

**FINANCIAL STATEMENTS**  
**For**  
**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**  
**For year ended**  
**DECEMBER 31, 2010**

**INDEPENDENT AUDITOR'S REPORT**

To the Chairperson and Members of the Employee Pension Plan Committee of:

**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**

We have audited the accompanying financial statements of the Canadian Forces Non-Public Funds Employees Pension Plan, which comprise the statement of net assets available for benefits and accrued pension benefits and deficit as at December 31, 2010 and the statement of changes in accrued pension benefits, the statement of changes in deficit and the statement of changes in net assets available for benefits for the year then ended, and a summary of significant accounting policies and other explanatory information.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, 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.

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

*Basis for Qualified Opinion*

Canadian generally accepted accounting principles require disclosure of sensitivity analysis for each type of market risk to which the Plan is exposed to at the financial statement date, showing how net assets available for benefits would have been affected by changes in the relevant risk variables that were reasonably possible at that date. The Plan has not provided this disclosure and in this respect, the financial statements are not in accordance with Canadian generally accepted accounting principles.

*Qualified Opinion*

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, the net assets available for benefits and accrued pension benefits and deficit of the Plan as at December 31, 2010 and the changes in the accrued pension benefits, deficit and net assets available for benefits for the year then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants  
Licensed Public Accountants

Ottawa, Ontario  
January 16, 2012.

**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**

**STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AND  
ACCRUED PENSION BENEFITS AND DEFICIT**

**DECEMBER 31, 2010**

	<u>2010</u>	<u>2009</u>
<b><u>NET ASSETS AVAILABLE FOR BENEFITS</u></b>		
Cash	\$ 114,968	\$ 918,573
Investments (note 4 and schedule A)	157,007,528	131,506,938
Due from Canadian Forces Central Fund (note 5)	1,986,798	1,539,060
Pension receivable (note 6)	<u>31,466</u>	<u>55,062</u>
	159,140,760	134,019,633
Less accounts payable and accrued liabilities	<u>254,106</u>	<u>499,154</u>
	<b><u>\$ 158,886,654</u></b>	<b><u>\$ 133,520,479</u></b>
 <b><u>ACCRUED PENSION BENEFITS AND DEFICIT</u></b>		
Actuarial value of accrued pension benefits (note 7)	\$ 170,679,000	\$ 140,778,000
Deficit (note 7)	<u>(11,792,346)</u>	<u>(7,257,521)</u>
Net assets available for benefits	<b><u>\$ 158,886,654</u></b>	<b><u>\$ 133,520,479</u></b>

Signed:

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(See accompanying notes)

**Welch LLP**

An Independent Member of BKR International

**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**  
**STATEMENT OF CHANGES IN ACCRUED PENSION BENEFITS**  
**YEAR ENDED DECEMBER 31, 2010**

	<u>2010</u>	<u>2009</u>
<b>INCREASE IN BENEFITS</b>		
Interest accrued on benefits	\$ 8,930,641	\$ 6,322,868
Benefits accrued	12,210,847	12,914,941
Adjustment to valuation of accrued pension benefits	<u>16,745,860</u>	<u>-</u>
Increase in accrued benefits	37,887,348	19,237,809
 <b>DECREASE IN ACCRUED BENEFITS</b>		
Annuity payments and refunds	<u>7,986,348</u>	<u>7,917,809</u>
 <b>NET INCREASE IN ACCRUED PENSION BENEFITS</b>	29,901,000	11,320,000
 <b>ACCRUED PENSION BENEFITS AT BEGINNING OF YEAR</b>	<u>140,778,000</u>	<u>129,458,000</u>
 <b>ACCRUED PENSION BENEFITS AT END OF YEAR</b>	<u>\$ 170,679,000</u>	<u>\$ 140,778,000</u>

(See accompanying notes)

