

# Financial Report

- 34 Financial Overview
- 36 Management's Responsibility for  
Financial Reporting
- 37 Auditor's Report
- 38 Financial Statements

## FINANCIAL OVERVIEW

### Restatement of Financial Statements

The Council restated its financial statements for 2003-2004. Canadian generally accepted accounting principles were incorrectly applied to the translation of non-Canadian dollar denominated investments. As a result net investment income, investments and other related financial statement items were overstated in last year's annual report. The comparative figures presented for 2003-2004 in this year's annual report reflect the restatement of values.

### Investments

The Council earned net investment income of \$14.8 million in 2004-2005. This amount is significantly higher than the restated amount of \$934,000 for previous year. Dividend and interest income for the year were fairly consistent with the figures reported last year at \$5.0 million and \$3.2 million respectively. The Council also realized \$6.5 million in gains on the disposal of investments during the year.

During the year the Council's investment portfolio was re-invested according to a new asset mix policy. In moving from a portfolio which was invested 85% in global equities and 15% in Canadian bonds to a portfolio invested 68% in global equities, 20% in Canadian bonds and 12% in other alternative investments, including real estate and income trusts, the Council has increased the diversity of its holdings and sources of investment returns.

The market value of the portfolio at year end was \$276.8 million, or \$6.6 million greater than the cost. This figure represents an increase of \$15.3 million over the market value of the previous year. The table below shows the investment returns generated by the investment managers on both the Council and other endowments and the Killam endowments.

	Council and other endowments		Killam endowments	
	1 YR	5 YR	1 YR	5 YR
Total fund return	8.2%	1.5%	8.0%	1.9%
Total fund objective	6.0%	-3.0%	6.0%	-1.7%

### Parliamentary Appropriation and Grant Expenditures

The Council's parliamentary appropriation of \$152.1 million was \$3.5 million lower than that of the previous year. This was the result of the loss of funding for specific initiatives and the Council's contribution to the government-wide resource reallocation exercise.

The impact of this revenue reduction was most felt in Council's granting programs. Grant expenses were \$4.5 million lower in 2004-2005 and totaled \$132.3 million. Nonetheless, some 4,349 artists and arts organizations and 14,441 authors in the Public Lending Right program benefited from Council programs.

### **Canada Council Art Bank**

The Art Bank was able to acquire new artworks totaling \$229,000 during the past year for its rental operation. Once again the Art Bank was able to operate at break-even for the past year, and continued to build up its reserve for new purchases, which amounted to \$445,000 at March 31, 2005.

### **Administration Costs**

The Council's overall administration costs were \$129,000 lower in 2004-2005 and \$273,000 under budget. General administration expenses were \$630,000 lower than the previous year.

### **Financial Statement Presentation**

This year's financial statement presentation contains additional disclosure on Derivative Financial Instruments and enhanced disclosure on the Investments held by the Council. These are both significant items for the Council. The information provided should better inform readers of Council's activities and the steps taken by the Council to mitigate the inherent risks associated with these activities.

Accounting standards recently adopted by the Canadian Institute of Chartered Accountants (CICA) will have an impact on the method in which financial information is reported in subsequent years. These new standards will come into effect in 2007-2008 unless they are adopted at an earlier date by the Council. They affect the recognition, measurement and classification of financial instruments and the recognition of income on financial instruments. The Council is currently determining the impact these standards will have on its financial reporting.

CANADA COUNCIL FOR THE ARTS

**MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING**

The accompanying financial statements of the Canada Council for the Arts and all the information in this annual report are the responsibility of Management and have been approved by the Council.

The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, Management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Management has prepared the financial information presented elsewhere in the annual report and has ensured that it is consistent with that in the financial statements.

The Canada Council for the Arts maintains systems of internal accounting and administrative controls of high quality, consistent with reasonable cost. Such systems are designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that the organization's assets are appropriately accounted for and adequately safeguarded.


The Members of Council are responsible for the management of the business and activities of the Canada Council for the Arts. In particular, they are responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. They exercise this responsibility through the Audit and Finance Committee, which is composed of Members who are not employees of the Canada Council for the Arts. The Audit and Finance Committee meets with Management, the internal auditors and the Auditor General of Canada on a regular basis. The Committee reports its findings to Council for consideration when approving the financial statements.

The independent auditor, the Auditor General of Canada, is responsible for auditing the financial statements of the Canada Council for the Arts, and for issuing her report thereon.



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Director  
John Hobday



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Secretary-Treasurer  
Mark Watters

June 13, 2005



Auditor General of Canada  
Vérificatrice générale du Canada

## AUDITOR'S REPORT

To the Canada Council for the Arts  
and the Minister of Canadian Heritage

I have audited the balance sheet of the Canada Council for the Arts as at March 31, 2005 and the statements of operations, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the Council's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Council as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink, appearing to read 'Lyse Ricard'.

