

FINANCIAL STATEMENTS
For
CANADIAN FORCES CENTRAL FUND
For year ended
MARCH 31, 2014

INDEPENDENT AUDITOR'S REPORT

To the Non-Public Property Board

We have audited the accompanying financial statements of the Canadian Forces Central Fund, which comprise the statement of financial position as at March 31, 2014, and the statements of operations and changes in net assets and cash flows for the year ended March 31, 2014, 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 accounting standards for not-for-profit organizations, 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

Our responsibility is to express an opinion on these 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 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.

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 financial statements present fairly, in all material respects, the financial position of the Canadian Forces Central Fund as at March 31, 2014, and the results of its operations and its cash flows for the year ended March 31, 2014 in accordance with Canadian accounting standards for not-for-profit organizations.



Chartered Accountants
Licensed Public Accountants

Ottawa, Ontario
October 10, 2014.

CANADIAN FORCES CENTRAL FUND
STATEMENT OF FINANCIAL POSITION
MARCH 31, 2014

	<u>2014</u>	<u>2013</u>
<u>ASSETS</u>		
CURRENT ASSETS		
Cash and cash equivalents (note 4)	\$ 4,975,364	\$ 5,079,132
Accrued interest receivable	274,926	259,109
Accounts receivable (note 5)	64,863,704	65,756,000
Prepaid expenses	176,721	208,067
Current portion of project loans receivable (note 6)	<u>2,590,727</u>	<u>2,768,214</u>
	<u>72,881,442</u>	<u>74,070,522</u>
OTHER ASSETS		
Project loans receivable (note 6)	23,802,343	26,844,353
Long-term investments (note 7)	<u>45,397,433</u>	<u>38,686,267</u>
	<u>69,199,776</u>	<u>65,530,620</u>
	<u>142,081,218</u>	<u>139,601,142</u>
TRUST ASSETS (note 8)		
Cash and long-term investments	<u>142,863,238</u>	<u>131,549,898</u>
	<u>\$ 284,944,456</u>	<u>\$ 271,151,040</u>
<u>LIABILITIES AND NET ASSETS</u>		
CURRENT LIABILITIES		
Accounts payable and employee deductions payable (note 5)	\$ 15,473,348	\$ 16,006,392
TRUST LIABILITIES (note 8)		
	<u>142,863,238</u>	<u>131,549,898</u>
	158,336,586	147,556,290
NET ASSETS		
Unrestricted	<u>126,607,870</u>	<u>123,594,750</u>
	<u>\$ 284,944,456</u>	<u>\$ 271,151,040</u>

Approved:



Shirley Tang-Jassemi
Chief Financial Officer
Chef des services financiers
613-996-5797

(See accompanying notes)

CANADIAN FORCES CENTRAL FUND
STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
YEAR ENDED MARCH 31, 2014

	<u>2014</u>	<u>2013</u>
Operating revenue		
Dividends and interest	\$ 4,590,552	\$ 4,111,203
Gain on sale of portfolio investments	2,024,497	1,996,182
Loan interest	1,214,586	1,255,662
Loss from Queensway Corporate Campus (note 7(b))	(428,517)	(452,019)
Re-insurance guarantee fee (note 9)	250,000	250,000
Other	<u>856,256</u>	<u>877,306</u>
	<u>8,507,374</u>	<u>8,038,334</u>
Operating expenses		
CFCF management	327,125	323,143
Interest to base/wing funds, messes and trusts	11,200,332	6,921,258
CFMWS user fees for services (note 10)	350,000	350,000
Investment services	237,229	254,708
Other	<u>187,420</u>	<u>482,530</u>
	<u>12,302,106</u>	<u>8,331,639</u>
Net operating loss before CFCF contributions	<u>(3,794,732)</u>	<u>(293,305)</u>
CFCF contributions (note 11)		
Programs and distributions	612,467	771,700
NPF services and operations	<u>5,803,037</u>	<u>6,369,731</u>
	<u>6,415,504</u>	<u>7,141,431</u>
Net expense before items below	(10,210,236)	(7,434,736)
Unrealized gain on portfolio investments (note 7(a)(iii))	<u>13,223,356</u>	<u>5,719,575</u>
Net revenue (expense)	3,013,120	(1,715,161)
Net assets, beginning of year	<u>123,594,750</u>	<u>125,309,911</u>
Net assets, end of year	<u>\$ 126,607,870</u>	<u>\$ 123,594,750</u>

(See accompanying notes)

