Canada Council for the Arts
Narrative Discussion
For the Quarter ended June 30, 2011

Financial Results

This narrative discussion relates to the financial results of the Canada Council for the Arts (the Council) for the quarter ended June 30, 2011 as set out in the accompanying Quarterly Financial Statements. Those statements, which are presented and disclosed in accordance with the requirements of the Financial Administration Act, are the first such quarterly financial statements to be published by the Council. Additionally, they are the first set of financial statements produced in accordance with Public Sector Accounting Standards (PSAS) as issued by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants.

In the course of preparation of these statements the Council has been required to redetermine, revise and re-establish its accounting policies and several significant accounting issues have had to be resolved. Note 2 to the financial statements sets out significant matters relating to the transition to Public Sector Accounting Standards and reconciles account balances and transactions from the previous accounting framework to the current method of presentation. Note 3 discloses information regarding the Council's adoption effective April 1, 2011 of new accounting standards issued by PSAB. In this regard, the adoption of PSAS 3450- Financial Instruments was of special significance as it allowed the Council to continue to use fair value accounting for its investments. Note 4 sets out the Council's accounting policies. Note 16 sets out comparative information for the prior year.

Readers of these statements should be aware that future quarterly financial statements may vary somewhat in format and disclosure from the current statements as the Council's quarterly reporting and PSAS presentation experience and expertise evolves and improves. Further, these quarterly statements are unaudited. Therefore, the format and extent of disclosure may be different from that of the Council's audited annual financial statements for the year ended March 31, 2012 which will also be the first such statements prepared in accordance with PSAS.

The transition to PSAS causes significant issues in relation to the presentation of comparative information. Therefore the Council obtained an exemption from the Treasury Board of Canada Secretariat. This exemption does not provide full comparative presentation relief but allows the Council to present such information using the previous accounting framework (former Canadian Generally Accepted Accounting Principles). The comparative information is presented in a condensed format in Note 16.

The Council is not required under the Financial Administration Act to prepare and file a Corporate Plan with the government of Canada. Therefore, neither this narrative discussion nor the quarterly financial statements disclose a comparison of results as against the Council's Corporate Plan. As required by PSAS,the Council's annual audited financial statements for the year ended March 31, 2012 will disclose comparisons to the Council's approved budget for the year.

For the quarter ended June 30, 2011, the Council recorded a loss of $28.3 M. This loss arises almost completely from the difference in timing regarding the recording of revenue from Parliamentary appropriations which is recognized during the year as the appropriation is drawn down and the recording of grants expenses. The expenses for multi-year operating grants for which budget for the current year has been approved and which meet certain other criteria are expensed at the start of the year. Most, but not all such grants are paid during the first quarter of the year. The impact of this timing difference will decline with each quarter. The Council anticipates no material change to its Parliamentary appropriation for the year ended March 31, 2012. Grants expenses are forecast to be $2.7M higher than budgeted. However, in net, the full amount of that over expense relates to grants payments paid out of the Council's accumulated surplus that were carried over from prior years and approved by the Board of the Council to be paid during the current year. Net investment income for the quarter was not materially different from that anticipated. A shortfall on investment income earned from interest and dividends that may exceed $2M is anticipated. This arises largely from uncertainty regarding the global economy and corporate and sovereign returns.

The Statement of Changes in Net Financial Assets discloses a $28.1M decrease in net financial assets during the quarter. This decrease relates almost entirely to the $28.3 M deficit from operations for the period discussed above. The Statement of Remeasurement gains and losses discloses a net gain for the quarter of $307K. As all gains were unrealized, none were reclassified to the Statement of Operations. Subsequent to June 30, 2011 Canadian and Global financial markets have been subject to major swings. At present, the Council cannot reliably forecast either realized or unrealized investment gains or losses for the year.

Note 13 to the financial statements discloses a net change in non-cash items of $45.2M This arises primarily from the $49.1M increase in grants payable in comparison to the value as at March 31, 2011. This increase arises primarily from multi-year grants expensed at the start of the year which had not been paid by the end of the quarter. Taking into account the deficit for the period, and adjusting for changes in non-cash capital items the cash provided by operating activities during the quarter was $16.7M. In addition to operating activities, capital, investing and financing transactions also affect cash balances. The net result of all of these for the quarter was an increase in cash and cash equivalents of $16.0M. The majority of this increase was subsequently offset by grants payments issued during July.

