

Quarterly Financial Statements of

CANADA COUNCIL FOR THE ARTS

*June 30, 2011
(Unaudited)*



**Canada Council
for the Arts**

**Conseil des Arts
du Canada**

CANADA COUNCIL FOR THE ARTS
Quarterly Financial Statements
for the quarter ended June 30, 2011
(Unaudited)

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CANADA COUNCIL FOR THE ARTS

Statement of Financial Position

as at June 30, 2011 (in thousands of dollars)

(Unaudited)

	<u>June 30, 2011</u>
FINANCIAL ASSETS	
Cash and cash equivalents (Note 5)	\$ 13,771
Accounts receivable	1,944
Derivatives (Note 6)	308
Portfolio investments (Note 7)	279,859
TOTAL FINANCIAL ASSETS	\$ 295,882
LIABILITIES	
Grants payable	75,019
Accounts payable and accrued liabilities	1,677
Deferred parliamentary appropriations	-
Deferred revenues	2,045
Derivatives (Note 6)	21
Employee future benefits	2,353
Externally restricted contributions (Note 8)	62,598
TOTAL LIABILITIES	\$ 143,713
NET FINANCIAL ASSETS	\$ 152,169
NON-FINANCIAL ASSETS	
Tangible capital assets	2,562
Prepaid expenses	650
TOTAL NON-FINANCIAL ASSETS	\$ 3,212
ACCUMULATED SURPLUS (Note 9)	\$ 155,381
Accumulated surplus is comprised of:	
Accumulated surplus from operations	\$ 155,074
Accumulated remeasurement gains	307
ACCUMULATED SURPLUS (Note 9)	\$ 155,381

The accompanying notes form an integral part of the financial statements.

CANADA COUNCIL FOR THE ARTS

Statement of Operations

period ended June 30, 2011 (in thousands of dollars)

(Unaudited)

	<u>June 30, 2011</u>
Revenue	
Parliamentary appropriations	\$ 87,013
Net investment income (Note 10)	706
Net Art Bank revenue (Note 11)	(58)
Other revenue	741
	<hr/>
Total revenue	88,402
	<hr/>
Expenses	
Programs	
Grants	107,887
Administration	3,049
Services	1,672
	<hr/>
	112,608
Canadian Commission for UNESCO (Note 12)	464
General administration	3,658
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Total expenses	116,730
	<hr/>
DEFICIT FROM OPERATIONS FOR THE PERIOD	(28,328)
	<hr/>
ACCUMULATED SURPLUS FROM OPERATIONS, BEGINNING OF PERIOD	183,402
	<hr/>
ACCUMULATED SURPLUS FROM OPERATIONS, END OF PERIOD	\$ 155,074

The accompanying notes form an integral part of the financial statements.

CANADA COUNCIL FOR THE ARTS
Statement of Change in Net Financial Assets
period ended June 30, 2011 (in thousands of dollars)
(Unaudited)

	<u>June 30, 2011</u>
DEFICIT FROM OPERATIONS FOR THE PERIOD	\$ (28,328)
Acquisition of tangible capital assets	(44)
Amortization of tangible capital assets	249
	<u>205</u>
Acquisition of prepaid expenses	774
Use of prepaid expenses	(1,152)
	<u>(378)</u>
Net remeasurement gains	307
DECREASE IN NET FINANCIAL ASSETS	(28,194)
NET FINANCIAL ASSETS, BEGINNING OF PERIOD	180,363
NET FINANCIAL ASSETS, END OF PERIOD	<u>\$ 152,169</u>

The accompanying notes form an integral part of the financial statements.

CANADA COUNCIL FOR THE ARTS
Statement of Remeasurement Gains and Losses
period ended June 30, 2011 (in thousands of dollars)
(Unaudited)

	<u>June 30, 2011</u>
Accumulated remeasurement gains and (losses), beginning of period	\$ -
Unrealized gains (losses) attributable to:	
Derivatives	340
Foreign exchange	(115)
Portfolio investments	82
Amounts reclassified to the Statement of Operations:	
Derivatives	-
Foreign exchange	-
Portfolio investments	-
NET MEASUREMENT GAINS FOR THE PERIOD	307
ACCUMULATED REMEASUREMENT GAINS, END OF PERIOD	\$ 307

The accompanying notes form an integral part of the financial statements.