**CANADIAN FORCES CENTRAL FUND
STATEMENT OF CASH FLOWS
YEAR ENDED MARCH 31, 2014**

	<u>2014</u>	<u>2013</u>
CASH PROVIDED FROM (USED IN)		
Operating activities		
Net revenue (expense)	\$ 3,013,120	\$ (1,715,161)
Items not affecting cash:		
Gain on sale of portfolio investments	(2,024,497)	(1,996,182)
Loss from Queensway Corporate Campus	428,517	452,019
Unrealized gain on portfolio investments	<u>(13,223,356)</u>	<u>(5,719,575)</u>
	(11,806,216)	(8,978,899)
Changes in level of:		
Accrued interest receivable	(15,817)	(115,193)
Accounts receivable	892,296	12,443,770
Prepaid expenses	31,346	(475)
Accounts payable and employee deductions payable	<u>(533,044)</u>	<u>1,271,443</u>
	<u>(11,431,435)</u>	<u>4,620,646</u>
Investing activities		
Decrease in project loans receivable	3,219,497	2,783,492
Decrease (increase) in long-term investments	<u>8,108,170</u>	<u>(5,580,111)</u>
	<u>11,327,667</u>	<u>(2,796,619)</u>
Increase (decrease) in cash and cash equivalents	(103,768)	1,824,027
Cash and cash equivalents, beginning of year	<u>5,079,132</u>	<u>3,255,105</u>
Cash and cash equivalents, end of year	<u>\$ 4,975,364</u>	<u>\$ 5,079,132</u>

(See accompanying notes)

CANADIAN FORCES CENTRAL FUND
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED MARCH 31, 2014

1. NATURE OF OPERATIONS

The Canadian Forces Central Fund (CFCF) was established by the Chief of the Defence Staff (CDS) on February 1, 1968, under Section 2 and Sections 38 to 41 of the National Defence Act, to provide banking services to units and trusts from non-public funds and financial assistance to units in establishing and improving messes, recreational and social facilities for the benefit of Canadian Forces personnel and their dependants. Responsibility for directing the affairs of CFCF rests with the Director General Morale and Welfare Services as delegated by the CDS.

In common with other non-public funds, CFCF is exempt from paying income tax under Part 1 of the Income Tax Act.

A significant portion of the transactions in these financial statements relate to military base activities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

These financial statements have been prepared in accordance with Canadian accounting standards for not-for-profit organizations.

Cash and cash equivalents

Cash and cash equivalents consist of balances with banks, short-term investments and cash at the brokers' account.

Financial instruments

(a) *Measurement of financial instruments*

CFCF initially measures its financial assets and liabilities at fair value adjusted by, in the case of a financial instrument that will not be measured subsequently at fair value, the amount of transaction costs directly attributable to the instrument.

Cash and portfolio investments are subsequently measured at fair value. Changes in fair value are recognized in the statement of operations in the period incurred. The fair value of portfolio investments is determined by reference to published price quotations in an active market at year-end.

Investment in Queensway Corporate Campus (QCC) is accounted for under the equity method. All other financial assets and liabilities are subsequently measured at amortized cost.

(b) *Transaction costs*

Transaction costs are recognized in the statement of operations in the period incurred, except for financial instruments that will be subsequently measured at amortized cost.

Revenue recognition

Revenue from investments are recognized when earned.

Use of estimates

The preparation of financial statements in conformity with Canadian accounting standards for not-for-profit organizations requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Management makes estimates in determining the estimated net realizable value of accounts receivable, project loans receivable and the amount of accrued liabilities. Actual results could differ from those estimates. These estimates are reviewed annually and as adjustments become necessary, they are recognized in the financial statements in the period they become known.

CANADIAN FORCES CENTRAL FUND
NOTES TO THE FINANCIAL STATEMENTS - Cont'd.
YEAR ENDED MARCH 31, 2014

3. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

CFCF is exposed to various risks through its financial instruments. The following analysis provides a measure of CFCF's risk exposure and concentrations.

CFCF does not use derivative financial instruments to manage its risks.

Credit risk

Credit risk arises principally from cash and cash equivalents, accrued interest receivable, accounts receivable, project loans receivable and long-term investments. CFCF generally places its cash and cash equivalents in Canadian federal and provincial government bonds, bonds of corporations with high credit ratings and bankers' acceptances.

CFCF does not require collateral or other security to support project loans advanced to military bases and ships and therefore, these loans bear an element of credit risk. However, losses due to amounts proving uncollectible have traditionally been low due in part to the fact that CFCF administers the cash balances of most of its creditors.

Liquidity risk

Liquidity risk refers to the adverse consequences that CFCF will encounter difficulty in meeting obligations associated with financial liabilities, which are comprised of accounts payable and employee deductions payable.

