

Financial Statements of

CANEX

31 March 2008

Auditors' Report

To the Non-Public Property Board

We have audited the balance sheet of CANEX as at 31 March 2008 and the statements of earnings and comprehensive income, accumulated other comprehensive income and retained earnings and of 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 2008 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 24, 2008

CANEX
Financial Statements
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CANEX

Balance Sheet

as at 31 March 2008

(in 000's of Canadian dollars)

	<u>31 March 2008</u>	<u>1 April 2007</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 7,102	\$ 7,654
Due from Canadian Forces Central Fund (Note 3)	20,650	11,031
Accounts and accrued receivables	572	3,478
Inventory	17,133	16,162
Prepaid expenses	1,586	1,062
	47,043	39,387
PROPERTY AND EQUIPMENT (Note 4)	20,615	21,415
	\$ 67,658	\$ 60,802
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 8,873	\$ 9,851
Current portion of loans payable (Note 5)	1,960	1,979
	10,833	11,830
LOANS PAYABLE (Note 5)	9,555	10,672
	20,388	22,502
CONTINGENCIES (Notes 8 and 11)		
EQUITY		
Contributed capital	23,280	23,280
Accumulated other comprehensive income	1,370	58
Retained earnings	22,620	14,962
	47,270	38,300
	\$ 67,658	\$ 60,802

Refer to the accompanying notes to the financial statements

APPROVED BY

CANEX
Statement of Earnings and Comprehensive Income
year ended 31 March 2008
(in 000's of Canadian dollars)

	31 March 2008	1 April 2007
Sales	\$ 148,852	\$ 140,773
Cost of merchandise sold and services provided	113,388	106,904
Gross profit	35,464	33,869
Other revenue (Note 6)	10,199	10,175
	45,663	44,044
Operating expenses		
Payroll and benefits	18,317	18,788
Other operating expenses	11,272	11,646
Amortization of property and equipment	2,819	2,819
Interest on loans payable (Note 5)	478	500
Levies (Note 7)	338	344
	33,224	34,097
Earnings before royalties and contributions	12,439	9,947
Royalties and contributions (Note 10)	(4,781)	(6,255)
NET EARNINGS	7,658	3,692
Changes in unrealized gains and losses on translation of self-sustaining foreign operations	1,312	1,822
COMPREHENSIVE INCOME	\$ 8,970	\$ 5,514

Refer to the accompanying notes to the financial statements

CANEX

Statement of Accumulated Other Comprehensive Income and Retained Earnings

year ended 31 March 2008

(in 000's of Canadian dollars)

	<u>31 March 2008</u>	<u>1 April 2007</u>
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), BEGINNING OF YEAR	\$ 58	(1,764)
Changes in unrealized gains and losses on translation of self-sustaining foreign operations	<u>1,312</u>	<u>1,822</u>
ACCUMULATED OTHER COMPREHENSIVE INCOME, END OF YEAR	\$ 1,370	\$ 58
RETAINED EARNINGS, BEGINNING OF YEAR	\$ 14,962	\$ 11,270
NET EARNINGS	<u>7,658</u>	<u>3,692</u>
RETAINED EARNINGS, END OF YEAR	\$ 22,620	\$ 14,962

Refer to the accompanying notes to the financial statements

CANEX

Statement of Cash Flows

year ended 31 March 2008

(in 000's of Canadian dollars)

	31 March 2008	1 April 2007
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings	\$ 7,658	\$ 3,692
Add items not affecting cash		
Amortization of property and equipment	2,819	2,819
Loss on disposal of property and equipment	9	79
	10,486	6,590
Net changes in non-cash operating working capital items (Note 13)	(7,195)	(3,519)
Cash provided by operating activities	3,291	3,071
INVESTING		
Purchase of property and equipment	(1,961)	(3,190)
Proceeds on disposal of property and equipment	7	23
Cash used for investing activities	(1,954)	(3,167)
FINANCING		
Issuance of loans payable	812	1,500
Repayment of loans payable	(1,948)	(1,907)
Cash used in financing activities	(1,136)	(407)
Effect of exchange rate on foreign currency translation adjustment	(753)	2,941
NET CASH INFLOW (OUTFLOW)	(552)	2,438
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	7,654	5,216
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 7,102	\$ 7,654
Refer to the accompanying notes to the financial statements		
Supplemental cash flow information:		
Cash paid for interest on loans payable	\$ 478	\$ 500

CANEX
Notes to the Financial Statements
year ended 31 March 2008
(in 000's of Canadian dollars)

1. BASIS OF ORGANIZATION

The Canadian Forces Exchange System (CANEX) is a Division of the Canadian Forces Personnel Support Agency (CFPSA), 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.

