

CANEX

Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)



Independent auditor's report

To the Non-Public Property Board

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Canadian Forces Exchange System (CANEX) (the Entity) as at March 31, 2019 and the results of its operations and its cash flows for the year then ended in accordance with Canadian Accounting Standards for Private Enterprises (ASPE).

What we have audited

The Entity's consolidated financial statements comprise:

- the consolidated balance sheet as at March 31, 2019;
- the consolidated statement of operations for the year then ended;
- the consolidated statement of retained earnings for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

Independence

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

PricewaterhouseCoopers LLP
99 Bank Street, Suite 710, Ottawa, Ontario, Canada K1P 1E4
T: +1 613 237 3702, F: +1 613 237 3963

"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.



Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with ASPE, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.



- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Entity to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants

Ottawa, Ontario
November 25, 2019

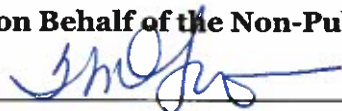
CANEX

Consolidated Balance Sheet For the year ended March 31, 2019

(in thousands of Canadian dollars)

	2019 \$	2018 \$
Assets		
Current assets		
Cash	5,933	4,967
Due from Canadian Forces Central Fund (note 7)	11,817	26,310
Account and accrued receivables	790	471
Inventory	27,499	22,271
Prepaid expenses	747	208
	<u>46,786</u>	<u>54,227</u>
Property and equipment (notes 3, 9 and 10)	<u>42,721</u>	<u>41,786</u>
	<u>89,507</u>	<u>96,013</u>
Liabilities and Equity		
Current liabilities		
Accounts payable and accrued liabilities	4,630	4,473
Current portion of loans payable to Canadian Forces Central Fund (note 4)	<u>2,684</u>	<u>2,546</u>
	7,314	7,019
Asset retirement obligation (note 10)	880	717
Loans payable to Canadian Forces Central Fund (note 4)	<u>37,573</u>	<u>33,973</u>
	<u>45,767</u>	<u>41,709</u>
Equity		
Contributed capital	23,280	23,280
Cumulative translation adjustment	(1,392)	1,528
Retained earnings	<u>21,852</u>	<u>29,496</u>
	<u>43,740</u>	<u>54,304</u>
	<u>89,507</u>	<u>96,013</u>
Commitments and contingencies (notes 8 and 9)		

Approved on Behalf of the Non-Public Property Board



Shirley Tang- Jassemi, Chief Financial Officer

The accompanying notes are an integral part of these consolidated financial statements.

CANEX

Consolidated Statement of Retained Earnings For the year ended March 31, 2019

(in thousands of Canadian dollars)

	2019	2018
	\$	\$
Retained earnings – Beginning of year	29,496	32,197
Net loss for the year	<u>(7,644)</u>	<u>(2,701)</u>
Retained earnings – End of year	<u>21,852</u>	<u>29,496</u>

The accompanying notes are an integral part of these consolidated financial statements.

CANEX

Consolidated Statement of Operations For the year ended March 31, 2019

(in thousands of Canadian dollars)

	2019	2018
	\$	\$
Sales	130,038	129,776
Cost of merchandise sold	104,724	100,548
Gross profit	25,314	29,228
Other revenue (notes 5 and 7)	11,476	11,325
	<u>36,790</u>	<u>40,553</u>
Expenses		
Payroll and benefits (note 6)	20,525	20,503
Other operating expenses (note 7)	13,656	13,450
Amortization of property and equipment (note 10)	4,902	4,117
Interest on loans payable to Canadian Forces Central Fund (note 4)	1,649	1,469
	<u>40,732</u>	<u>39,539</u>
Earnings (loss) before royalties and contributions	(3,942)	1,014
Royalties and contributions (note 7)	(3,702)	(3,715)
Net loss for the year	<u>(7,644)</u>	<u>(2,701)</u>

The accompanying notes are an integral part of these consolidated financial statements.

CANEX

Consolidated Statement of Cash Flows For the year ended March 31, 2019

(in thousands of Canadian dollars)

	2019 \$	2018 \$
Cash provided by (used in)		
Operating activities		
Net loss for the year	(7,644)	(2,701)
Items not affecting cash		
Amortization of property and equipment	4,902	4,117
Loss on disposal of property and equipment	3	168
	(2,739)	1,584
Net change in non-cash working capital items (note 12)	8,826	1,866
	6,087	3,450
Investing activities		
Purchase of property and equipment	(5,743)	(19,875)
Proceeds on disposal of property and equipment	8	4
	(5,735)	(19,871)
Financing activities		
Proceeds from the issuance of loans payable to Canadian Forces Central Fund	6,469	19,467
Repayment of loans payable to Canadian Forces Central Fund	(2,730)	(6,553)
	3,739	12,914
Effect of foreign exchange rate on cash	(3,125)	3,135
Net change in cash for the year	966	(372)
Cash – Beginning of year	4,967	5,339
Cash – End of year	5,933	4,967
Supplementary non-cash information		
Non-cash additions to property and equipment	(163)	(13)
Non-cash additions to asset retirement obligation	163	13

The accompanying notes are an integral part of these consolidated financial statements.