CFCF manages this risk by maintaining sufficient cash and cash equivalents to meet their current obligations and management establishes budget and cash estimates to determine their future cash flow requirements. CFCF has an operating credit facility of \$10 million which bears interest at the bank's prime rate plus 0.50%. As at March 31, 2014, none of this operating credit facility was utilized.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is comprised of currency risk, interest rate risk and other price risk.

i) Currency risk

Currency risk refers to the risk that the fair value of financial instruments or future cash flows associated with the instruments will fluctuate relative to the Canadian dollar due to changes in foreign exchange rates.

CFCF's exposure to foreign currency risk is primarily related to fluctuations in the value of the Canadian dollar relative to that of the U.S. dollar. As at March 31, 2014, approximately \$26 million of CFCF's long-term investments are exposed to fluctuations in the U.S. dollar.

ii) Interest rate risk

Interest rate risk refers to the risk that the fair value of financial instruments or future cash flows associated with the instruments will fluctuate due to changes in market interest rates.

Exposure to interest rate risk on long-term investments is disclosed in note 7. CFCF pays interest on net trust liabilities to the units and funds based on the bank's prime rate or CFCF's investment rate of return.

iii) Other price risk

Other price risk refers to the risk that the fair value of financial instruments or future cash flows associated with the instruments will fluctuate because of changes in market prices (other than those arising from currency risk or interest rate risk), whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all similar instruments traded in the market.

Other price risk affecting long-term investments is disclosed in note 7.

Changes in risk

There have been no material changes in CFCF's risk exposures from the prior year.

CANADIAN FORCES CENTRAL FUND
NOTES TO THE FINANCIAL STATEMENTS - Cont'd.
YEAR ENDED MARCH 31, 2014

4. CONSOLIDATED BANK ACCOUNT

CFCF maintains cash, which it does not control, in its consolidated bank account on behalf of other funds, trusts and units. CFCF controls the interest earned on such funds less a percentage paid back to the units and funds (Base/Wing/Funds and Messes receive 3% with options to elect at the bank's prime rate plus 0.25% or CFCF's investment rate of return less 0.5% for its cash balance in excess of CFCF liabilities while trust accounts receive varying percentages based on cash balances and options selected).

	<u>2014</u>	<u>2013</u>
Cash and cash equivalents	\$ 19,086,089	\$ 20,400,127
Allocated to trust assets	<u>(14,110,725)</u>	<u>(15,320,995)</u>
	<u>\$ 4,975,364</u>	<u>\$ 5,079,132</u>

5. ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE

As part of the Non-Public Property Board approved Customer Relationship Management Project, CFCF assumes and manages the accounts receivable and accounts payable of all activities undertaken by Base/Wing/Unit Funds, the Canadian Forces Exchange System (CANEX), Specialty Interest Activities and Messes.

To cover credit losses relating to credit risk and uncollectible accounts, each accounts receivable item purchased from Base/Wing/Unit Funds, CANEX, Specialty Interest Activities and Messes has been assessed a fee to cover an estimated amount that will not be collected. If, at the end of a fiscal year, the actual recovery rate of accounts receivable from a specific entity is different than the fee assessed, the assessed fee is adjusted for the subsequent year. Any amount in excess of the actual credit losses is returned to the entity at the end of each fiscal year.

Accounts receivable are comprised of the following:

	<u>2014</u>	<u>2013</u>
CANEX	\$ 56,346,613	\$ 56,938,187
CFMWS	330,652	36,494
Base/Wing/Funds/Messes	<u>1,793,160</u>	<u>2,236,200</u>
	58,470,425	59,210,881
Trade receivables of CFCF	<u>6,393,279</u>	<u>6,545,119</u>
	<u>\$ 64,863,704</u>	<u>\$ 65,756,000</u>

In regards to the accounts receivable that are assumed on behalf of CANEX, approximately \$53.5 million (2013 - \$54.2 million) relates to CANEX's interest free credit plans that are available for eligible patrons with the balance of the accounts receivable being for trade receivables. There are varying repayment terms in regards to the CANEX credit plans ranging from one year to three year plans.

Accounts payable and employee deductions payable relate to these amounts owing by the following:

	<u>2014</u>	<u>2013</u>
CANEX	\$ 3,883,148	\$ 4,304,692
CFMWS	1,599,709	3,649,706
Base/Wing/Funds/Messes	<u>5,104,725</u>	<u>3,744,661</u>
	10,587,582	11,699,059
CFCF	<u>4,885,766</u>	<u>4,307,333</u>
	<u>\$ 15,473,348</u>	<u>\$ 16,006,392</u>

Included in accounts payable and employee deductions payable at March 31, 2014 is government remittances payable of \$1,425,938 (2013 - \$1,525,931).