Lyse Ricard, CA  
Assistant Auditor General  
for the Auditor General of Canada

Ottawa, Canada  
June 13, 2005

## FINANCIAL STATEMENTS

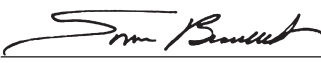
CANADA COUNCIL FOR THE ARTS  
Balance Sheet as at March 31

	2005	2004 (Restated - Note 17)
	(in thousands of dollars)	
<b>ASSETS</b>		
Current Assets		
Cash equivalents (Note 4)	\$ 1,614	\$ 4,748
Accrued investment income	3,917	224
Accounts receivable	4,793	3,183
Prepaid expenses	211	176
Derivative related amounts receivable (Note 5)	555	-
	<u>11,090</u>	<u>8,331</u>
Investments (Note 6)	270,243	262,927
Works of art and musical instruments (Note 7)	19,099	19,278
Other capital assets (Note 8)	4,400	4,153
	<u>293,742</u>	<u>296,488</u>
Total Assets	<u>\$ 304,832</u>	<u>\$ 294,689</u>
<b>LIABILITIES</b>		
Current Liabilities		
Bank indebtedness	\$ 1,782	\$ 1,798
Grants payable	21,324	22,601
Accounts payable and accrued liabilities	2,517	3,011
Deferred parliamentary appropriations	3,289	441
Derivative related amounts payable (Note 5)	526	-
	<u>29,438</u>	<u>27,851</u>
Deferred revenues	2,553	2,608
Employee future benefits (Note 9)	1,424	1,328
Deferred contributions (Note 10)	945	1,306
	<u>5,922</u>	<u>5,942</u>
Total Liabilities	<u>34,360</u>	<u>33,093</u>
<b>PRIVATE ENDOWMENTS (Note 11)</b>	<u>68,548</u>	<u>69,343</u>
<b>EQUITY</b>		
Endowment		
Original contribution	50,000	50,000
Appropriated surplus	121,245	123,600
	<u>171,245</u>	<u>173,600</u>
Surplus		
Invested in works of art and musical instruments	19,099	19,278
Unrestricted	11,580	(625)
	<u>30,679</u>	<u>18,653</u>
Total Equity	<u>201,924</u>	<u>192,253</u>
Total Liabilities, Private Endowments and Equity	<u>\$ 304,832</u>	<u>\$ 294,689</u>

On behalf of the Council:



Karen Kain  
Chair



Simon Brault  
Vice-Chair

*(The accompanying notes and schedules form an integral part of the financial statements)*

CANADA COUNCIL FOR THE ARTS  
Statement of Operations for the year ended March 31

	2005	2004 (Restated - Note 17)
	(in thousands of dollars)	
<b>REVENUE</b>		
Net investment income (Note 12)	\$ 14,764	\$ 934
Net Art Bank revenue (Note 13)	76	274
Other	2,047	1,492
	<u>16,887</u>	<u>2,700</u>
<b>EXPENSES</b>		
Programs		
Grants (Schedule 1)	132,328	136,794
Administration (Schedule 2)	9,121	8,620
Services	3,915	4,799
	<u>145,364</u>	<u>150,213</u>
Canadian Commission for UNESCO (Note 13)	1,946	1,634
General administration (Schedule 2)	11,609	12,239
	<u>158,919</u>	<u>164,086</u>
Net cost of operations before parliamentary appropriation	142,032	161,386
Parliamentary appropriation	152,111	155,604
<b>Surplus (deficit) for the year</b>	<u>\$ 10,079</u>	<u>\$ (5,782)</u>

*(The accompanying notes and schedules form an integral part of the financial statements)*

CANADA COUNCIL FOR THE ARTS  
Statement of Changes in Equity for the year ended March 31

	2005	2004 (Restated - Note 17)
	(in thousands of dollars)	
<b>ENDOWMENT</b>		
Original contribution	\$ 50,000	\$ 50,000
Appropriated surplus		
Balance at beginning of the year	123,600	116,070
Appropriated (to) from unrestricted surplus during the year	(2,355)	7,530
Balance at end of the year	121,245	123,600
<b>Balance of Endowment at end of the year</b>	<b>\$ 171,245</b>	<b>\$ 173,600</b>
<b>SURPLUS</b>		
Invested in works of art and musical instruments		
Balance at beginning of year	\$ 19,278	\$ 19,368
Net disposals during the year	(408)	(308)
Appropriated from unrestricted surplus during the year	229	218
Balance at end of the year	19,099	19,278
Unrestricted		
Balance at beginning of the year, as previously reported	13,548	17,584
Cumulative adjustments to prior years – Note 17	(14,173)	(4,679)
Balance at beginning of the year, restated	(625)	12,905
Surplus (deficit) for the year	10,079	(5,782)
Appropriated from (to) endowment during the year	2,355	(7,530)
Appropriated to surplus invested in works of art and musical instruments during the year	(229)	(218)
Balance at end of the year	11,580	(625)
<b>Balance of surplus at end of the year</b>	<b>\$ 30,679</b>	<b>\$ 18,653</b>