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

1 Basis of organization

CANEX is a commercial activity of Canadian Forces Morale and Welfare Services (CFMWS) operating under the authority of the Chief of the Defence Staff (CDS) in his Non-Public Property (NPP) capacity.

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 North Atlantic Treaty Organization Air Base at Geilenkirchen (NATO Air Base) under the name NATEX, in accordance with the concession contract (NATEX contract) between CANEX and the NAEWF E-3A Component headquarters. CANEX also operates an automotive sales transaction office in Germany under the name AMSTO.

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

2 Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian accounting standards for private enterprises.

Principles of consolidation

These consolidated financial statements include the accounts of CANEX and its controlled subsidiaries, NATEX and AMSTO (collectively, CANEX or the Organization). All significant transactions and balances between these entities have been eliminated.

Cash equivalents

Short-term investments, with original terms and maturity of three months or less, are considered cash equivalents as they are highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of change in value.

Inventory

Inventory, which is composed of retail products, is recorded at the lower of cost and net realizable value. The cost method for inventory is substantially determined using average cost. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs necessary to make the sale, which correspond to the direct cost of the inventory.

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

Property and equipment and intangible assets

Property and equipment and intangible assets are initially recorded at cost and are then amortized on a straight-line basis over their estimated useful lives at the following annual rates.

Buildings	5%
Motor vehicles and computer equipment	24%
Point of sale system	17%
Fixtures and equipment	12%
Building improvements	9%

Work-in-progress is amortized when the asset is substantially completed.

Impairment of property and equipment

Property and equipment are tested for recoverability whenever events or changes in circumstances indicate their carrying amount may not be recoverable. An impairment loss is recognized when its carrying value exceeds the total undiscounted cash flows expected from its use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value. No impairment loss was recorded for the years ended March 31, 2019 and 2018.

Asset retirement obligation

Asset retirement obligations relate to estimated future costs to remove underground motor fuel storage tanks and are based on CANEX's prior experience in removing these fuel tanks, the fuel tanks' estimated useful lives, external estimates and governmental regulatory requirements. A discounted liability is recorded for the fair value of an asset retirement obligation with a corresponding increase to the carrying value of the related long-lived asset at the time an underground storage fuel tank is installed. To determine the initial recorded liability, the future estimated cash flows are discounted at a rate representing the Canadian Forces Central Fund (CFCF) banking facility and local banking arrangement rates, taking into consideration inflation. The amount added to property and equipment is amortized.

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

Employee future benefits

CANEX participates in the Canadian Forces Non-Public Funds Employees Pension Plan (the Plan), which is a multi-employer, contributory, defined benefit plan. The Plan provides retirement benefits relating to contributions and years of service of staff of all Non-Public Funds. Substantially all CANEX employees are eligible to be members of the Plan.

CANEX's portion of the Plan is accounted for as a defined contribution plan as there is insufficient information available to use defined benefit plan accounting. As a result, CANEX's contributions to the Plan are included as an expense in the consolidated statement of operations. A pension asset has not been recorded on the consolidated balance sheet.

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

Revenue recognition

Revenue from the sale of merchandise is recorded on acceptance by the customer. CANEX records revenue from Canadian sales under its credit plan when the customer takes possession of the merchandise and collectibility is assured. Credit plan balances are transferred to the CFCF (note 3). Concession and administrative fees are recognized each period in accordance with the terms of the agreements.

Income taxes

CANEX is a Crown NPP entity and is therefore not subject to income taxes in Canada or Germany. Accordingly, no provision for income taxes has been recorded in these consolidated financial statements.

Foreign currency translation

Functional currencies

Items included in the consolidated financial statements are measured using the currencies of the primary economic environment in which the entities operate (the functional currencies). The functional currency of NATEX and AMSTO is the Euro. NATEX and AMSTO are considered self-sustaining foreign operations.