CANADIAN FORCES CENTRAL FUND
NOTES TO THE FINANCIAL STATEMENTS - Cont'd.
YEAR ENDED MARCH 31, 2014

6. PROJECT LOANS RECEIVABLE

CFCF provides unsecured loans to military bases and ships to share in the financing of capital projects. CFCF provides interest-free working capital loans to units on United Nations operations for the duration of the deployment. Starting in May 2002, ships may obtain a line of credit on their Consolidated Bank Account when being deployed on various operations instead of an interest-free loan. Loans to CANEX and to bases bear interest at 4%. Repayment terms vary from 3 to 20 years. Periodically, the Non-Public Property Board approves the full or partial forgiveness of specific loan balances. No loans were forgiven in either the 2013 or 2014 fiscal year-ends.

	<u>2014</u>	<u>2013</u>
Interest bearing loans	\$ 23,031,803	\$ 26,010,308
Interest-free loans	<u>3,361,267</u>	<u>3,602,259</u>
	26,393,070	29,612,567
Less current portion	<u>2,590,727</u>	<u>2,768,214</u>
	<u>\$ 23,802,343</u>	<u>\$ 26,844,353</u>

7. LONG-TERM INVESTMENTS

	2014		2013	
	Market value	Cost	Market value	Cost
Portfolio investments				
Canadian stocks	\$ 74,048,446	\$ 59,204,818	\$ 62,307,947	\$ 56,652,858
Canadian bond fund	59,043,194	59,830,988	54,591,313	53,707,462
Foreign stocks	<u>26,083,082</u>	<u>17,993,177</u>	<u>22,612,169</u>	<u>20,228,726</u>
Total - portfolio investments	159,174,722	<u>\$ 137,028,983</u>	139,511,429	<u>\$ 130,589,046</u>
Equity in Queensway				
Corporate Campus	<u>14,975,224</u>		<u>15,403,741</u>	
Sub-totals	174,149,946		154,915,170	
Less allocation to trusts	<u>(128,752,513)</u>		<u>(116,228,903)</u>	
	<u>\$ 45,397,433</u>		<u>\$ 38,686,267</u>	

(a) *Portfolio investments*

Portfolio investments are managed by external investment managers who are under the direction of the Investment committee reporting to the Non-Public Property Board.

(i) *Interest rate risk*

The organization manages its interest rate risk exposure through its investment in the aforementioned Canadian bond fund. This fund minimizes its interest rate risk by using a laddered portfolio with varying terms to maturity. The laddered structure of maturity helps to enhance the average portfolio yield while reducing the sensitivity of the portfolio to the impact of interest rate fluctuations.

(ii) *Credit and market risk*

Risk and volatility of investment returns are mitigated through the diversification of investments in different business sectors and corporation sizes.

(iii) The unrealized gain on portfolio investments is calculated as follows:

	<u>2014</u>	<u>2013</u>
Current year's unrealized gain	\$ 22,145,739	\$ 8,922,383
Reversal of prior year's unrealized gain	<u>(8,922,383)</u>	<u>(3,202,808)</u>
	<u>\$ 13,223,356</u>	<u>\$ 5,719,575</u>

CANADIAN FORCES CENTRAL FUND
NOTES TO THE FINANCIAL STATEMENTS - Cont'd.
YEAR ENDED MARCH 31, 2014

7. LONG-TERM INVESTMENTS - Cont'd.

(b) *Equity in Queensway Corporate Campus*

The Queensway Corporate Campus (QCC) is accounted for under the equity method. The QCC was acquired by CFCF on December 24, 2009 for \$56.8 million with \$18 million provided at the time of the purchase and the balance of \$38.8 million financed through long-term debt. This campus encompasses the real estate located at 4200 Labelle Street, 4210 Labelle Street and 1223 Michael Street.

The equity in QCC as at March 31 is comprised as follows:

Balance Sheet of QCC as at March 31st is as follows:

		<u>2014</u>	<u>2013</u>
Cash	\$	2,249,932	\$ 2,882,225
Accounts receivable		205,352	21,551
Deferred tenant recoveries		3,427,209	3,428,453
Deferred tenant inducement		<u>137,507</u>	<u>154,695</u>
		6,020,000	6,486,924
Real estate	\$ 58,413,568		
Less accumulated amortization	<u>(11,736,125)</u>	<u>46,677,443</u>	<u>49,440,928</u>
Total assets		52,697,443	55,927,852
Less			
Accounts payable and accrued liabilities	471,336		
Government remittances payable	224,464		
Accrued interest	101,197		
Due to CFCF	1,091,087		
Long-term debt	<u>35,834,135</u>	<u>37,722,219</u>	<u>40,524,111</u>
Equity		<u>\$ 14,975,224</u>	<u>\$ 15,403,741</u>