CANADA COUNCIL FOR THE ARTS

Statement of Cash Flows

period ended June 30, 2011 (in thousands of dollars)

(Unaudited)

	<u>June 30, 2011</u>
OPERATING TRANSACTIONS	
Deficit for the period	\$ (28,328)
Non-cash items	
Amortization of tangible capital assets	249
Gain (loss) on disposal of tangible capital assets	-
Increase in prepaid expenses	(378)
Net change in non-cash items (Note 13)	45,181
Cash provided by operating activities	16,724
CAPITAL TRANSACTIONS	
Proceeds on sale of tangible capital assets	-
Cash used to acquire tangible capital assets	(44)
Cash used by capital activities	(44)
INVESTING TRANSACTIONS	
Acquisition of portfolio investments	(2,896)
Disposal of portfolio investments	2,221
Cash used by investing activities	(675)
FINANCING TRANSACTIONS	
Contributions received from non-owners	-
Cash provided by financing activities	-
NET INCREASE IN CASH AND CASH EQUIVALENTS	16,005
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	(2,234)
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 13,771

The accompanying notes form an integral part of the financial statements.

CANADA COUNCIL FOR THE ARTS

Notes to the Financial Statements

for the quarter ended June 30, 2011

(Unaudited)

1. AUTHORITY AND ACTIVITIES

The Canada Council for the Arts (the "Council"), established by the Canada Council Act in 1957 and subsequently amended in 2001 by Bill C-40 to the Canada Council for the Arts Act, is not an agent of Her Majesty and is deemed to be a registered charity for the purposes of the Income Tax Act. In accordance with section 85(1.1) of the Financial Administration Act, the Council is exempt from Divisions I to IV of Part X of this Act, except for subsection 105(2) and sections 113.1 and 119 of Division II, sections 131 to 148 of Division III and section 154.01 of Division IV. The Council is a Crown corporation whose objectives are to foster and promote the study and enjoyment of and the production works in the arts.

The Council achieves its objectives primarily through grant programs to professional Canadian artists and arts organizations. The Council incurs administration and services expenses in the delivery of programs. Program administration expenses represent the direct costs of program delivery. Program services expenses mainly represent the costs associated with the adjudication of the Council's grants. General administration costs represent the costs related to corporate management, communications, human resources, information management, finance, accommodation and amortization.

The Canada Council for the Arts Act assigns the Council with the functions and duties for the Canadian Commission for UNESCO (the "Commission"). The Commission advises the Government of Canada on its relations with the United Nations Educational, Scientific and Cultural Organization (UNESCO). The Commission also fosters co-operation between Canadian organizations in civil society and UNESCO.

2. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS

Prior to the 2011-12 financial statements, the Council classified itself as a Government Business-Type Organization ("GBTO") and followed the recommendations of the Canadian Institute of Chartered Accountants (CICA) Accounting Handbook - Part V ("CGAAP"). In October 2009, the Public Sector Accounting Board ("PSAB") determined that the category will cease to exist for fiscal years ending on or after January 1, 2011, and GBTOs are required to reclassify themselves in accordance with PSA Standards. In accordance with recommendations of the Public Sector Accounting Handbook, the Council has determined that it is an "other government organization" ("OGO") and has determined that Public Sector Accounting Standards ("PSAS") is the most appropriate framework for reporting purposes. The Council has adopted PSAS for its fiscal year beginning April 1, 2011.

The adoption of PSAS is accounted for by retroactive application with restatement of prior periods. The following is a summary of the main qualitative differences for the Council between its previous and current financial statements:

CANADA COUNCIL FOR THE ARTS

Notes to the Financial Statements

for the quarter ended June 30, 2011

(Unaudited)

2. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

- The Balance Sheet has been replaced by the Statement of Financial Position, segregating financial and non-financial assets as well as the net financial assets (financial assets less liabilities) of the Council; and accumulated surplus/deficit at the Statement of Financial Position date.
- The Statement of Operations and Statement of Comprehensive Income have been replaced by the Statement of Operations and the Statement of Remeasurement Gains and Losses. The Statement of Operations reports earned revenues, realized gains and losses and incurred expenses. The Statement of Remeasurement Gains and Losses reports unrealized gains and losses and reclassifications upon realization.
- The Statement of Changes in Equity has been replaced by the Statement of Changes in Net Financial Assets, which represents the expenditures of a public sector reporting entity less revenue, as well as acquisitions of tangible capital assets and other items explaining the difference between the surplus/deficit of the period and the change in net financial assets for the period.

The following tables present the reconciliation of account balances and transactions from the previous reporting framework to the current method of presentation as at March 31, 2011(certain amounts have been reclassified to conform to the presentation adopted in 2011-2012):

CANADA COUNCIL FOR THE ARTS
Notes to the Financial Statements
for the quarter ended June 30, 2011
(Unaudited)

2. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

Statement of Financial Position	CICA Accounting Handbook - <u>Part V</u>	<u>Adjustments</u>	<u>PSA Standards</u>
Financial Assets			
Cash and cash equivalents	\$ 340	\$ -	\$ 340
Accounts receivable	2,690	-	2,690
Derivatives	5	-	5
Portfolio investments	279,232	-	279,232
Total financial assets	282,267	-	282,267
Liabilities			
Bank overdraft	2,574	-	2,574
Grants payable	25,927	-	25,927
Accounts payable and accrued liabilities	4,900	-	4,900
Deferred parliamentary appropriations	-	-	-
Deferred revenue	2,108	-	2,108
Derivatives	187	-	187
Externally restricted donations	-	63,917 ¹	63,917
Employee future benefits	2,291	-	2,291
Total liabilities	37,987	63,917	101,904
Net financial assets	244,280	(63,917)	180,363
Non-financial assets			
Tangible capital assets	23,496	(20,729) ²	2,767
Prepaid expenses	272	-	272
Total non-financial assets	23,768	(20,729)	3,039
Accumulated surplus	\$ 268,048	\$ (84,646)	\$ 183,402
Accumulated surplus is comprised of:			
Reserve - Excess of investment income	\$ 121,445	\$ -	\$ 121,445
Accumulated surplus	82,152	(20,729) ²	61,423 ³
Accumulated other comprehensive income	64,451	(63,917) ¹	534 ³
	\$ 268,048	\$ (84,646)	\$ 183,402

¹ The Council has reclassified Externally restricted donations from accumulated other comprehensive surplus/deficit to liabilities in accordance with PSAS 3100 "Restricted Assets and Revenues"

² The Council has reversed previously recorded purchase and "in-kind" contributions of works of art and musical instrument bank since PSAS 3150 "Tangible Capital Assets" does not allow the recognition thereof.

³ The Council has grouped these balances together in accumulated surplus for purposes of presentation in these interim financial statements.

CANADA COUNCIL FOR THE ARTS

Notes to the Financial Statements

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(Unaudited)

3. ADOPTION OF NEW ACCOUNTING STANDARDS

New accounting standards

Financial instruments

As at April 1, 2011, the Council early adopted PSA Handbook Section 3450, "Financial Instruments". This new standard provides guidance for recognition, measurement and disclosure of financial instruments. The transitional provisions in the standard state that when a government organization applies this standard in the same period it adopts PSAS for the first time, this standard cannot be applied retroactively. Comparative amounts are presented in accordance with the accounting policies applied by the government organization immediately preceding its adoption of Public Sector Accounting Standards. Consequently, unrealized gains and losses reported in the opening balance sheet remain in accumulated other comprehensive surplus/deficit. The Council has grouped this balance with the Accumulated Surplus from Operations in the current period. The impacts of the adoption of these new standards are as follows:

The Council now discloses a Statement of Re-measurement Gains and Losses.

The Statement of Financial Position discloses accumulated remeasurement gains of \$307 as at June 30, 2011, which would have previously been classified as accumulated other comprehensive surplus/(deficit) from operations.

As the Council previously recorded its derivatives and portfolio investments at fair value, there were no other quantitative impacts on the Statement of Financial Position.

The Council has previously disclosed in its prior financial statements the various risks related to financial instruments. Note 4 to the March 31, 2011 CGAAP financial statements provide similar information as required by this new Standard.

Foreign Currency

As of April 1, 2011, the Council early adopted PSA Handbook Section 2601, "Foreign Currency Translation". This revised standard establishes standards on how to account for and report transactions that are denominated in a foreign currency. The transitional provisions in the standard state that when a government organization applies this standard in the same period it adopts PSAS for the first time, this standard cannot be applied retroactively. Comparative amounts are presented in accordance with the accounting policies applied by the government organization immediately preceding its adoption of Public Sector Accounting Standards. Other than disclosed above under Financial Instruments, there was no impact of adopting this standard.

Financial Statement Presentation

As of April 1, 2011, the Council adopted PSA Handbook Section 1201, "Financial Statement Presentation". This Section establishes general reporting principles and standards for the disclosure of information in financial statements. This standard is applicable to fiscal periods that

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PSA Handbook Sections 2601, "Foreign Currency Translation" and 3450, "Financial Instruments" are adopted. Other than previously stated in this Note, there were no significant impacts of adopting this standard for the quarter ended June 30, 2011.

4. SIGNIFICANT ACCOUNTING POLICIES

Basis of accounting

The Council considers itself to be an OGO. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (CGAAP) for the Public Sector as promulgated by the Canadian Institute of Chartered Accountants ("CICA"). Previously, the Council's financial statements were prepared in accordance with Part V of the CICA Handbook (Pre-changeover Accounting Standards).

Management has obtained an exemption from the Treasury Board of Canada Secretariat (TBS) from presenting comparative information for the first year of quarterly reporting under PSAS. This exemption does not provide full relief from presenting comparative information altogether but rather allows the Council to present such information under the previous accounting framework.

The Council believes that the most appropriate presentation of the comparative information presented under the previous accounting framework is in the notes to the financial statements. The Council presents this information in a condensed format (see Note 16), without notes. This financial information should be read with the audited financial statements of the Council for the year ended March 31, 2011 prepared in accordance with CGAAP.