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Notes to the Financial Statements

year ended 31 March 2008

(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. 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:

Financial instruments

In its position as an unincorporated Crown NPP entity effective 2 April 2007, CANEX adopted the following sections:

- a) Section 3855, *Financial Instruments - Recognition and Measurement*. This Section describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial statements. Under the new standard, financial assets and liabilities are initially recorded at fair value. Subsequently, financial instruments classified as financial assets or liabilities held-for-trading, financial assets available-for-sale and derivative financial instruments, part of a hedging relationship or not, have to be measured at fair value on the balance sheet at each reporting date, whereas other financial instruments are measured at amortized cost using the effective interest rate method.
- b) Section 1530, *Comprehensive Income*. This Section describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income is the change in equity, which results from transactions and other events. These transactions and events include unrealized gains and losses resulting from changes in fair value of investments classified as available-for-sale and from foreign currency translation of self-sustaining foreign subsidiaries.
- c) Section 3861, *Financial instruments - Disclosure and Presentation*. This Section establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them.
- d) Section 3251, *Equity*. This Section establishes standards for the presentation of equity and changes in equity during the reporting period.

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.

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Notes to the Financial Statements
year ended 31 March 2008
(in 000's of Canadian dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial instruments (Continued)

These new standards were applied retrospectively as at 2 April 2007 without restatement of prior year figures other than reclassifying the foreign currency translation adjustment to accumulated other comprehensive income.

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 3). 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 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%

CANEX
Notes to the Financial Statements
year ended 31 March 2008
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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 2007/08 or FY 2006/07.

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 generally accepted accounting principles 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 2008
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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Future accounting changes

a) Inventories

In June 2007, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3031, *Inventories*, replacing Section 3030, *Inventories*. The new Section will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2008. Accordingly, CANEX will adopt the new standards for its fiscal year beginning April 1, 2008. It provides more guidance on the measurement and disclosure requirements for inventories. CANEX is currently evaluating the impact of the adoption of this new Section on its financial statements.

b) Financial instruments

In December 2006, the CICA issued Section 3862, Financial Instruments - Disclosures; Section 3863, Financial Instruments - Presentation; and Section 1535, Capital Disclosures. All three Sections will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2007. Accordingly, CANEX will adopt the new standards for its fiscal year beginning April 1, 2008. Section 3862 on financial instruments disclosures, requires the disclosure of information about: a) the significance of financial instruments for the entity's financial position and performance and b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 on the presentation of financial instruments is unchanged from the presentation requirements included in Section 3861. Section 1535 on capital disclosures requires the disclosure of information about an entity's objectives, policies and processes for managing capital. CANEX is currently evaluating the impact of the adoption of these new Sections on its financial statements.

3. 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 to or from CFCF is non-interest-bearing and due on demand with the exception of \$11,988 (FY 2006/2007 - \$8,125) bearing interest at a rate of prime plus 0.25% per annum and due on demand.

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Notes to the Financial Statements

year ended 31 March 2008

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3. AMOUNTS DUE FROM CANADIAN FORCES CENTRAL FUND (Continued)

At the conclusion of fiscal 2007/08 and previously at the conclusion of fiscal 2006/07, CFCF assumed 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 were assumed by CFCF for consideration at their fair value. On a go-forward basis, all credit plan balances and other trade receivables and all trade payables will be assumed by CFCF at fair value, with a 1% fee being charged to CANEX by the CFCF for credit losses on the net 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.