**Welch** LLP

An Independent Member of BKR International

**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**

**STATEMENT OF CHANGES IN DEFICIT**

**YEAR ENDED DECEMBER 31, 2010**

	<u>2010</u>	<u>2009</u>
Deficit of net assets available for benefits versus accrued benefits at beginning of year	\$ (7,257,521)	\$ (17,534,426)
Net increase in net assets available for benefits	25,366,175	21,596,905
Net increase in accrued pension benefits	<u>(29,901,000)</u>	<u>(11,320,000)</u>
Deficit of net assets available for benefits versus accrued benefits at end of year	<u>\$ (11,792,346)</u>	<u>\$ (7,257,521)</u>

(See accompanying notes)

**Welch** LLP

An Independent Member of BKR International

**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**  
**STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS**  
**YEAR ENDED DECEMBER 31, 2010**

	<u>2010</u>	<u>2009</u>
<b>INCREASE IN ASSETS</b>		
Contributions - employer	\$ 14,223,830	\$ 8,840,887
- employee	<u>4,478,355</u>	<u>4,214,616</u>
	18,702,185	13,055,503
Realized gain - equities	2,503,942	444,091
Current period increase in market value of investments	10,828,351	15,568,606
Dividend income	1,517,816	1,363,159
Interest earned on investments	<u>67,403</u>	<u>191,169</u>
Total increase in assets	<u>33,619,697</u>	<u>30,622,528</u>
<b>DECREASE IN ASSETS</b>		
Withdrawals		
Annuity payments	4,712,488	4,448,561
Refunds	<u>3,273,860</u>	<u>3,469,248</u>
	7,986,348	7,917,809
Operating expenses		
Pension administration and professional fees (note 2)	-	813,449
Investment management fees	266,434	246,268
Miscellaneous	<u>740</u>	<u>48,097</u>
	267,174	1,107,814
Total decrease in assets	<u>(8,253,522)</u>	<u>(9,025,623)</u>
<b>INCREASE IN NET ASSETS</b>	25,366,175	21,596,905
<b>NET ASSETS AVAILABLE FOR BENEFITS AT BEGINNING OF YEAR</b>	<u>133,520,479</u>	<u>111,923,574</u>
<b>NET ASSETS AVAILABLE FOR BENEFITS AT END OF YEAR</b>	<u>\$ 158,886,654</u>	<u>\$ 133,520,479</u>

(See accompanying notes)

**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**YEAR ENDED DECEMBER 31, 2010**

**1. DESCRIPTION OF PENSION PLAN**

The Canadian Forces Non-Public Funds Employees Pension Plan (the "Plan") became effective January 1, 1969 and was established under the provisions of Section 38 of the National Defence Act to account for the accumulation of employee deductions and employer contributions from participating bases, the transfer of such funds to the custodian for investment purposes and the recording of fund assets and liabilities. The Plan's trustee is Manulife Financial, its fund manager is Standard Life and its actuary is Mercer (Canada) Limited. The Plan's registration number with the Office of the Superintendent of Financial Institutions ("OSFI") is 55228.

The Plan is a registered pension plan as defined in the Income Tax Act and as such, is not subject to income taxes. The Plan's registration number for income tax purposes is 0277954.

The following description of the Plan is a summary only. For more information, reference should be made to the Plan text.

**a) General**

The Plan is a contributory defined benefit plan integrated with the Canada/Quebec Pension Plan and registered under the Pension Benefits Standards Act of Canada. Plan membership is compulsory from the date of hire for all full-time employees over 18 years of age. Part-time employees may join the Plan after two consecutive calendar years with earnings in excess of 35% of the Year's Maximum Pensionable Earnings.

**b) Funding policy**

The Plan is funded by the plan members (employees) and the sponsor (employer).

The employee contributes 4.5% of earnings which are not in excess of the Canada/Quebec Pension Plan Year's Maximum Pensionable Earnings ("YMPE") and 6% of the member's annualized earnings in excess of the YMPE. Members cease making contributions when they reach 35 years of service.