*(The accompanying notes and schedules form an integral part of the financial statements)*



CANADA COUNCIL FOR THE ARTS  
Statement of Cash Flows for the year ended March 31

	2005	2004 (Restated - Note 17)
	(in thousands of dollars)	
<b>OPERATING ACTIVITIES</b>		
Surplus (deficit) for the year	\$ 10,079	\$ (5,782)
Items not affecting cash and cash equivalents		
Unrealized losses on foreign exchange	7,645	12,186
Distribution income from foreign denominated investments	(4,357)	(2,361)
Deferred contributions transferred from private endowments	(795)	(2,922)
Amortization – other capital assets	901	1,198
Amortization – other capital assets – Art Bank	117	106
Employee future benefits	96	81
	<u>13,686</u>	<u>2,506</u>
Change in non-cash operating assets and liabilities	<u>(4,707)</u>	<u>4,055</u>
Cash provided by operating activities	<u>8,979</u>	<u>6,561</u>
<b>FINANCING ACTIVITIES</b>		
Endowment contributions received	<u>-</u>	<u>85</u>
<b>INVESTING ACTIVITIES</b>		
Purchases of investments	(182,421)	(18,329)
Sales/maturities of investments	171,817	8,413
Acquisition of other capital assets and works of art and musical instruments	<u>(1,493)</u>	<u>(2,992)</u>
Cash used for investing activities	<u>(12,097)</u>	<u>(12,908)</u>
Decrease in cash and cash equivalents	(3,118)	(6,262)
Cash and cash equivalents at beginning of the year	<u>2,950</u>	<u>9,212</u>
<b>Net (bank indebtedness) cash position at the end of the year</b>	<u>\$ (168)</u>	<u>\$ 2,950</u>
Represented by:		
Cash equivalents	\$ 1,614	\$ 4,748
Bank indebtedness	(1,782)	(1,798)
	<u>\$ (168)</u>	<u>\$ 2,950</u>

*(The accompanying notes and schedules form an integral part of the financial statements)*

CANADA COUNCIL FOR THE ARTS  
Notes to Financial Statements  
March 31, 2005

1. Authority, Operations and Objectives

The Canada Council for the Arts, 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 of the *Financial Administration Act*, the Canada Council is exempt from Divisions I to IV of Part X of this Act. The Canada Council for the Arts is a national organization whose objectives are to foster and promote the study, enjoyment and production of works in the arts.

The Council achieves its objectives through a grants program to professional Canadian artists and arts organizations. The Council incurs administration and services expenses in the delivery of programs. Program administration expenses are detailed in Schedule 2 and represent the direct costs of program delivery. Program services expenses mainly represent the costs associated with the adjudication of 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 Canadian Commission for UNESCO 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. Significant Accounting Policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The significant accounting policies of the Council are:

(a) Measurement uncertainty

The preparation of financial statements in accordance with Canadian GAAP requires the Council to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the year. Employee-related liabilities, accrued investment income and the estimated useful lives of capital assets are the most significant items where estimates are used. Actual results could differ from those estimated.

(b) Cash equivalents

Cash equivalents are carried at cost. 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 Council's balance sheet comprise units in a short-term pooled fund.

(c) Investments

The investments are recorded at cost and are written down to market value when the loss in value is considered to be other than a temporary decline. The investments may be sold in response to changes in Council's liquidity requirements and to rebalance the asset mix to benchmarks stipulated in Council's investment policy.

(d) Other capital assets and works of art and musical instruments

Equipment and leasehold improvements are carried at cost less the 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	term of the lease

Purchased works of art and musical instruments are capitalized at cost. Donated works of art and musical instruments are recorded at their appraised value. No amortization is recorded on these assets.

(e) 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 March 31<sup>st</sup>. 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. 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 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 year in which the services are rendered and represent the total pension obligations of the Council. The Council currently is not required to make contributions with respect to actuarial deficiencies of the Public Service Pension Plan.