NATEX and AMSTO's assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the consolidated balance sheet date. NATEX's and AMSTO's revenues and expenses are translated at the exchange rate in effect on the dates on which such items are recognized in earnings (loss) for the year. Gains and losses resulting from the translation of the accounts of NATEX and AMSTO are recorded as translation adjustments in a separate component of equity.

Foreign currency transactions and balances

Foreign currency transactions are translated into functional currencies using the exchange rate in effect at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are adjusted to reflect the exchange rate in effect at the consolidated balance sheet date. An exchange gain or loss that arises on translation or settlement is included in the determination of net earnings (loss) for the year.

Use of estimates

The preparation of consolidated financial statements in accordance with Canadian accounting standards for private enterprises requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. The estimates are reviewed annually and as adjustments become necessary, they are recognized in the consolidated financial statements in the year they become known.

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

3 Property and equipment

	2019		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	
Buildings	48,289	22,900	25,389
Motor vehicles and computer equipment	2,485	2,384	101
Point of sale system	10,345	3,513	6,832
Fixtures and equipment	9,495	8,626	869
Building improvements	25,924	20,412	5,512
Work-in-progress	4,018	-	4,018
	<u>100,556</u>	<u>57,835</u>	<u>42,721</u>
			2018
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	
Buildings	47,380	20,920	26,460
Motor vehicles and computer equipment	2,581	2,215	366
Point of sale system	8,377	2,241	6,136
Fixtures and equipment	9,695	8,635	1,060
Building improvements	25,212	19,773	5,439
Work-in-progress	2,325	-	2,325
	<u>95,570</u>	<u>53,784</u>	<u>41,786</u>

4 Loans payable to CFCF

Loans payable held by CFCF bear interest at a fixed rate of 4% (2018 – 4%) per annum and are unsecured. Principal repayments over the next five years and thereafter are as follows:

	\$
Year ending March 31, 2020	2,684
2021	2,695
2022	2,658
2023	2,687
2024	2,702
Thereafter	<u>26,831</u>
	40,257
Less: Current portion	<u>2,684</u>
Long-term portion	<u>37,573</u>

As of March 31, 2019, per NPP Board approved business plan, a further \$4,264 (2018 – \$7,311) was committed through a CFCF loan for property and equipment relating to new or improved locations.

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

5 Other revenue

	2019 \$	2018 \$
Concessions	4,542	4,456
The Personal Insurance Company	3,717	3,419
NATEX other (including interest)	1,073	1,028
Other commission (duty free, post office)	918	748
AMSTO	354	848
Home heating oil	315	236
Rental and delivery	238	259
Miscellaneous	161	196
Advertising	158	135
	<hr/>	<hr/>
	11,476	11,325

6 Pension plan

CANEX' share of contributions to the Plan was \$1,057 (2018 – \$1,006) and is included in the payroll and benefits expense on the consolidated statement of operations.

Extrapolations of an actuarial valuation prepared as at December 31, 2018 indicated the following information about the overall Plan:

	December 31 2018 \$	December 31 2017 \$
Fair value of plan assets	362,095	355,840
Accrued benefit obligation	<u>(282,280)</u>	<u>(260,814)</u>
Surplus	<hr/> 79,815	<hr/> 95,026

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 surplus of \$93,500 (2017 – \$87,900).

Conversely, under the hypothetical solvency (or windup) 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 windup liabilities on the valuation date. This valuation resulted in a deficit of \$41,800 (2017 – \$29,300).

These valuations are utilized to assess monthly and annual employer contributions.

7 Related party transactions

Transactions with related parties and are measured at their exchange amounts, which are the amounts established and agreed to by the related parties involved.

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

Amount due from (to) CFCF

CFCF, which provides banking services and financial assistance to NPP activities at Bases, Wings and Units as well as to CANEX, also operates under the authority of the CDS in his NPP capacity. Due from CFCF, \$11,817 (2018 – \$26,310) comprises interest and non-interest bearing funds:

	2019 \$	2018 \$
Interest bearing	24,581	26,266
Non-interest bearing	(12,764)	44
Total	<u>11,817</u>	<u>26,310</u>

Interest bearing relates to due from CFCF previously held by NATEX/AMSTO. These funds receive interest based on the CFCF rate of return less 0.5%. Interest earned from CFCF of \$1,492 (2018 - \$1,334) is included in other revenue.

Non-interest bearing relates to CANEX operations and is due from/to CFCF on demand.