The Council's significant accounting policies are as follows:

Financial instruments

All financial instruments are initially measured at fair value. The following table identifies the Council's financial assets and liabilities and identifies how they are subsequently measured:

Financial asset or liability	Subsequent measurement
Cash and cash equivalents	Fair value
Accounts receivable	Amortized cost
Portfolio investments	Fair value
Derivatives	Fair value
Grants payable	Amortized cost
Accounts payable and accrued liabilities	Amortized cost

CANADA COUNCIL FOR THE ARTS

Notes to the Financial Statements

for the quarter ended June 30, 2011
(Unaudited)

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash equivalents

Cash equivalents represent short-term, highly liquid investments that are readily convertible into known amounts of cash and that are subject to an insignificant risk of changes in value. Cash equivalents on the Council's Statement of Financial Position comprise units in a short-term pooled fund. Distributed income is recorded on an accrual basis and is recognized in the Statement of Operations under net investment income in the period in which it is earned.

Derivatives

The Council does not apply hedge accounting to its foreign exchange derivatives. Derivatives are recognized at fair value on the Statement of Financial Position. Derivatives with a positive (negative) fair value are reported as assets (liabilities). As of April 1, 2011, all unrealized changes in the fair value of derivatives are recognized on the Statement of Remeasurement Gains and Losses operations under derivatives unrealized gains/losses or as a liability under externally restricted contributions for the portion which is restricted in the year in which they occur. Once realized, these gains and losses are recognized in the Statement of Operations.

Portfolio investments

As of April 1, 2011, unrealized changes in the fair value of portfolio investments are recognized in the Statement of Remeasurement Gains and Losses or as a liability under externally restricted contributions for the portion which is restricted. Once realized, these gains or losses are recognized in net investment income. Purchases and sales of portfolio investments are recorded on the trade date. Management fees paid are expensed in the period.

Capital assets

Office equipment and leasehold improvements are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method, over the estimated useful lives of the assets as follows:

Office equipment	5 years
Leasehold improvements	remaining term of the lease

Under PSAS, works of arts and musical instruments, which have cultural and historical value, are not recognized as a tangible capital asset in the financial statements as a reasonable estimate of the future benefits associated with such assets cannot be made. Refer to Note 2 for the impact on transition to PSAS of removing these assets from the books and records.

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Notes to the Financial Statements
for the quarter ended June 30, 2011
(Unaudited)

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Employee future benefits

i) Severance benefits

Employees are entitled to severance benefits, as provided for under conditions of employment and the collective agreement. The cost of these benefits is accrued as the employees render the services necessary to earn them. The liability is calculated based on management's best estimates and assumptions, on the employee's salary and number of years of service as at the reporting date. For employees who have attained the age of 50, with one year or more of continuous service, one week's salary is calculated for each completed year of continuous service up to a maximum of 28 weeks. For employees who have not attained the age of 50, with one or more years of service, one-half of one week's salary is calculated for each completed year of continuous service up to a maximum of 26 weeks. Term employees who have 12 consecutive months of continuous service are entitled to either two days pay for each completed year of continuous service or five days pay, whichever is greater. These benefits represent the only employment obligation of the Council that entails settlement by future payment.

ii) Pension benefits

All eligible employees participate in the Public Service Pension Plan (the "Plan") administered by the Government of Canada. The Council's contribution to the plan reflects the full cost as employer. The amount is currently based on a multiple of the employee's required contributions and may change over time depending on the experience of the Plan. These contributions are expensed during the period in which the services are rendered and represent the total pension obligations of the Council. The Council is not currently required to make contributions with respect to any actuarial deficiencies of the Public Service Pension Plan.

Externally restricted contributions

Externally restricted contributions consist of private endowments and restricted donations received by the Council.

Externally restricted income is recognized as revenue in the financial statements in the period in which the resources are used for the purpose or purposes specified. An externally restricted inflow received before this criterion has been met is reported as a liability until the resources are used for the purpose or purposes specified.

CANADA COUNCIL FOR THE ARTS

Notes to the Financial Statements

for the quarter ended June 30, 2011
(Unaudited)

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reserve from excess investment income

This reserve represents the sum of excess investment income since the establishment of the Council in 1957. In periods when net investment income exceeds the amount of net budgeted investment income, an amount may be transferred from the accumulated surplus (deficit) to the reserve from excess investment income. In periods when net investment income is less than the amount of net budgeted investment income, an amount may be transferred to the accumulated surplus (deficit) from the reserve from excess investment income. These transfers are approved by the Board. This balance is included with the total accumulated surplus from operations.

Revenue recognition

i) Parliamentary appropriations

Parliamentary appropriations are recognized as revenue in the period for which it is approved by Parliament.

Parliamentary appropriations for specific projects are deferred and recognized on the statement of operations in the period in which the related expenses are incurred.