4. PROPERTY AND EQUIPMENT

	31 March 2008			1 April 2007
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Buildings	\$ 22,226	\$ 12,392	\$ 9,834	\$ 10,184
Motor vehicles and computer equipment	2,164	1,961	203	362
POS system	2,214	1,399	815	959
Fixtures and equipment	11,171	7,703	3,468	3,451
Building improvements	18,867	12,572	6,295	6,459
	\$ 56,642	\$ 36,027	\$ 20,615	\$ 21,415

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Notes to the Financial Statements
year ended 31 March 2008
(in 000's of Canadian dollars)

5. LOANS PAYABLE

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

FY 2008/2009	\$ 1,975
FY 2009/2010	1,713
FY 2010/2011	1,341
FY 2011/2012	1,082
FY 2012/2013	896
Thereafter	<u>4,508</u>
	11,515
Less: Current portion	<u>1,960</u>
Long-term portion	<u>\$ 9,555</u>

6. 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 2007/08, \$882 of interest revenue was earned (FY 2006/07 - \$753) and is recorded in other revenue.

7. 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.

8. GAS BAR DECOMMISSIONING COSTS

CANEX continues to work closely with Shell Canada Products Limited and DND on the decommissioning of former CANEX gas bars and the remediation of contaminated sites. During FY 2007/08 and FY 2006/07, CANEX incurred no additional costs related to the decommissioning efforts. Total closure and remediation costs incurred to date by CANEX are \$3,700. The ultimate cost of this decommissioning cannot be determined at this time. A reserve of \$97 (FY 2007/08 - \$100) is included in accounts payable and accrued liabilities. The estimate for FY 2007/08 represents management's best estimate of CANEX's known future liability relating to this matter. No new significant provision for known or probable site restoration costs for current gas bar operations have been recorded as of 31 March 2008.

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Notes to the Financial Statements
year ended 31 March 2008
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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. Based on the actuarial valuation dated 31 December 2006, the net assets of the Plan exceeded the net liabilities; therefore, due to the position of the Plan, contributions were reduced. In FY 2007/08 CANEX contributed \$878 (FY 2006/07 - \$1,571) to the Plan. Plan contributions are included in payroll and other benefits.

10. RELATED PARTY TRANSACTIONS

Royalties and contributions

In FY 2007/08, CANEX paid royalties of \$3,204 (FY 2006/07 - \$3,263) 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 2007/08, NATEX contributed \$1,402 (FY 2006/07 - \$1,492) to the NATO Air Base. NATEX contributions are based on various percentages of consumer sales, in accordance with the NATEX contract.

During FY 2006/2007, CANEX contributed \$1,000 to the Canadian Forces Bases, Wings and Units from profits generated from the Support Our Troops Campaign, and an additional \$500 in FY 2006/2007 was contributed to the Military Families Fund to support the morale and welfare of CF members and their families. In FY 2007/08, CANEX contributed \$125 to the Beechwood Cemetery and \$50 to the Montfort Hospital.

Department of National Defence

During FY 2007/08, DND contributed \$2,203 (FY 2006/07 - \$2,111) to CANEX in support of payroll costs and \$193 (FY 2006/07 - \$183) 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.

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Notes to the Financial Statements
year ended 31 March 2008
(in 000's of Canadian dollars)

10. RELATED PARTY TRANSACTIONS (Continued)

Canadian Forces Personnel Support Agency

The CFPSA 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 \$3,038 (FY 2006/07 - \$2,795). 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, 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.

Credit risk

CANEX provides credit to its customers through its credit plan. CANEX has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks (see Note 3).

Currency risk

CANEX earns certain revenue and incurs certain expenses in currencies other than its functional currencies (Canadian dollar and Euro) and is therefore subject to foreign currency risk. Included in the other operating expenses is a foreign exchange loss of \$41 (FY 2006/07 - gain of \$189).

CANEX
Notes to the Financial Statements
year ended 31 March 2008
(in 000's of Canadian dollars)

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

	<u>2008</u>	<u>2007</u>
Accounts and accrued receivables	\$ 3,272	\$ 17,497
Inventory	2,357	313
Prepaid expenses	(440)	601
Due to and from CFCF	(9,619)	(16,932)
Accounts payable and accrued liabilities	(2,765)	(4,998)
	<u>\$ (7,195)</u>	<u>\$ (3,519)</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 2007/08</u>	<u>FY 2006/07</u>
Total assets	\$ 31,372	\$ 28,897
Sales and other revenue	37,948	39,912
Net earnings	1,646	670