Due to the timing of the recent federal election the Council's cash requirements against its appropriation were supplied through the use of Governor General's Special Warrants. Supply was formally approved by Parliament when it was recalled in June.

The Council's Portfolio investments arise from a $50M endowment received from the government in 1957 when the Council was created and from externally restricted contributions received subsequently. At June 30, 2011 the fair value of the Portfolio was $279.9 M, of which $75.3 M was externally restricted. The Council's liability for these contributions was $62.6M The government's original endowment is included in accumulated surplus as disclosed in Note 9.

The Council owns approximately seventeen thousand works of art. These are held by its Art Bank and rented out. The Art Bank is self-financing and reinvests its profits in new art purchases. The Art Bank recorded a loss of $58 K for the quarter. A loss of $340K is anticipated for the year. However, $320K of this loss will result from the purchase of art works funded by the accumulated net profits of prior years. The Council also operates a Musical Instrument Bank and it currently owns a fine cello bow and six quality musical instruments. In addition the Council manages ten instruments on loan, nine of which are lent by anonymous donors. Using a donation of funds from the Council's Edith Webb Endowment, during the quarter the Council purchased a Cello valued at $500K which has been renamed the 1730 Newland Joannes Franciscus Celoniatus Cello. At June 30, 2011 the appraised value of the Council's works of art was approximately $70M and the appraised value of its musical instruments was $28.0M USD. These are included on the Statement of Financial Position with tangible capital assets and are valued nominally at $1.00

RISK ANALYSIS AND SIGNIFICANT CHANGES DURING AND SUBSEQUENT TO THE QUARTER

At June 30, 2011 the fair value of the Council's investment portfolio was $279.9M. These represent investments in units of equity, fixed income and alternative pooled funds, limited real estate partnerships and an infrastructure fund. As discussed above global markets and the global economy are currently undergoing significant and rapid swings the impact of which cannot at present be reliably forecast. The Council is currently reassessing its investment policy, asset allocation mix and expenditure policy and will likely approve changes during the second and third quarters of this fiscal year. These changes will address Council's long-term investment and income requirements which must take into account the up and down market changes and changes in risk and certainty that constantly occur over the shorter-term.

In compliance to a request from government, the Council has budgeted and acted in a manner to ensure fiscal restraint such that administrative expenses for the current year and the next will not exceed those for 2010-11. For the first quarter of the year, the Council's expenses were less than the plan, being better, by approximately $500K. The Council forecasts to remain on plan for the remainder of the year.

The Government has commenced a Strategic and Operating Review with the goal of reducing certain expenditures by $4B on an ongoing basis by fiscal 2014-15. The review currently applies to 67 departments and agencies, including the Council. All are asked to develop scenarios that would implement either 5% or 10% reductions in their funding. The Council has participated actively in the process to date and provided its proposals, consistent with direction approved by its Board, on August 18, 2011. The outcome and impact of the government's decision regarding the Strategic and Operating Review will not be known until Budget 2012 is tabled in Parliament in February 2012.

The Council has collective agreements with two bargaining units of the Public Service Alliance of Canada. Both agreements expired on July 1, 2011. The parties met in July to commence the negotiations for new agreements.

The Council's management has recently approved plans regarding its leased space and its information systems. Both, when implemented over the next three years will redesign the Council's manner of operation while reducing costs.

USE OF APPROPRIATION

The following information is intended to supplement that provided elsewhere in this discussion regarding the Council's use of its Parliamentary appropriation.

The Council receives its main funding through parliamentary appropriation voted by Parliament. The Council records the parliamentary appropriation received in the period as revenue in the Statement of Operations. The Council is required to submit a monthly cash flow analysis to the Department of Canadian Heritage to justify its monthly drawdown cash requirements. The monthly drawdown is invested in a short term pooled fund managed by a professional investment manager from which the Council draws its daily cash requirements.

The parliamentary appropriation approved and received by the Council during the period is as follows:

	2011
Operating funding	
Approved annual funding – Vote 10 – Operating costs	181,761
Additional non-recurring funding for programming initiatives	-
Operating funding received and recorded in the Statement of Operations	(87,013)
Balance of Operating funding to be received	94,748