Parliamentary appropriations are mainly used for operations.

ii) Government transfers

Government transfers are transfers of monetary assets from a government to the Council for which the government making the transfer does not:

- (a) receive any goods or services directly in return, as would occur in a purchase/sale or other exchange transaction;
- (b) expect to be repaid in the future, as would be expected in a loan; or
- (c) expect a direct financial return, as would be expected in an investment.

The Council recognizes government transfers as revenue in the period the transfer is authorized and all eligibility criteria have been met, except when and to the extent that the transfer gives rise to an obligation that meets the definition of a liability for the Council.

CANADA COUNCIL FOR THE ARTS
Notes to the Financial Statements
for the quarter ended June 30, 2011
(Unaudited)

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue recognition (Continued)

iii) Contributions

The Council receives non-owner contributions that are externally restricted for specific purposes by the donors.

Externally restricted non-owner contributions, including realized and unrealized gains and losses for the associated externally restricted investment income, are recognized as a liability until the resources are used for their specified purpose, at which time the contributions are recognized as revenue.

Unrestricted non-owner contributions are recognized as other revenue in the period received or in the period the funds are committed to the Council if the amount can be reasonably estimated and collection is reasonably assured.

iv) Art Bank rental revenues

Revenues generated from the rental of works of art are recognized over the period of the rental. They are included in net Art Bank revenue.

v) Other revenues

Other revenues consist mainly of the cancellation in the current period of grants approved in previous periods.

Grants

Grants are recorded as an expense in the period for which they are approved by the Board.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the exchange rate in effect at the date of the statement of financial position. Revenue and expense items are translated at exchange rates prevailing throughout the period. As of April 1, 2011, unrealized foreign exchange gains and losses are recognized in the Statement of Remeasurement Gains and Losses. Once realized, the cumulative gain or loss previously recognized in the statement of Remeasurement Gains and Losses are recognized in net investment income.

CANADA COUNCIL FOR THE ARTS

Notes to the Financial Statements

for the quarter ended June 30, 2011
(Unaudited)

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Operating leases

The Council enters into operating leases for its office accommodation. Lease inducements are recorded as a reduction to the office accommodation expense on a straight-line basis over the term of the lease.

Measurement uncertainty

The preparation of financial statements in accordance with Canadian GAAP for the public sector requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the financial statement date and the reported amounts of revenues and expenses during the reporting period. Employee-related liabilities, the estimated useful lives of capital assets and the fair value of financial instruments are the most significant items where estimates are used. Actual results could differ from those estimated.

5. CASH EQUIVALENTS

The Council invests its cash in excess of daily requirements in a short-term pooled fund managed by State Street Global Advisors. All instruments held in the pooled funds are rated R1 (low) or A (low) or better as rated by a recognized bond rating agency. These funds are comprised of securities issued by different levels of government, chartered banks and corporate issuers. Except for instruments guaranteed by governments, no more than 10% of the short-term portfolio is invested with any one issuer. The Council's investment in the pooled fund was \$22,875,000 as at June 30, 2011.

6. DERIVATIVES

The use of derivatives is limited to foreign currency forward contracts. The Council currently uses foreign currency forward contracts that represent commitments to purchase or sell foreign currencies for delivery at a specific date in the future at a fixed rate to manage its foreign currency exchange risk. These contracts are typically for a one-month period.

The Council enters into foreign currency forward contracts to manage its exposure to foreign currency exchange risk on the non-Canadian dollar denominated portion of its investments portfolio, except for the emerging market component which was unhedged and represented approximately 3% of the investment portfolio. The hedge strategy allows hedging of the designated assets within a range of 30% to 70% of the foreign exposure. The Council does not apply hedge accounting.

CANADA COUNCIL FOR THE ARTS
Notes to the Financial Statements
for the quarter ended June 30, 2011
(Unaudited)

6. DERIVATIVES (Continued)

Foreign currency forward contracts have notional amounts that serve as points of reference for calculating payments and are not the actual amounts that are exchanged. These amounts are not recorded on the Statement of Financial Position, as they do not represent their fair value. As at June 30, 2011, the Council held foreign currency forward contracts as follows:

<u>Currency</u>	<u>Forward rate</u>	<u>Notional amount¹ (in 000's)</u>	<u>Settlement date</u>	<u>Fair value (in 000's)</u>
US dollar	1.036	28,025	August 2, 2011	233
Euro	0.715	10,613	August 2, 2011	(18)
British Pound	0.645	4,964	August 2, 2011	20
Japanese Yen	83.611	4,164	August 2, 2011	22
Other assets	2.794	3,725	August 2, 2011	33
Other liabilities	5.809	930	August 2, 2011	(3)

¹ The notional amount represents the Council's exposure to those currencies as per its dynamic hedging strategy.

The fair value of outstanding foreign exchange forward contracts reflect the potential gain/loss if settlement were to take place. The unrealized gain of \$286,000 on foreign currency forward contracts that matured on June 30, 2011, but were only settled after the date of the statement of financial position are recorded with accounts receivable. The net investment income includes a net derivative loss for the period of \$524,000.