CFCF assumes all trade payables from CANEX for consideration at their fair value. In addition, the risks and rewards of receivable collection related to the credit plan and other trade receivables are assumed by CFCF for consideration at their fair value. All credit plan balances and other trade receivables and all trade payables are assumed by the CFCF at fair value. At year-end, CANEX recorded a provision of 1% for the estimate of potential future losses on the credit plan receivables balance (2018 – 1%). Fees charged by CFCF amounted to \$588 (2018 – \$610).

Royalties and contributions

CANEX contributed \$3,150 (2018 – \$3,150) to enhance NPP Morale and Welfare Programs at Canadian Forces Bases, Wings and Units.

NATEX contributed \$552 (2018 – \$564) to the NATO Air Base. NATEX' contributions are based on various percentages of consumer sales, in accordance with the NATEX contract.

Department of National Defence

Department of National Defence (DND) contributions of \$2,555 (2018 – \$2,424) toward payroll costs, travel and supplies are included in the consolidated statement of operations.

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

DND provides certain facilities and land. It also pays for and provides other services on behalf of, and at no cost to, CANEX. These services include payment in lieu of taxes and the use of legal, environmental and other advisory services. The fair value of the facility and services provided to CANEX by DND has not been determined and therefore has not been recorded in the consolidated financial statements.

Canadian Forces Morale and Welfare Services

The CFMWS provides accounting, information technology, and human resources services to CANEX. These transactions occurred in the normal course of operations and are recorded in other operating expenses at the exchange amount of \$3,343 (2018 – \$3,341). This is the amount of consideration established and agreed to by the related parties.

8 Commitments

CANEX is committed to minimum annual payments under motor fuel supply agreements as follows:

	\$
Year ending March 31, 2020	8,500
2021	8,500
2022	6,583
2023	2,083
2024	62
	<hr/>
	25,728
	<hr/>

9 Contingencies

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

In December 2016, a gas leak was discovered at the 4 Wing Cold Lake CANEX gas station and reported to Environment Canada in January 2017. Public support is anticipated for environmental remediation. CFMWS carries environmental insurance coverage of \$5,000 per incident, \$5,000 aggregate with a \$25 deductible with Chubb Insurance Company of Canada as a safeguard, which would cover CANEX gas stations. The CANEX deductible would be limited to \$5 as CFMWS is the holder of the policy.

Due to the uncertainty of a possible financial exposure relating to the Cold Lake leakage, CANEX has concluded that the occurrence of this contingency is not determinable at this time and any eventual liability cannot be reasonably estimated, therefore no liability has been recorded within CANEX's consolidated financial statements.

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

10 Asset retirement obligation

The discounted value of the asset retirement cost included in the buildings category of property and equipment is estimated at \$369. The amortization of this asset has generated an expense of \$144 in 2019 (2018 – \$55). The total undiscounted amount of estimated cash flows to settle the asset retirement obligation is approximately \$1,055 (discounted value – \$880) and is expected to be incurred over the next 24 years. Should changes occur in estimated future removal costs, fuel tank useful lives or governmental regulatory requirements, revisions to the liability shall be made. Of the total liability recorded in the consolidated balance sheet as at March 31, 2019, no amount is expected to be paid within the next 12 months.

During the year, \$nil (2018 – \$540) was paid toward the retirement of fuel tanks.

11 Financial instruments and risk management

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. Credit plan balances are transferred to the CFCF. The amount outstanding on the CANEX credit plan due to the CFCF is \$58,762 (2018 – \$61,230).

Currency risk

Included in other expenses is a foreign exchange gain of \$182 (2018 – \$180). The carrying amounts of CANEX's foreign currency denominated balances are as follows:

	Current assets				Current liabilities			
	€	2019 \$	€	2018 \$	€	2019 \$	€	2018 \$
NATEX	4,958	7,438	4,463	7,082	346	519	316	502
AMSTO	1,775	2,663	2,044	3,243	174	261	118	188

12 Net change in non-cash working capital items

	2019 \$	2018 \$
Due from CFCF	14,493	3,305
Account and accrued receivables	(304)	(62)
Inventory	(4,947)	(1,548)
Prepaid expenses	(535)	209
Accounts payable and accrued liabilities	119	(38)
	<hr/>	<hr/>
	8,826	1,866

CANEX

Notes to Consolidated Financial Statements

March 31, 2019

(in thousands of Canadian dollars)

13 NATEX/AMSTO operations

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

	2019			2018		
	€	\$	%	€	\$	%
Total assets	5,447	8,172	11	7,184	11,399	12
Sales and other revenue	10,805	16,414	12	11,491	17,249	12
Earnings before royalties and contributions	1,178	1,767	(28)	830	1,245	123