The employer contributes actuarially recommended amounts sufficient to satisfy any experience deficiency and provide pension benefits accruing to plan members during the current year. The most recent actuarial valuation of the Plan was as at December 31, 2010.

**c) Service pension**

Employees meeting eligibility conditions are entitled to annual pension benefits beginning at age 65 for service on or after January 1, 1997 equal to 1.5% of the employees' average pensionable earnings up to the average YMPE plus 2% of the employees' average pensionable earnings above the average YMPE times the number of years of pensionable service since January 1, 1997 plus, for service before January 1, 1997, the greater of:

- a) 40% of the employees' total required contributions before January 1, 1997;
- b) 1.5% of the employees' average pensionable earnings up to the average YMPE plus 2% of the employees' average pensionable earnings above the average YMPE times the years of pensionable service before January 1, 1997; or
- c) 1.8% of the employees' average pensionable earnings for 1994, 1995 and 1996 up to \$34,900 plus 2.4% of the employees' average pensionable earnings for 1994, 1995 and 1996 above \$34,900 but below \$52,350 plus 2% of the employees' average pensionable earnings for 1994, 1995 and 1996 above \$52,350 times the number of years of pensionable service before January 1, 1997.



**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**

**NOTES TO THE FINANCIAL STATEMENTS - Cont'd.**

**YEAR ENDED DECEMBER 31, 2010**

**1. DESCRIPTION OF PENSION PLAN - Cont'd.**

**c) Service pension - Cont'd.**

Employees with less than three years of pensionable service are only eligible for the greater of a) or b) for their service prior to January 1, 1997. Pensions in payment have been indexed on an adhoc basis at a rate of 75% of the consumer price index. The most recent adjustment was effective September 1, 2007.

Pensionable earnings means base salary and wages including overtime and performance pay, but excluding bonuses or other special remuneration. Average pensionable earnings mean the employee's average earnings as a plan member during the three highest-paid consecutive years of pensionable service in the ten years before the retirement date. If the employee has less than three years of pensionable service, then the actual average of earnings received will be used.

Employees who have ten or more years of pensionable service may retire at age 60 and receive an immediate unreduced pension. Employees who are age 50 with ten or more years of pensionable service may elect to retire early and receive a pension reduced by 0.25% for each month that the actual retirement date precedes their 60th birthday. Employees who are age 55 with less than ten years of pensionable service may elect to retire early and receive a pension reduced by 0.25% for each month that the actual retirement date precedes their 65th birthday.

The Chief Executive Officer approved an initiative to give the Canadian Forces Non-Public Funds full-time and part-time employees the opportunity to buy-back pensionable services during the previously imposed mandatory or the voluntary waiting periods. The pension buy-back commenced in year 2004. For the previously imposed mandatory periods, the buy-back cost is shared between the employee and the employer and for the voluntary waiting periods, the employee is fully responsible for the cost.

**d) Bridge benefits**

An employee who retires early from active service and who satisfies the eligibility requirements as follows:

- a) has attained age 55 at retirement,
- b) must have completed at least five years of pensionable services at retirement, and
- c) the sum of the employees' age and completed years of pensionable service at retirement must be equal to at least sixty-five,

is entitled to also receive an annual bridge benefit payable in equal monthly instalments in an amount equal to \$15 per month for each completed year of pensionable service, to a maximum of 20 years. Such bridge benefit is payable from the date that the early retirement pension commences and ceases with the payment immediately preceding or coinciding with the earlier of the employee's normal retirement date or the date of death.