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Notes to the Financial Statements
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7. PORTFOLIO INVESTMENTS

	2011			
	(in thousands of dollars)			
	<u>Cost</u>	<u>Unrealized losses</u>	<u>Unrealized gains</u>	<u>Fair value</u>
Canada Council Endowment and Special Funds				
Pooled funds				
Equity	\$ 107,242	\$ -	\$ 341	\$ 107,583
Fixed income	73,309	863	-	72,446
Alternatives	20,017	-	1,456	21,473
Money market	5,512	-	-	5,512
Real estate	8,798	-	488	9,286
Infrastructure	7,208	581	-	6,627
	<u>222,086</u>	<u>1,444</u>	<u>2,285</u>	<u>222,927</u>
Killam Funds				
Pooled funds				
Equity	27,691	-	86	27,777
Fixed income	18,605	236	-	18,369
Alternatives	5,150	-	370	5,520
Money market	722	-	-	722
Real estate	2,350	-	132	2,482
Infrastructure	2,243	181	-	2,062
	<u>56,761</u>	<u>417</u>	<u>588</u>	<u>56,932</u>
Total investments	<u>\$ 278,847</u>	<u>\$ 1,861</u>	<u>\$ 2,873</u>	<u>\$ 279,859</u>

Unrealized gains/losses on investments are primarily due to the timing of the market prices, foreign exchange movements, or the early years in the business cycle for some investments. The Council does not consider these investments to be other-than-temporarily impaired as at June 30, 2011.

CANADA COUNCIL FOR THE ARTS
Notes to the Financial Statements
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(Unaudited)

7. PORTFOLIO INVESTMENTS (Continued)

The Council manages two separate portfolios, the Canada Council Endowment and Special Funds and the Killam Funds. The Killam Trustees requested that their donation be invested separately. Apart from the Killam Fund, all other externally restricted contributions are consolidated into the Canada Council Endowment and Special Funds and represent 8.24% of that Fund with a total fair value of \$18,369,000. The total fair value of the externally restricted investment including the Killam Fund is \$75,301,000.

The long-term objectives of the Canada Council Endowment and Special Funds and the Killam Funds are to generate long-term real returns to supplement the costs of administering the various programs, while maintaining the purchasing power of the endowed capital.

The Council invests in units of equity, fixed income and alternative pooled funds and in limited partnership units of four real estate funds and an infrastructure fund. The permitted and prohibited investments as well as the asset mix are governed by a Board approved investment policy. All of the investments are managed by professional investment managers.

The Council manages its portfolio to the following benchmarks adopted by the Board in October 2010. The benchmarks allow asset class allocations to vary between a minimum and a maximum.

<u>Asset Classes</u>	<u>Actual Market Value</u>	<u>Minimum</u>	<u>Benchmark</u>	<u>Maximum</u>
Canadian equities	5%	0%	5%	7%
Global equities	44%	30%	40%	50%
Fixed income	32%	25%	35%	40%
Alternatives	10%	5%	10%	15%
Real estate	4%	0%	5%	7%
Infrastructure	3%	0%	5%	7%
Money market	2%	0%	0%	15%

The money market asset class includes short-term pooled funds used for capital committed to future investment in limited partnership units of real estate and infrastructure funds. These funds had a balance of \$6,230,000.

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7. PORTFOLIO INVESTMENTS (Continued)

Investments in the equity pooled funds are comprised of units of three pooled funds, one Canadian fund and two funds that are invested in the global equity markets. The Canadian equities are measured against the returns of the Standard and Poor's Toronto Stock exchange Index. The global equities are measured against the returns of the Morgan Stanley Capital International World Hedge Index. Investments in the fixed income pooled fund are comprised of Canadian Government and corporate bonds with a minimum credit quality of BBB or equivalent rated by a recognized bond rating agency.

The fixed income fund is intended to replicate the returns of the DEX Universe Bond Index. Investments in the alternative pooled funds are comprised of units of two hedge funds with diversified positions across global asset classes. These investments are measured against the returns of the Scotia Capital 91-day T-bill plus 20%. The assets included in the real estate funds are commercial real estate properties in Canada and the United States. These investments are measured against the returns of the Investment Property Databank for the Canadian managers and the National Council of Real Estate Investment Fiduciaries (NCREIF) for the US manager. The infrastructure fund includes a portfolio of diversified infrastructure investments. These investments are measured against the Consumer Price Index plus 4.5%.

8. EXTERNALLY RESTRICTED CONTRIBUTIONS

Externally restricted contributions consist of private endowments and restricted donations received by the Council. The restricted endowment principal of \$38,758,000 is required to be maintained intact. Also, the Council may transfer a portion of the income earned on these donations to the externally restricted endowment principal once the operational needs of the restricted funds have been met. If the operational needs of the restricted funds exceed the income earned, then a transfer from externally restricted endowment principal to operations for all or a portion of the excess will be made.