(f) Endowment – appropriated surplus

In years when net investment income exceeds the operational requirements of the Council, an amount may be appropriated to the appropriated surplus of the endowment account from the balance of the unrestricted surplus. In years when net investment income does not meet the operational requirements of the Council, an amount may be appropriated from the appropriated surplus of the endowment account to the unrestricted surplus.

(g) Revenue Recognition

(i) Investment income

Investment income is recorded on an accrual basis and includes realized gains and losses on disposal of investments, foreign currency gains and losses on matured currency forward contracts, dividends and interest earned on pooled funds, changes in the unrealized fair value of the unsettled derivatives, and exchange gains or losses from the re-measurement of foreign denominated investments using the currency exchange rates in effect on March 31<sup>st</sup>. Gains and losses on investments sold during the year are recorded when they are realized and the corresponding asset is removed from the balance sheet. Realized gains and losses represent the difference between sale proceeds and cost, less related costs of disposition.

(ii) Parliamentary appropriation

Parliamentary appropriation is recognized as revenue in the year for which it is approved by Parliament. Parliamentary appropriation intended for future years received from Parliament before the end of the year are recorded as deferred parliamentary appropriation. The parliamentary appropriation is mainly used for operations.

(iii) Contributions

The Canada Council for the Arts follows the deferred contribution method of accounting for contributions.

Unrestricted contributions are recognized as other revenue in the year received or in the year the funds are committed to the Canada Council for the Arts if the amount can be reasonably estimated and collection is reasonably assured. Unrestricted investment income is recorded as revenue in the year it is earned.

Contributions externally restricted, and related investment income are recorded as deferred contributions and are recognized as revenue in the year in which the related expenses are incurred.

Endowment contributions are recognized as direct increases to private endowments.

Contributions in kind are recorded at their fair value when they are received.

(iv) Art Bank rental revenues

Revenues generated from the rental of works of art are recognized in the year in which services are provided. They are included in Net Art Bank revenue.

(v) Other revenues

Other revenues mainly consist of the cancellation of grants approved in previous years.

(h) Grants

Grants are recorded as an expense for the year in which they are approved by the Council.

(i) Derivative financial instruments

The Council is exposed to foreign currency risk because it holds assets of global equities denominated in foreign currencies. Derivative financial instruments ("derivatives") are used by the Council in the management of its foreign currency exposure.

The Council's investment policies and goals restrict the use of derivatives to currency forward and futures contracts to manage risk. The Council holds its derivatives until maturity and does not use them for speculative purposes.

The Council does not apply hedge accounting to its derivatives. Derivatives are recognized on the balance sheet upon acquisition, and removed from the balance sheet when they are settled. Both on initial recognition and subsequently, each derivative is recognized as either an asset or a liability on the balance sheet at its fair value. Derivatives with a positive fair value are reported as derivative related amounts receivable as a component of total assets. Derivatives with a negative fair value are reported as derivative related amounts payable as a component of total liabilities. All changes in the fair value of derivatives are recognized on the statement of operations under net investment income in the period in which they occur.

(j) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate in effect at the balance sheet date. Revenue and expense items are translated at average exchange rates during the year. All exchange gains and losses are included in determining net income for the year.

(k) Operating leases

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

(l) Future accounting changes

In January 2005 the Canadian Institute of Chartered Accountants (CICA) issued the following two accounting standards that will impact the Council:

**Financial Instruments – Recognition and Measurement** - This standard sets out criteria for the recognition, derecognition, measurement and classification of financial instruments. The Council will be required to categorize its financial assets as held for trading, held to maturity, available for sale, or as loans and receivables. The related accounting treatment will be dependent on the classification. Financial assets categorized as held for trading or available for sale are to be measured at fair value while financial assets held to maturity, loans and receivables are measured at amortized cost.

Comprehensive Income - This standard requires certain gains and losses that would otherwise be recorded as part of net income to be presented in other comprehensive income until such time as it is considered appropriate for them to be recognized in net income. The Council may be required to present a new financial statement titled Comprehensive Income to record such amounts until they are realized.

These new standards will come into effect for the Council's 2007/2008 fiscal year, however early adoption provisions exist. The Council is in the process of determining the impact these standards will have on its financial reporting.

3. Change in Accounting Policy

**Accounting Guideline 13-Hedging Relationships (AcG-13) and Emerging Issues Committee Abstract 128-Accounting for Trading, Speculative or Non-hedging Derivative Financial Instruments (EIC-128)**

The CICA issued AcG-13 for hedging relationships that became effective for the Council on April 1, 2004. The new standard sets out more stringent criteria that hedging relationships must meet in order for the Council to apply hedge accounting. Any derivative financial instruments held by the Council which do not qualify as hedges under this guideline must be carried at fair value on the balance sheet, and any changes in the fair value must be charged or credited to the statement of operations in accordance with EIC-128.