**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**

**NOTES TO THE FINANCIAL STATEMENTS - Cont'd.**

**YEAR ENDED DECEMBER 31, 2010**

**1. DESCRIPTION OF PENSION PLAN - Cont'd.**

**e) Death benefits**

The normal form of pension provides for monthly payments for life of retired members with 180 payments guaranteed. Should the employee die before receiving the guaranteed 180 monthly payments, the remainder will continue to be paid to the beneficiary. If the employee has a spouse at retirement, the automatic option provides that a joint pension in an amount that is the actuarial equivalent of the normal form is payable throughout the joint lifetime of the employee and spouse, reducing to 60% on the death of the employee. An employee may elect a joint and survivor pension which provides for a benefit of 100% to the surviving spouse after death. In the event the normal form is not the form payable, the benefit payable will be the actuarial equivalent of the normal form, which cannot exceed the amount payable under the normal form.

The surviving spouse, or if there is no surviving spouse, the beneficiary of a plan member who dies with less than two year's service receives a refund of the member's contribution with interest.

If death occurs two or more years after Plan membership, the surviving spouse will be entitled to elect among the following alternatives: transfer to a locked-in RRSP, transfer to a registered pension plan or purchase an immediate life annuity or a deferred life annuity.

Where there is no surviving spouse, the beneficiary is entitled to the transfer value of the guaranteed monthly pension payments in a lump sum as if the member had actually retired on the day prior to the member's death and had elected the normal type of pension payable. The transfer value of the guaranteed monthly pension payments shall not be less than the member's required contributions with interest.

**f) Termination benefits**

An employee with less than two year's Plan membership is entitled to a refund of employee contributions plus interest on termination. After two years of Plan membership, the employee is entitled upon termination to a deferred pension under the Plan and depending on the circumstances may transfer the lump sum value of the employees' pension to a locked-in RRSP, purchase a deferred life annuity or transfer to a new employer's pension plan.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**a) *Basis of presentation***

These financial statements present the aggregate financial position of the Plan as a separate financial reporting entity independent of the sponsors and plan members. The financial statements are prepared to assist plan members and others in reviewing the activities of the Plan for the fiscal period.

**b) *Investments***

Investments are recorded as of the trade date and are carried at fair or market value with this value being the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable willing parties.

## CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN

### NOTES TO THE FINANCIAL STATEMENTS - Cont'd.

YEAR ENDED DECEMBER 31, 2010

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Cont'd.

c) Pension administration and professional fees

During the 2010 fiscal year-end, management decided pension administration costs and professional fees would be accounted for as employee benefits in the year-end financial statements of the Canadian Forces Personnel and Family Support Services.

d) *Use of estimates*

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of current period change in the fair value of investments. Actual results could differ from such estimates and assumptions.

#### 3. FINANCIAL INSTRUMENTS

The Plan's financial instruments consist of cash, investments, due from Canadian Forces Central Fund, pension receivable and accounts payable and accrued liabilities. The Plan's investments consist predominantly of assets whose values are exposed to fluctuations in interest rates, foreign exchange rates and financial markets. Other financial instruments are not exposed to significant interest, currency or credit risks.

*Interest rate risk*

Interest rate risk refers to the impact of interest rate changes on the Plan's investments. Interest rate changes directly impact the fair value of the Plan's bonds and short-term notes. The Plan employs investment diversification to manage this risk.

*Foreign currency risk*

Foreign currency risk is the risk that the value of a foreign currency denominated investment will fluctuate due to changes in foreign exchange rates. The Plan employs investment diversification to manage this risk.

*Market risk*

Market risk is the risk that the fair value of an investment will fluctuate as a result of change in market price. Again, the Plan employs investment diversification to minimize this risk.

*Credit risk*

The Plan has extended credit to certain members for pension buy-backs from 2004 and 2005. The risk associated with these receivables defaulting is minimal as the amounts are being repaid monthly.

#### 4. PENSION INVESTMENTS

Pension investments, administered by an independent trustee, are valued at market, representing the value at the statement date which could be realized in the event that such investments were converted to cash. The net unrealized market gain or loss is reflected in the statement of changes in net assets available for benefits.

**CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN**

**NOTES TO THE FINANCIAL STATEMENTS - Cont'd.**

**YEAR ENDED DECEMBER 31, 2010**

**5. DUE FROM CANADIAN FORCES CENTRAL FUND (CFCF)**

The amount due from CFCF of \$1,986,798 (2010 - \$1,539,060) represents amounts held in trust. CFCF operates under the authority of the Chief of the Defence staff in his Non-Public Property (NPP) capacity. Responsibility for directing the affairs of CFCF rests with the Non-Public Property Board.

**6. PENSION RECEIVABLE**

The pension receivable consists of the remaining 2004 and 2005 pension buy-back instalments owing from employees that will be fully repaid over the next couple of years.

**7. ACTUARIAL VALUE OF ACCRUED PENSION BENEFITS**

Accrued pension benefits is the actuarially determined present value amount required to satisfy all future pension obligations for active and retired plan members at the statement date. An actuarial valuation of the Plan was made as at December 31, 2010 by Mercer (Canada) Limited, the Plan's actuaries.

The significant assumptions used are:

- life expectancy of participants as per the 1994 Uninsured Pensioners Mortality Table;
- 5.5% interest rate; and
- 3.5% salary escalation rate.

The purpose of the aforementioned actuarial valuation is to determine the value of the Accrued Pension Benefits as at December 31, 2010 for financial statement purposes. Based on the year-end valuation of the Accrued Pension Benefits in the amount of \$170,679,000, the Plan is in a deficit position at December 31, 2010 of \$11,792,346. In addition, the Plan was also actuarially valued at December 31, 2010 on a going concern basis as well as on the solvency basis.

Under the going concern basis, this valuation compares the relationship between the value of the Plan's assets and the present value of the expected future benefit cash flows in respect of accrued service, assuming the Plan will be maintained indefinitely. Under this scenario, the valuation resulted in a deficit of \$26.02 million.

Conversely, under the hypothetical solvency (or wind-up) basis, the Plan is assumed to be wound up and settled on the valuation date, assuming benefits are settled in accordance with the existing taxation rules and under circumstances producing the maximum wind-up liabilities on the valuation date. This valuation resulted in a deficit of \$28.21 million.

These valuations are utilized to assess monthly and annual employer contributions. The Plan is required to have its next actuarial valuation performed as at December 31, 2011.

## CANADIAN FORCES NON-PUBLIC FUNDS EMPLOYEES PENSION PLAN

## INVESTMENTS

DECEMBER 31, 2010

	2010		2009	
	Market	Acquisition Cost	Market	Acquisition Cost
<b>EQUITIES</b>				
Canadian stocks	\$ 59,212,161	\$ 46,706,912	\$ 47,929,885	\$ 40,875,896
US stocks	530,704	296,584	-	-
Indexed US equity fund	27,215,753	27,029,188	22,492,497	24,853,978
Indexed EAFA fund	13,736,478	11,258,325	13,404,625	11,258,325
	<u>100,695,096</u>	<u>85,291,009</u>	<u>83,827,007</u>	<u>76,988,199</u>
<b>BONDS</b>				
Bond index fund	37,943,981	28,726,750	34,124,803	26,269,073
Government of Canada and provincial bonds	13,526,712	9,652,381	12,618,807	9,652,381
	<u>51,470,693</u>	<u>38,379,131</u>	<u>46,743,610</u>	<u>35,921,454</u>
<b>SHORT-TERM NOTES</b>	4,691,542	4,691,542	799,520	799,520
<b>ACCRUED INVESTMENT INCOME</b>	150,197	150,197	136,801	136,801
	<u>4,841,739</u>	<u>4,841,739</u>	<u>936,321</u>	<u>936,321</u>
<b>TOTAL INVESTMENTS</b>	<u>\$ 157,007,528</u>	<u>\$ 128,511,879</u>	<u>\$ 131,506,938</u>	<u>\$ 113,845,974</u>