	2011 (in 000's)
Balance, beginning of period	\$ 63,917
Unrealized losses on portfolio investment	(15)
Unrealized gains on derivatives	129
Transferred to investment income (Note 10)	(1,433)
Balance at end of period	\$ 62,598

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9. ACCUMULATED SURPLUS

	2011 (in 000's)
Reserve for excess investment income	121,445
Accumulated surplus from operations	
Endowment - original contribution	50,000
Surplus	
Balance at beginning of the period	11,957
Deficit for the period	(28,328)
Balance at end of the period	(16,371)
Total accumulated surplus from operations	33,629
Accumulated remeasurement gains	307
Balance of accumulated surplus at end of the period	\$ 155,381

Included in accumulated surplus/(deficit) is the original contribution by the Government of Canada of \$50 million, which constituted a government transfer ("Endowment Fund") when the Council was established in 1957.

10. NET INVESTMENT INCOME

	2011 (in 000's)
Realized gain (loss) on portfolio investments	\$ -
Transfer from external restricted donations (Note 8)	1,433
Net losses on derivatives	(524)
Interest and dividend income	218
Investment portfolio management costs	(421)
	\$ 706

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11. NET ART BANK REVENUE

	2011 (in 000's)
Rental revenue	\$ 487
Other income	13
Administration expense	(552)
Amortization of other capital assets	(6)
	\$ (58)

12. CANADIAN COMMISSION FOR UNESCO

	2011 (in 000's)
Program expenses	\$ 159
Program - contributions received	-
Administration expense	305
	\$ 464

Program expenses represent mainly the costs associated with the Commission's activities at national and international meetings related to education, science and culture. These costs are offset by contributions received from other organizations partnering with the Commission on these activities. Administration expenses represent the direct costs of delivering the Commission's programs.

13. NET CHANGE IN NON-CASH ITEMS

	2011 (in 000's)
Decrease in accounts receivable	\$ 746
Increase in grants payable	49,092
Decrease in accounts payable and accrued liabilities	(3,223)
Decrease in deferred revenues	(63)
Increase in employee future benefits	62
Decrease in externally restricted donations ⁴	(1,433)
Net change	\$ 45,181

⁴ The decrease excludes the unrealized gains/losses on changes in fair value of the portfolio investment and derivatives as they are recorded as a liability under externally restricted contributions (Note 8).

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14. RELATED PARTY TRANSACTIONS

The Council is related in terms of common ownership to all Government of Canada departments, agencies and Crown corporations. The Council enters into transactions with related parties in the normal course of business on normal trade terms applicable to all individuals and enterprises, and these transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

15. FINANCIAL RISKS AND FAIR VALUE

The Council is exposed to a variety of financial risks as a result of its activities. These risks include credit risk, liquidity risk and market risk (price risk, interest rate risk and currency risk). The long term goal of the Council's investment policy is to produce long term real returns to supplement the costs of administering the various programs, while maintaining the purchasing power of the endowed capital. This policy allows the use of certain derivative financial instruments.

In order to manage risk, the Council invests in a diversified portfolio that is managed by professional investment managers. The Council's investments are guided by a Statement of Investment Policies and Goals which is approved by the Board and reviewed on an annual basis. The Council is assisted in the oversight and management of its portfolio by an Investment Committee that includes independent experts with experience in both the investment field and the asset classes being invested in. In addition, the Council uses the services of an independent investment consultant to assist the investment Committee in its work. As the investment markets continue to evolve, the Investment Committee recommends adjustments to the asset mix to minimize the overall risk of the portfolio.

a) Establishing fair value

The carrying value of cash and cash equivalents, accounts receivable, grants payable and accounts payable and certain accrued liabilities approximates their fair values due to their short-term maturity.

The fair value of derivative instruments is calculated using supportable observable market inputs including the current market spot and the forward exchange rates at period end (see Note 6).

The fair values of the investments are determined as follows:

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15. FINANCIAL RISKS AND FAIR VALUE (Continued)

Pooled fund investments are valued at the unit values supplied by the pooled fund managers, which represent the Council's proportionate share of the underlying net assets at fair values, determined using closing market prices.

Real estate investment values are supplied by the fund managers using independently audited appraisals which are based on a valuation model with non-observable data. The independently audited appraisals are obtained annually.