The Council has entered into foreign currency forward contracts during the year to hedge certain investments. These hedging relationships do not qualify for hedge accounting. As a result, the Council adopted EIC-128 prospectively in 2004-2005 as required by Canadian GAAP. Prior to 2004-2005, the Council used the hedge accounting method (settlement method) for its derivative financial instruments.

As a result of the implementation of EIC-128, the Council reported a net unrealized fair value adjustment gain of \$29,000 (unrealized gain of \$555,000 and unrealized loss of \$526,000) on the statement of operations for 2004-2005. This amount has been reported on the statement of operations under net investment income. The impact of recognizing derivatives at fair value on the balance sheet resulted in an increase in the assets of \$555,000 and in an increase in liabilities of \$526,000.

4. Cash Equivalents

The objective of the Canada Council with respect to the management of liquidity is to ensure that the capital value of the funds is preserved, that the investments are liquid and that interest income is maximized given the quality and liquidity constraints of the investment policy. The permitted and prohibited investments are governed by a Board approved short-term funds investment policy.

The Canada Council invests temporary surplus cash in a short-term pooled fund managed by Lancaster Investment Counsel. All instruments held in the pooled fund are rated R1 (low) or A (low) or better by a recognized bond rating agency. This fund is comprised of securities issued by federal, federally guaranteed and corporate issuers. Except for federal and federally guaranteed instruments, no more than 10% of the short-term portfolio is invested with any one issuer. For the year ended March 31, 2005 the overall portfolio return was 2.63% (2004 – 2.47%) and as at March 31, 2005 the average weighted term to maturity is 37 days (2004 – 77 days).

The net book value of cash equivalents as at March 31, 2005 and March 31, 2004 approximated the market value.

5. Derivative Financial Instruments

Derivative use has been limited to 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 three month period.

In any transaction there is a potential for loss. This loss potential is represented by (1) credit risk, wherein the counterparty fails to perform an obligation as agreed upon, causing the other party to incur a financial loss, and (2) market risk, where an exposure exists as a result of changes in foreign exchange rates or interest rates.

The Council manages its exposure to credit risk by contracting only with creditworthy counterparties. During the year, the Council entered into foreign currency forward contracts to manage its exposure to foreign currency exchange risk on the non Canadian dollar denominated equity funds managed by Barclays Global Investors. The Council manages its exposure to market risk using limits set out in the Council's investment policy.

Although foreign currency forward contracts are measured in terms of their notional amounts, these amounts are not recorded on the balance sheet as the notional amounts serve as points of reference for calculating payments and are not the actual amounts that are exchanged. At March 31, 2005, the Council held foreign currency forward contracts, for settlement July 6, 2005, with a notional amount of \$93 million (2004 - \$106 million).

Beginning April 1, 2004, and on a prospective basis in accordance with AcG-13, the Council now recognizes and measures its foreign currency forward contracts at fair value, with changes in fair value being recognized in income. The net fair value of outstanding foreign exchange forward contracts is \$29,000 (unrealized gain of \$555,000 and unrealized loss of \$526,000) and reflects the fair value of the net potential gain if settlement were to take place on March 31, 2005. The positive fair value is recorded on the balance sheet under derivative related amounts receivable and the negative fair value under derivative related amounts payable and the net unrealized gain on the statement of operations in Net investment income. Prior to April 1, 2004, the Council did not measure derivative financial instruments at fair value but rather on a settlement basis. The fair value of outstanding foreign exchange forward contracts as at March 31, 2004 was \$1,337,000. This unrecognized and unrealized gain on these currency forward contracts was not recorded on the balance sheet.

Net investment income includes a foreign exchange gain of \$8.5 million (2004 - \$4.1 million) on matured foreign currency forward contracts. Included in Accrued investment income, is a receivable of \$2.6 million (2004 - (\$0.9 million)) for foreign currency forward contracts that matured on March 31<sup>st</sup>, and settled on April 6, 2005 (2004 - April 6, 2004).

