

Financial Statements of

CANEX

31 March 2009

Auditors' Report

To the Non-Public Property Board

We have audited the balance sheet of CANEX as at 31 March 2009 and the statements of earnings and comprehensive income, accumulated other comprehensive income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of CANEX management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of CANEX as at 31 March 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte + Touche LLP

Chartered Accountants
Licensed Public Accountants

June 12, 2009

CANEX
Financial Statements
31 March 2009

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CANEX
Balance Sheet
as at 31 March 2009
(in 000's of Canadian dollars)

	<u>2009</u>	<u>2008</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 9,655	\$ 7,102
Due from Canadian Forces Central Fund (Note 4)	18,301	20,650
Accounts and accrued receivables	811	572
Inventory	18,394	17,133
Prepaid expenses	629	1,586
	47,790	47,043
PROPERTY AND EQUIPMENT (Note 5)	26,562	20,615
	\$ 74,352	\$ 67,658
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 8,822	\$ 8,873
Current portion of loans payable (Note 6)	1,854	1,960
	10,676	10,833
LOANS PAYABLE (Note 6)	9,240	9,555
	19,916	20,388
CONTINGENCIES (Note 11)		
EQUITY		
Contributed capital	23,280	23,280
Accumulated other comprehensive income	1,980	1,370
Retained earnings	29,176	22,620
	54,436	47,270
	\$ 74,352	\$ 67,658

Refer to the accompanying notes to the financial statements.

APPROVED BY

CANEX
Statement of Earnings and Comprehensive Income
year ended 31 March 2009
(in 000's of Canadian dollars)

	<u>2009</u>	<u>2008</u>
Sales	\$ 153,963	\$ 148,852
Cost of merchandise sold and services provided	<u>117,609</u>	<u>113,388</u>
Gross profit	36,354	35,464
Other revenue (Note 7)	<u>10,167</u>	<u>10,199</u>
	<u>46,521</u>	<u>45,663</u>
Operating expenses		
Payroll and benefits	19,580	18,317
Other operating expenses	11,994	11,272
Amortization of property and equipment	2,817	2,819
Interest on loans payable (Note 6)	453	478
Levies (Note 8)	365	338
	<u>35,209</u>	<u>33,224</u>
Earnings before royalties and contributions	11,312	12,439
Royalties and contributions (Note 10)	<u>(4,756)</u>	<u>(4,781)</u>
NET EARNINGS	6,556	7,658
Changes in unrealized gains and losses on translation of self-sustaining foreign operations	<u>610</u>	<u>1,312</u>
COMPREHENSIVE INCOME	<u>\$ 7,166</u>	<u>\$ 8,970</u>

Refer to the accompanying notes to the financial statements.

CANEX

Statement of Accumulated Other Comprehensive Income and Retained Earnings

year ended 31 March 2009
(in 000's of Canadian dollars)

	<u>2009</u>	<u>2008</u>
ACCUMULATED OTHER COMPREHENSIVE INCOME, BEGINNING OF YEAR	\$ 1,370	\$ 58
Changes in unrealized gains and losses on translation of self-sustaining foreign operations	610	1,312
ACCUMULATED OTHER COMPREHENSIVE INCOME, END OF YEAR	\$ 1,980	\$ 1,370
RETAINED EARNINGS, BEGINNING OF YEAR	\$ 22,620	\$ 14,962
NET EARNINGS	6,556	7,658
RETAINED EARNINGS, END OF YEAR	\$ 29,176	\$ 22,620

Refer to the accompanying notes to the financial statements.

CANEX
Statement of Cash Flows
year ended 31 March 2009
(in 000's of Canadian dollars)

	<u>2009</u>	<u>2008</u>
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings	\$ 6,556	\$ 7,658
Add items not affecting cash		
Amortization of property and equipment	2,817	2,819
Loss (gain) on disposal of property and equipment	(14)	9
	<u>9,359</u>	<u>10,486</u>
Net changes in non-cash operating working capital items (Note 13)	(1,890)	(7,195)
Cash provided by operating activities	<u>7,469</u>	<u>3,291</u>
INVESTING		
Purchase of property and equipment	(8,864)	(1,961)
Proceeds on disposal of property and equipment	38	7
Cash used for investing activities	<u>(8,826)</u>	<u>(1,954)</u>
FINANCING		
Issuance of loans payable	1,598	812
Repayment of loans payable	(2,019)	(1,948)
Cash used in financing activities	<u>(421)</u>	<u>(1,136)</u>
Effect of exchange rate on foreign currency translation adjustment	4,331	(753)
NET CASH INFLOW (OUTFLOW)	<u>2,553</u>	<u>(552)</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>7,102</u>	<u>7,654</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 9,655</u>	<u>\$ 7,102</u>
Cash and cash equivalents		
Cash	\$ 8,242	\$ 6,274
Short-term investments	1,413	828
	<u>\$ 9,655</u>	<u>\$ 7,102</u>
Refer to the accompanying notes to the financial statements.		
Supplemental cash flow information:		
Cash paid for interest on loans payable	\$ 453	\$ 478

CANEX

Notes to the Financial Statements

year ended 31 March 2009
(in 000's 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 Department of National Defence (DND) designed to contribute to the morale, well-being and efficiency of Canadian Forces personnel, 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 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."