Infrastructure investment values are supplied by the fund managers using internally determined appraisals. The appraisals are based on a valuation model with non-observable data.

b) Fair value hierarchy

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and,
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The following table presents the financial instruments recorded at fair value in the Statement of Financial Position, classified using the fair value hierarchy described above:

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15. FINANCIAL RISKS AND FAIR VALUE (Continued)

	Financial assets at fair value as at June 30, 2011			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(in thousands of dollars)			
Cash and cash equivalents	\$ 13,771	\$ -	\$ -	\$ 13,771
Derivatives	308	-	-	308
<i>Portfolio investments</i>				
<i>Canada Council Endowment and Special Funds</i>				
Pooled funds				
Equity	-	107,583	-	107,583
Fixed income	-	72,446	-	72,446
Alternatives	-	-	21,473	21,473
Money market	-	5,512	-	5,512
Real estate	-	-	9,286	9,286
Infrastructure	-	-	6,627	6,627
<i>Killam funds</i>				
Pooled funds				
Equity	-	27,777	-	27,777
Fixed income	-	18,369	-	18,369
Alternatives	-	-	5,520	5,520
Money market	-	722	-	722
Real estate	-	-	2,482	2,482
Infrastructure	-	-	2,062	2,062
Total	\$ 14,079	\$ 232,409	\$ 47,450	\$ 293,938

	Financial liabilities at fair value as at June 30, 2011			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(in thousands of dollars)			
Derivatives	\$ 21	\$ -	\$ -	\$ 21
Total	\$ 21	\$ -	\$ -	\$ 21

During the period, there were no significant transfers of amounts between Level 1 and 2.

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15. FINANCIAL RISKS AND FAIR VALUE (Continued)

The following table reconciles the changes in fair value of financial instruments classified as Level 3 during the period:

	<u>Alternative funds</u>	<u>Real estate funds</u> (in thousands of dollars)	<u>Infrastructure funds</u>	<u>Total</u>
<i>Canada Council Endowment and Special Funds</i>				
Opening balance	\$ 21,589	\$ 8,049	\$ 6,694	\$ 36,332
Unrealized gains or losses recognized in re-measurement statement	(107)	191	(61)	23
Unrealized gains or losses recognized in externally restricted donations	(9)	17	(6)	2
Purchases	-	1,029	-	1,029
Settlements	-	-	-	-
Impairment	-	-	-	-
Closing balance	<u>\$ 21,473</u>	<u>\$ 9,286</u>	<u>\$ 6,627</u>	<u>\$ 37,386</u>

	<u>Alternative funds</u>	<u>Real estate funds</u>	<u>Infrastructure funds</u>	<u>Total</u>
<i>Killam Funds</i>				
Opening balance	\$ 5,550	\$ 2,154	\$ 2,082	\$ 9,786
Unrealized gains or losses recognized in externally restricted donations	(30)	57	(20)	7
Purchases	-	271	-	271
Settlements	-	-	-	-
Impairment	-	-	-	-
Closing balance	<u>\$ 5,520</u>	<u>\$ 2,482</u>	<u>\$ 2,062</u>	<u>\$ 10,064</u>

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16. COMPARATIVE INFORMATION

Management has obtained an exemption from the Treasury Board of Canada Secretariat (TBS) from presenting comparative information for the first year of quarterly reporting under PSAS. This exemption does not provide full relief from presenting comparative information altogether but rather, allows the Council to present such information under previous GAAP (CGAAP). The comparative information is included below in a condensed format:

	<u>2011</u>
Balance Sheet as at March 31	
(in thousands of dollars)	
Current assets	\$ 3,307
Investment	279,232
Other assets	<u>23,496</u>
Total Assets	\$ 306,035
Total liabilities	\$37,987
Total equity	<u>268,048</u>
Total liabilities and equity	\$ 306,035
	<u>2011</u>
Statement of Operations for the year ending March 31	
(in thousands of dollars)	
Parliamentary appropriation	\$ 181,277
Net investment income	(36,942)
Other revenue	<u>1,979</u>
Total revenue	146,314
Programs	174,433
Other	<u>18,405</u>
Total expenses	192,838
Net results for the year	\$ (46,524)

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16. **COMPARATIVE INFORMATION (Continued)**

	<u>2011</u>
Equity for the year ending March 31 (in thousands of dollars)	
Contributed surplus	\$ 50,000
Retained earnings	11,423
Accumulated other comprehensive income	64,451
Reserve from the capitalization of investment income	121,445
Reserve for investment in works of art and musical instruments	<u>20,729</u>
Total Equity	<u>\$ 268,048</u>
	 <u>2011</u>
Statement of Comprehensive Income for the year ending March 31 (in thousands of dollars)	
Nets results for the year	\$ (46,524)
Available-for-sale financial assets	51,500
Restricted contributions from non-owners	<u>1,650</u>
Comprehensive income for the year	<u>\$ 6,626</u>
	 <u>2011</u>
Statement of cash Flows for the year ending March 31 (in thousands of dollars)	
Operating activities	\$ 2,932
Investing activities	<u>(6,192)</u>
Decrease in cash and cash equivalents	(3,260)
Cash and cash equivalents at beginning of the year	<u>1,026</u>
Net (bank overdraft) cash position at the end of the year	<u>\$ (2,234)</u>