#### 6. Investments

	2005			2004 (Restated Note - 17)		
	Cost \$	%	Market Value \$ (in thousands of dollars)	Cost \$	%	Market Value \$
<u>Canada Council and Other Endowments</u>						
Pooled funds						
Equity	\$ 157,812	74.3	\$ 162,085	\$ 173,510	85.0	\$ 172,985
Fixed income	41,408	19.5	42,513	30,689	15.0	32,730
Alternative	4,283	2.0	4,523	-	-	-
Income Trusts	8,450	4.0	9,607	-	-	-
Real Estate	472	0.2	470	-	-	-
Mortgages	1	0.0	1	3		3
	<u>212,426</u>	<u>100.0</u>	<u>219,199</u>	<u>204,202</u>	<u>100.0</u>	<u>205,718</u>
<u>Killam Endowments</u>						
Pooled Funds						
Equity	43,415	75.1	42,568	51,390	87.5	47,980
Fixed income	10,961	18.9	11,241	7,335	12.5	7,823
Alternative	1,137	2.0	1,200	-	-	-
Income Trusts	2,186	3.8	2,488	-	-	-
Real Estate	118	0.2	118	-	-	-
	<u>57,817</u>	<u>100.0</u>	<u>57,615</u>	<u>58,725</u>	<u>100.0</u>	<u>55,803</u>
Total investments	<u>\$ 270,243</u>		<u>\$ 276,814</u>	<u>\$ 262,927</u>		<u>\$ 261,521</u>

The long term objectives of the Canada Council and Other Endowments and the Killam Endowments 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 Canada Council invests in units of equity, fixed income and alternative pooled funds, in segregated income trusts and in units of a real estate 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 Council Members in June 2004. In doing so, asset class allocations can vary between a minimum and a maximum.

Asset Classes	Actual %	Minimum %	Benchmark %	Maximum %
Equities	74.5%	55%	68%	80%
Fixed income	19.4%	10%	20%	25%
Alternatives	2.0%	0%	4%	6%
Income Trusts	3.9%	0%	4%	6%
Real Estate	0.2%	0%	4%	6%

As at March 31<sup>st</sup>, 2005, the Council is making progress towards meeting these benchmarks. Departures from these benchmarks represent assets in transition from one asset class to another.

Investments in the equity pooled funds are comprised of units of four pooled funds. These funds are invested in the global equity markets. Investments in the fixed income pooled fund are comprised of Canadian Government and corporate bonds with a minimum credit quality of BBB rated by a recognized bond rating agency. Investment in the alternative pooled fund is comprised of diversified positions across Canadian and global asset classes. Investments in income trusts are comprised principally of Canadian income funds that include: Real Estate Investment Trusts; Business and Industrial Funds; Commodity-based Royalty Trusts; and Pipeline and Power Generation Trusts. The assets included in real estate are commercial real estate properties valued between \$2 and \$15 million each.

Funds	2005 Annualized return %	2004 Annualized return %
Equities		
Templeton Master Trust – Series 2	6.5%	42.7%
Barclays Indexed Equity	10.6%	37.8%
Fixed income – Barclays Universe Bond Index	5.0%	10.7%
Alternatives – Barclays Global Market Selection class A	11.7%	N/A
Income Trusts - Acuity	18.6%	N/A

The Equity pooled funds are managed by two managers. Franklin Templeton Investments manage the global Templeton Master Trust – Series 2, an actively managed portfolio of global equities. Barclays Global Investors manages three index funds that are measured against the returns of global equity markets. These are: the BGICL Active Canadian Equity Fund, the BGICL Alpha Tilts Fund B and the BGICL International Alpha Tilts B. The fixed income pooled fund is comprised of the BGICL Universe Bond Index Class A. The fixed income fund is intended to replicate the returns of the Scotia Capital Universe Bond Index. The alternative pooled fund is comprised of the BGICL Global Market Selection Class A. The income trusts are managed by Acuity Investment Management and are managed on a segregated basis. These investments are measured against the returns of the Scotia Capital Income Trust Index. The investments in real estate are managed by Greiner-Pacaud Management Associates and will be made over a period of two to three years as investment opportunities arise. The real estate investments have just started and annualized returns are not available.

The market value is based on the market price calculated by the investment managers as at March 31<sup>st</sup>.



7. Works of Art and Musical Instruments

	2005	2004
	(in thousands of dollars)	
Works of Art	\$ 17,551	\$ 17,730
Musical Instruments	1,548	1,548
	<u>\$ 19,099</u>	<u>\$ 19,278</u>

The Canada Council for the Arts Art Bank has the largest number of contemporary Canadian works of art in Canada. It includes about 17,550 paintings, sculptures, drawings, photographs and prints by over 3,000 artists. The Art Bank rents art works to interested parties and presently has about 6,000 (2004 - 6,000) works on rental to federal government departments and agencies, associations, hospitals, schools, municipalities and private corporations.

The Canada Council for the Arts created the Musical Instrument Bank in 1985 and it presently owns a fine cello bow and five quality musical instruments. In addition, the Council manages seven instruments on loan from an anonymous donor until August 2006.