Statement of Operations of QCC for the year ended March 31st is as follows:

		<u>2014</u>	<u>2013</u>
Rental revenue	\$	<u>9,234,967</u>	\$ 8,860,907
Expenses			
Amortization		2,763,485	2,763,486
Property taxes		1,651,491	1,584,315
Interest		1,483,074	1,575,431
Repairs and maintenance		1,173,592	1,169,412
Utilities		1,034,565	921,471
Management fees		645,526	640,110
Other operating costs		<u>911,751</u>	<u>658,701</u>
		<u>9,663,484</u>	<u>9,312,926</u>
Net loss	\$	<u>(428,517)</u>	\$ (452,019)

Cash flows of QCC for the year ended March 31st is as follows:

		<u>2014</u>	<u>2013</u>
Cash flows from operating activities	\$	2,284,632	\$ 2,260,417
Cash flows from financing activities		<u>(2,916,925)</u>	<u>(83,621)</u>
Increase (decrease) in cash	\$	<u>(632,293)</u>	\$ 2,176,796

CANADIAN FORCES CENTRAL FUND
NOTES TO THE FINANCIAL STATEMENTS - Cont'd.
YEAR ENDED MARCH 31, 2014

8. TRUST ASSETS

CFCF maintains trust assets on behalf of the following entities:

	<u>2014</u>	<u>2013</u>
Base funds, messes and others	\$ 98,682,953	\$ 94,922,787
CANEX	30,050,133	28,779,537
CFMWS	(10,941,285)	(13,530,317)
MFF	3,987,729	3,933,630
Regimental funds and alike	15,267,741	15,419,126
NPF Pension/Benefits	1,999,130	1,784,498
QCC	(1,091,087)	(2,813,924)
SISIP/CFPAF	<u>4,907,924</u>	<u>3,054,561</u>
	<u>\$ 142,863,238</u>	<u>\$ 131,549,898</u>

9. RE-INSURANCE GUARANTEE FEE

CFCF is contingently liable to a maximum of \$100 million as part of the SISIP re-insurance coverage for Canadian wartime efforts with the annual fee being calculated at 0.25% of the amount guaranteed. This fee has been recorded at its carrying amount which is the amount agreed to by the management of both organizations.

10. RELATED PARTY TRANSACTIONS

Non-Public Property (NPP), as defined under the National Defence Act, consists of money and property contributed by Canadian Forces members and is administered for their benefit by the Canadian Forces Morale and Welfare Services (CFMWS). The CFMWS is responsible for delivering selected morale and welfare programs, services and activities through two operational divisions, Personnel Support Programs and Commercial Services (CANEX and SISIP Financial Services).

Under the National Defence Act, NPP is explicitly excluded from the Financial Administration Act. The government provides some services to NPP such as accommodation and security for which no charge is made. The cost of providing these services is included in the Public Accounts and is reported annually within the Department of National Defence in accordance with the requirements of the Financial Administration Manual Chapter 1019-8.

NPP estimated revenues and expenses of approximately \$400 million and \$331 million for the year ended March 31, 2014, respectively, and net equity of \$685 million at March 31, 2014 are excluded from the financial statements of the Government of Canada.

During the year, there was a charge to CFCF by CFMWS in the amount of \$350,000 (2013 - \$350,000) for accounting services provided by CFMWS. These transactions are in the normal course of operations and are measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

CANADIAN FORCES CENTRAL FUND
NOTES TO THE FINANCIAL STATEMENTS - Cont'd.
YEAR ENDED MARCH 31, 2014

11. CFCF CONTRIBUTIONS

During the year, \$612,467 (2013 - \$771,700) was provided by CFCF to programs and distributions provided by CFMWS. CFCF also contributed \$5,803,037 (2013 - \$6,369,731) to Non-Public Fund (NPF) services and operations representing financial support provided for the NPF wide services of accounting, human resources management, information management and information technology and consolidated insurance programs as well as the corporate operating costs.

12. CONTINGENT LIABILITIES

CFCF is contingently liable for \$44,000 (2013 - \$34,000) for letters of credit supplied to various provincial liquor boards on behalf of unit messes.

CFCF, along with CANEX and SISIP, has also provided a letter of acknowledgement to the Bank of Montreal to fund any shortfall in the long-term debt payments to be made by QCC. At March 31, 2014, this long-term debt of QCC amounted to \$35,834,135 (see note 7).