taking into consideration inflation. The amount that would be added to property and equipment is amortized.

Following the initial recognition of the asset retirement obligation, the carrying amount of the liability is increased to reflect the passage of time and then adjusted for variations in the current market-based discount rate or the scheduled underlying cash flows required to settle the liability.

Pension plan expense

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. The plan is considered a multi-employer defined benefit plan. Contributions to the plan are made by NPF on behalf of CANEX and CANEX reimburses NPF for the full cost of the contributions. These payments are included in payroll and benefits expense and are expensed as incurred.

Income taxes

CANEX is a 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 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 consolidated 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 a separate component of equity.

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

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Use of estimates

The preparation of consolidated financial statements in accordance with ASPE requires management to make estimates and assumptions which 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.

3 Amount due from Canadian Forces Central Fund

The CFCF, which provides banking services and financial assistance to NPP activities at Bases, Wings and Units 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 \$12,846 (2012 – \$13,122) 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, 2013 amounted to \$731 (2012 – \$315) and is included in other revenue.

The CFCF assumes all trade payables from CANEX for consideration at their fair value. In addition, the risks 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 an annually reviewed average fee (2013 and 2012 – 1%) 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, 2013 amounted to \$749 (2012 – \$1,014).

4 Property and equipment

	2013		
	Cost \$	Accumulated amortization \$	Net \$
Buildings	32,920	16,745	16,175
Motor vehicles and computer equipment	2,057	1,730	327
Point of sale system	2,913	2,334	579
Fixtures and equipment	10,927	8,493	2,434
Building improvements	25,735	18,298	7,437
Construction in progress	33	–	33
	<u>74,585</u>	<u>47,600</u>	<u>26,985</u>

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			2012
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	
Buildings	33,084	15,743	17,341
Motor vehicles and computer equipment	1,918	1,736	182
Point of sale system	2,670	2,167	503
Fixtures and equipment	11,230	8,560	2,670
Building improvements	25,683	17,276	8,407
Construction in progress	1,044	—	1,044
	<u>75,629</u>	<u>45,482</u>	<u>30,147</u>

5 Loans payable

Loans payable held by the CFCE bear interest at a fixed rate of 4% (2012 – 4%) per annum and are unsecured. Principal repayments over the next five years and thereafter are as follows:

	\$
2014	2,132
2015	2,100
2016	1,872
2017	1,814
2018	1,468
Thereafter	<u>12,920</u>
	22,306
Less: Current portion	<u>2,132</u>
Long-term portion	<u>20,174</u>

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6 Other revenue

Other revenues are comprised of the following:

	2013 \$	2012 \$
Concessions revenues	4,081	4,085
The personal commissions	2,899	2,153
AMSTO revenues	1,108	909
Other commission revenues (Duty Free, Post Office)	869	789
NATEX other revenues (including interest)	826	776
Rental and delivery revenues	208	197
Advertising revenues	368	338
Home heating oil revenues	227	274
Other miscellaneous revenues	180	112
	<hr/>	<hr/>
	10,766	9,633

7 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.

8 Pension plan

In the year ended March 31, 2013, CANEX contributed \$1,074 (2012 – \$1,030) to the Plan.

9 Related party transactions

Royalties and contributions

In the year ended March 31, 2013, CANEX contributed an amount of \$3,040 (2012 – \$3,166) to enhance NPP Morale and Welfare Programs at Canadian Forces Bases, Wings and Units.

In the year ended March 31, 2013, NATEX contributed \$667 (2012 – \$802) 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, 2013, the DND contributed \$2,599 (2012 – \$2,520) to CANEX towards payroll costs, travel and supplies. All amounts received are recorded against the corresponding operating expense in the consolidated statement of loss.

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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.

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 \$2,959 for the year ended March 31, 2013 (2012 – \$2,943). This is the amount of consideration established and agreed to by the related parties and represents management's best estimate of fair value.

10 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.

11 Environmental liability

CANEX has assessed that sites operated as gas stations under the old Shell program but not released yet to the DND/Canadian Forces might become a source of an eventual environmental liability if it was determined that leaks had occurred and caused the contamination of these sites. Due to the uncertainty of a possible contamination of these sites, CANEX has concluded that the occurrence of this contingency cannot be determinable at this time and any eventual liability cannot be reasonably estimated.

12 Asset retirement obligation

As at March 31, 2013, the discounted value of the asset retirement cost included in the Buildings category of property and equipment is estimated at \$620. The amortization of this asset has generated an expense of \$60 in 2013 (2012 – \$60). The total undiscounted amount of estimated cash flows to settle the asset retirement obligation is approximately \$990 (discounted value – \$755) and is expected to be incurred over the next 23 years. Should changes occur in estimated future removal costs, fuel tank useful lives or governmental regulatory requirements, revisions to the liability shall be made. Of the total liability recorded in the consolidated balance sheet as at March 31, 2013, no amount is expected to be paid within the next twelve months.

In 2013, \$nil has been paid toward the retirement of fuel tanks.

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13 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: liquidity risk, credit risk and market risk. The following analysis provides a measurement of risks as at March 31, 2013.

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.

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 in Germany.

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, 2013, no financial instruments are past due or impaired (note 3).

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.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk. CANEX is exposed mainly to interest rate risk and currency risk.

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 the CFCF (note 3). 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 5). The interest-bearing temporary investments included in cash and cash equivalents have limited exposure to interest rate risk due to their short-term maturity.

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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 currency and is therefore subject to foreign currency risk. Included in other operating expenses is a foreign exchange gain of \$35 (2012 – gain of \$67). The carrying amounts of CANEX's foreign currency-denominated financial assets and financial liabilities as at March 31, 2013 and 2012 are as follows:

	Current assets				Current liabilities			
	2013		2012		2013		2012	
	€	\$	€	\$	€	\$	€	\$
NATEX	11,778	15,360	11,061	14,735	794	1,036	709	944
AMSTO	10,391	13,552	9,295	12,383	3,807	4,965	3,310	4,409

Fair value

a) Establishing fair value

The fair values of amount due from the 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.

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).

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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, 2013, there were no significant transfers of amounts between levels.

14 Net change in non-cash operating working capital items

	2013	2012
	\$	\$
Due from CFCF	(2,535)	1,787
Account and accrued receivables	(430)	1,223
Inventory	200	838
Prepaid expenses	(109)	99
Accounts payable and accrued liabilities	489	146
	<hr/>	<hr/>
	(2,385)	4,093
	<hr/>	<hr/>

15 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:

	2013			2012		
	€	\$	%	€	\$	%
Total assets	23,451	30,585	38%	21,953	29,246	35%
Sales and other revenue	16,155	20,826	15%	18,027	24,646	17%
Net earnings	915	1,179	40%	439	600	40%

16 Comparative figures

Certain of the prior year figures have been reclassified to conform to the current year presentation.