8. Other Capital Assets

	2005			2004
	Cost	Accumulated amortization	Net Book Value	Net Book Value
	(in thousands of dollars)			
Office equipment	\$ 6,401	\$ 5,559	\$ 842	\$ 1,080
Leasehold improvements	4,670	1,112	3,558	3,073
	<u>\$ 11,071</u>	<u>\$ 6,671</u>	<u>\$ 4,400</u>	<u>\$ 4,153</u>

9. Employee Future Benefits

## i) Severance benefits

The Council provides severance benefits to its employees based on years of service and final salary. This benefit plan is not pre-funded and thus has no assets, resulting in a plan deficit equal to the accrued benefit obligation. Benefits will be paid from future appropriations or other sources of revenue. Information about the plan, measured as at March 31<sup>st</sup>, is as follows:

	2005	2004
	(in thousands of dollars)	
Accrued benefit obligation, beginning of year	\$ 1,328	\$ 1,247
Cost for the year	166	143
Benefits paid during the year	(70)	(62)
	<u>\$ 1,424</u>	<u>\$ 1,328</u>



## ii) Pension benefits

The Council and all eligible employees contribute to the Public Service Pension Plan. This pension plan provides benefits based on years of service and average earnings at retirement. The benefits are fully indexed to the increase in the Consumer Price Index. The Council's and employees' contributions to the Public Service Pension Plan for the year were as follows:

	2005	2004
	(in thousands of dollars)	
Employer's contributions	\$ 1,346	\$ 1,408
Employees' contributions	598	584

10. Deferred Contributions

Deferred contributions represent unspent externally restricted net income on endowments and contributions received by way of bequest and donations that have been restricted for specific purposes established by the donors. In addition, deferred contributions include other sources of revenue that have been restricted for specific purposes. The funds of the endowments are included with the Canada Council for the Arts' investment portfolio and a proportionate share for each endowment is calculated based upon the market value of the investment portfolio at the time the endowment was received. The additions include net investment income or loss (interest, dividends and net capital gains or losses) calculated annually as the proportionate share of each endowment plus any other sources of revenue. Use of funds is equal to the grants and administration expenses incurred in order to meet the specific purpose for each endowment.

	2005	2004
		(Restated - Note 17)
	(in thousands of dollars)	
Balance, beginning of year	\$ 1,306	\$ 1,279
Additions – Net investment income (loss)	1,707	(88)
Use of funds	(2,863)	(2,807)
Transferred from private endowments (Note 11)	795	2,922
Balance at end of year	<u>\$ 945</u>	<u>\$ 1,306</u>

11. Private Endowments

Private endowments consist of restricted donations received by the Council. The endowment principal of \$33,835,685 is required to be maintained intact. Also, the Council may transfer a portion of the income earned on these donations to the endowment principal once the operational needs of the Council have been met. If the operational needs of the Council exceed the income earned, then a transfer from endowment principal to operations of all or a portion of the excess, will be made.

Changes in private endowments are as follows:

	2005	2004
		(Restated - Note 17)
	(in thousands of dollars)	
Balance, beginning of year	\$ 69,343	\$ 72,180
Add donations received during the year		
Joan Lowndes Fund	-	85
Deduct		
Private endowments transferred to deferred contributions (Note 10)	(795)	(2,922)
Balance at end of year	<u>\$ 68,548</u>	<u>\$ 69,343</u>

12. Net Investment Income

	2005	2004 (Restated - Note 17)
	(in thousands of dollars)	
Net gains (losses) on disposal of investments	\$ 6,449	\$ (194)
Net gains (losses) on foreign currency	512	(8,038)
Dividends	4,960	4,175
Interest	3,205	3,172
Transfer from deferred contributions and private endowments	1,177	2,895
Investment portfolio management costs	(1,539)	(1,076)
	<u>\$ 14,764</u>	<u>\$ 934</u>

13. Net Art Bank Revenue and Canadian Commission for UNESCO

	2005	2004
	(in thousands of dollars)	
Net Art Bank Revenue		
Rental revenue	\$ 1,647	\$ 1,756
Other income	168	158
Administration	(1,622)	(1,534)
Amortization	(117)	(106)
Net Art Bank revenue	<u>\$ 76</u>	<u>\$ 274</u>

	2005	2004
	(in thousands of dollars)	
Canadian Commission for UNESCO		
Program expenses	\$ 767	\$ 698
Program – contributions received	(4)	(316)
Administration	1,183	1,252
	<u>\$ 1,946</u>	<u>\$ 1,634</u>

Program expenses mainly represent the costs associated with the Commission's activities at 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.