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 being remote, rural, semi-urban or urban, with each classification having a specified level of DND Public Fund Support.

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 HQ. CANEX also operates an automotive sales transaction office in Germany under the name AMSTO.

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

CANEX

Notes to the Financial Statements

year ended 31 March 2009
(in 000's of Canadian dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). As a Non-Public Property (NPP) enterprise carrying on a business, the financial statements of CANEX are prepared on the same basis as a private sector business and include the following significant accounting policies:

Change in accounting policy

On 1 April 2008, CANEX adopted the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1535, *Capital Disclosures*, CICA Handbook Section 3862, *Financial Instruments - Disclosures*, and CICA Handbook Section 3863, *Financial Instruments - Presentation*. Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose is to enable users of the financial statements to evaluate CANEX's objectives, policies and processes for managing capital. Refer to Note 3 for CANEX's Capital Disclosures.

CICA Handbook Sections 3862 and 3863 replace CICA Handbook Section 3861, *Financial Instruments - Disclosure and Presentation* by revising and enhancing disclosure requirements while carrying forward presentation requirements unchanged. They also place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how CANEX manages those risks.

CANEX also adopted the requirements of CICA Handbook Section 3031 on Inventories which provides guidance on the determination of cost of inventories and its subsequent recognition as an expense, and includes additional disclosure requirements. The accounting policy, which was adopted as of 31 March 2008, was applied retroactively with no impact on the comparative financial statements.

Financial instruments

CANEX has made the following classifications:

- cash and cash equivalents are classified as financial assets held-for-trading and are measured at fair value;
- due from Canadian Forces Central Fund, accounts and accrued receivables are classified as loans and receivables and are recorded at amortized cost using the effective interest rate method;
- accounts payable and accrued liabilities and loans payable classified as other liabilities are measured at amortized cost using the effective interest rate method.

CANEX

Notes to the Financial Statements

year ended 31 March 2009
(in 000's of Canadian dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial presentation

These financial statements include the accounts of CANEX, NATEX and AMSTO. These entities are collectively referred to as CANEX for purposes of these financial statements. All significant transactions and balances between the various 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 Canadian Forces Central Fund (CFCF) (See Note 4). Concession and administration 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.

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%
POS system	17%
Fixtures and equipment	12%
Building improvements	9%

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

CANEX

Notes to the Financial Statements

year ended 31 March 2009
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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 in FY 2008/09 or FY 2007/08.

Foreign currency translation

CANEX's reporting currency and functional currency is the Canadian dollar. The functional currency of NATEX and AMSTO is the Euro. Transactions in currencies other than the functional currencies are converted to the functional currency at the exchange rate in effect at the time the transaction occurs. Monetary assets and liabilities, which are denominated in currencies other than the functional currency, are translated at year-end exchange rates.

NATEX and AMSTO are considered self-sustaining foreign operations. NATEX and AMSTO assets and liabilities have been translated into Canadian dollars at the rate of exchange prevailing at the balance sheet date. NATEX and AMSTO 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.

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 financial statements.

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 disclosures of contingent assets and liabilities as at the date of the 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 financial statements relate to inventory valuation, useful lives of property and equipment, pension plan and gas bar decommissioning costs.

CANEX
Notes to the Financial Statements
year ended 31 March 2009
(in 000's of Canadian dollars)

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 operates. 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 31 March 2009, CANEX has \$65,827 (FY2007/08 - \$58,785) 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. AMOUNTS DUE FROM CANADIAN FORCES CENTRAL FUND

The Canadian Forces Central Fund (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 CFCF is non-interest-bearing and due on demand with the exception of \$12,372 (FY 2007/2008 - \$11,988) bearing interest at a rate of prime plus 0.25% per annum and is due on demand.

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 CFCF for consideration at their fair value. All credit plan balances and other trade receivables and all trade payables are assumed by CFCF at fair value, with a 1% fee being 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.

CANEX
Notes to the Financial Statements
year ended 31 March 2009
(in 000's of Canadian dollars)

5. PROPERTY AND EQUIPMENT

	2009			2008
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Buildings	\$ 22,631	\$ 13,149	\$ 9,482	\$ 9,834
Motor vehicles and computer equipment	2,186	2,019	167	203
POS system	2,517	1,672	845	815
Fixtures and equipment	11,064	8,296	2,768	3,468
Building improvements	20,248	13,738	6,510	6,295
Construction in progress	6,790	-	6,790	-
	\$ 65,436	\$ 38,874	\$ 26,562	\$ 20,615

6. LOANS PAYABLE

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

FY 2009/10	\$ 1,854
FY 2010/11	1,477
FY 2011/12	1,224
FY 2012/13	1,034
FY 2013/14	899
Thereafter	4,606
	11,094
Less: Current portion	1,854
Long-term portion	\$ 9,240

7. OTHER REVENUE

Other revenue consists primarily of concession fees at Bases, Wings and Units across Canada and administration fees for the Home Heating Oil and Insurance programs. In addition, in FY 2008/09, \$682 of interest revenue was earned (FY 2007/08 - \$882) and is recorded in other revenue.