14. Commitments

(a) Payments of grants extending into future years are subject to the provision of funds by Parliament. Future year grants approved prior to March 31, 2005 are payable as follows:

	(in thousands of dollars)
2006	\$ 55,199
2007	35,056

(b) The Council is party to long-term operating leases with respect to rental accommodation. The net minimum annual rental is as follows:

	(in thousands of dollars)	
2006	\$	3,143
2007		3,143
2008		3,143
2009		3,302
2010		3,314
2011 – 2014		11,335

#### 15. 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 and on normal trade terms applicable to all individuals and enterprises. During the year, the Council incurred grant expenses totaling \$297,000 (2004 - \$95,000) and recorded rental revenues of art works, contributions and other revenues totaling \$1,981,000 (2004 - \$2,148,000) with related parties.

As at March 31<sup>st</sup>, the Council recorded the following amounts on the balance sheet for transactions with related parties:

	2005	2004
	(in thousands of dollars)	
Accounts receivable	\$ 4,451	\$ 2,699
Grants payable	219	119
Accounts payable and accrued liabilities	6	11
Deferred revenues	771	694

The Council is not exposed to significant interest or credit risk related to its accounts receivable.

#### 16. Fair Value of Financial Instruments

The Council's financial instruments consist of cash equivalents, accounts receivable, accrued investment income, derivative related amounts receivable, investments, bank indebtedness, grants payable, accounts payable and accrued liabilities and derivative related amounts payable which are incurred in the normal course of business. The carrying amounts of these financial instruments, excluding the investments and derivative related amounts, approximate their fair value because of their short-term maturity.

The fair values of the investments are estimated market prices calculated by the investment managers. The market value is listed in note 6.

Fair value estimates for the derivative financial instruments are calculated using the current market spot and the forward exchange rates at year end. The fair value is listed in note 5.

## 17. Adjustments to Prior Years' Results

The Council has determined that the carrying value of its investments as at March 31, 2004 and in prior years (2001 to 2003) was overstated. The Council did not correctly apply Canadian generally accepted accounting principles requiring it to translate monetary assets denominated in foreign currency into Canadian dollars using the exchange rate in effect at the balance sheet date. Instead, its investments were carried at their cost, translated into Canadian dollars using the exchange rates in effect at the date of acquisition.

Consequently, the comparative financial statements presented for the year ended March 31, 2004 have been restated. The effect on these statements is as follows; Investments have decreased by \$18,171,000, Net investment income and Surplus (deficit) has decreased by \$9,494,000, deferred contributions have decreased by \$288,000, Private endowments have decreased by \$3,710,000, the beginning balance of Unrestricted Surplus has decreased by \$4,679,000 which represents the cumulative effect of the error on years prior to 2004, and the ending balance of Unrestricted Surplus has decreased by \$14,173,000. There is no impact on the information presented for the current year.

## 18. Comparative Figures

Certain of the 2004 figures have been reclassified to conform to the presentation adopted in 2005.

CANADA COUNCIL FOR THE ARTS  
Schedule of Grant Expenses by Section for the year ended March 31

	(in thousands of dollars)	
	<u>2005</u>	<u>2004</u>
<u>Arts Programs</u>		
Music	\$ 26,808	\$ 27,383
Theatre	22,461	22,605
Writing and Publishing	19,983	20,336
Visual Arts	17,318	17,354
Dance	14,819	16,392
Media Arts	12,262	12,738
Public Lending Right Commission	9,025	9,010
Equity	1,772	2,037
Interarts	1,517	1,587
Outreach	1,149	1,189
Other	2,937	3,937
<u>Killam Program</u>		
Killam Research Fellowships	1,009	1,203
Killam Prizes	500	500
<u>Other Prizes and Awards</u>		
Japan-Canada Fund	209	150
Commission internationale du théâtre francophone	113	97
Victor Martyn Lynch-Staunton Awards	105	86
Molson Prizes	100	100
John G. Diefenbaker Award	75	75
John B.C. Watkins Award	50	15
Other prizes and awards < \$50,000	116	-
	<u>\$ 132,328</u>	<u>\$ 136,794</u>

CANADA COUNCIL FOR THE ARTS  
**Schedule of Administration Expenses for the year ended March 31**

	(in thousands of dollars)			2004
	2005			
	Program	General Administration	Total	
Salaries	\$ 6,436	3,968	10,404	\$ 9,697
Employee benefits	1,498	1,111	2,609	2,672
Office accommodation	84	2,765	2,849	3,087
Professional and special services	276	1,071	1,347	1,354
Amortization	-	901	901	1,198
Staff travel	543	218	761	845
Printing, publications and duplicating	35	626	661	803
Communications	186	224	410	432
Meeting expenses including members' honoraria	58	217	275	298
Office expenses and equipment	5	263	268	268
Information management	-	226	226	171
Miscellaneous	-	19	19	34
	<u>\$ 9,121</u>	<u>11,609</u>	<u>20,730</u>	<u>\$ 20,859</u>