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Notes to the Financial Statements
year ended 31 March 2009
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8. LEVIES

Levies are paid to the Canadian Forces Personnel Assistance Fund at the rate of 0.15% of total sales. Levies on AMSTO revenue are paid to 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"). This Plan is a multi-employer, defined benefit pension plan, which provides retirement benefits relating to contributions and years of service. At December 31, 2008, the Plan was in a deficit position of \$17.5 million with an actuarial valuation to be completed as at December 31, 2009. In FY 2008/09 CANEX contributed \$940 (FY 2007/08 - \$878) to the Plan. Plan contributions are included in payroll and other benefits.

10. RELATED PARTY TRANSACTIONS

Royalties and contributions

In FY 2008/09, CANEX paid royalties of \$3,260 (FY 2007/08 - \$3,204) 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 FY 2008/09, NATEX contributed \$1,484 (FY 2007/08 - \$1,402) to the NATO Air Base. NATEX contributions are based on various percentages of consumer sales, in accordance with the NATEX contract.

In FY 2008/09, CANEX contributed \$2 to the Military Families Fund to support the morale and welfare of CF members and their families and \$10 to the Winnipeg Support Our Troops Lounge at the Winnipeg Airport.

In FY 2007/08, CANEX contributed \$125 to the Beechwood Cemetery and \$50 to the Montfort Hospital.

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Notes to the Financial Statements
year ended 31 March 2009
(in 000's of Canadian dollars)

10. RELATED PARTY TRANSACTIONS (Continued)

Department of National Defence

During FY 2008/09, DND contributed \$2,247 (FY 2007/08 - \$2,203) to CANEX in support of payroll costs and \$156 (FY 2007/08 - \$193) in support of travel, audit, and office expenses. All amounts received are recorded against the corresponding operating expense in the statement of earnings.

DND provides certain facilities, pays for, and provides other services on behalf of, and at no cost to CANEX. These services include payments 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 DND has not been determined and has not been recorded in the financial statements.

Canadian Forces Personnel and Family Support Services

The CFPFSS provides accounting, information technology, and human resources services to CANEX. These transactions are in the normal course of operations and are recorded in other operating expenses at the exchange amount of \$2,848 (FY 2007/08 - \$3,038). This is the amount of consideration established and agreed to by the related parties and represents management's best estimate of fair value.

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

Fair value

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

CANEX

Notes to the Financial Statements

year ended 31 March 2009
(in 000's of Canadian dollars)

12. FINANCIAL INSTRUMENTS (Continued)

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 31 March 2009, no financial instruments are past due or impaired (see Note 4).

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 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 include cash and cash equivalents which are invested at short-term interest rates and the Amounts Due from CFCF (see Note 4).

The loans payable bear interest at fixed rates. Consequently, the loans payable only have a fair value exposure and is not exposed to cash flow fluctuations (see 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 the other operating expenses is a foreign exchange loss of \$4 (FY 2007/08 - loss of \$41).

CANEX
Notes to the Financial Statements
year ended 31 March 2009
(in 000's of Canadian dollars)

12. FINANCIAL INSTRUMENTS (Continued)

Currency risk (Continued)

The carrying amount of CANEX's foreign currency denominated financial assets and financial liabilities as at 31 March 2009 is as follows:

	<u>Assets</u>		<u>Liabilities</u>	
	<u>2008/09</u>	<u>2007/08</u>	<u>2008/09</u>	<u>2007/08</u>
NATEX	\$ 16,502	\$ 8,528	\$ 1,417	\$ 5,164
AMSTO	13,274	5,398	5,462	1,518

If the foreign exchange rate for the Euro had been 10% higher/lower and all other variables were held constant, the change in CANEX's accumulated other comprehensive income for the year ended 31 March 2009 would have increased/decreased by \$2,289 (FY 07/08 - \$724) mainly due to the increase/decrease of the Euro exchange rate against the Canadian dollar.

13. NET CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

	<u>2009</u>	<u>2008</u>
Accounts and accrued receivables	\$ (69)	\$ 3,272
Inventory	(3,806)	2,357
Prepaid expenses	864	(440)
Due to and from CFCF	2,349	(9,619)
Accounts payable and accrued liabilities	1,228	(2,765)
	<u>\$ (1,890)</u>	<u>\$ (7,195)</u>

14. SEGMENTED INFORMATION

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

	<u>FY 2008/09</u>	<u>FY 2007/08</u>
Total assets	\$ 47,768	\$ 31,372
Sales and other revenue	39,836	37,948
Net earnings	1,424	1,646