Quarterly Financial Report

(Unaudited)

Period ended December 31, 2012
Published February 28, 2013

Canada Council for the Arts   Conseil des arts du Canada

Management Discussion and Analysis

Change Technology Communities Transparency Adaptability Flexibility Leadership Responsiveness Synergy Artists Partnership Equity Knowledge Experience Connections Engagement Public Trust

INTRODUCTION

This narrative discussion relates to the financial results of the Canada Council for the Arts (the Council) for the nine-month period ended December 31, 2012 as set out in the accompanying unaudited quarterly financial statements. Those statements are disclosed in accordance with the requirements of section 131.1 of the *Financial Administration Act* and are prepared in accordance with Public Sector Accounting Standards (PSAS) issued by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants.

Management is responsible for the information presented in the unaudited quarterly financial statements and in this narrative discussion, both of which have been reviewed and endorsed by the Audit and Finance Committee of the Council's Board of Directors. In assessing what information is to be provided in the narrative discussion, management applies the materiality principle as guidance for disclosure. Management considers information material if it is probable that its omission or misstatement, judged in the surrounding circumstances, would influence the decisions of the primary user of this information, the Government of Canada.

This discussion contains "forward-looking statements" that reflect management's expectations regarding the Council's results of operations. These statements are not facts but only estimates based upon information and assumptions that are currently available to, or made by, management and which are subject to a number of risks and uncertainties. These and other factors may cause actual results to differ substantially from the expectations stated or implied in the forward-looking statements.

The *Financial Administration Act* does not require the Council to file a Corporate Plan with the Government of Canada. Therefore, neither this narrative discussion nor the unaudited quarterly financial statements disclose a comparison of results against the Council's Corporate Plan. As required by PSAS, they do provide comparisons to the Council's approved annual budget for the year.

HIGHLIGHTS

In October 2012, the Canada Council held its Annual Public Meeting (APM) in Ottawa, at the Canada Council Art Bank. The APM saw the release of the *Annual Report* and the companion *Profiles of Canada Council Funding to Artists and Arts Organizations: National Overview, Provincial and Territorial Profiles* as well as a discussion paper on the Council's strategic theme of public engagement in the arts. The paper was the launch of an online conversation about this topic which is ongoing and informing the development of internal strategies. At the end of October, the Council also met with the National Arts Service Organizations from across the country to discuss recent developments.

Net Results

	Three months ending December 31				Nine months ending December 31			
(in thousands of dollars)	2012	2011	$ change	% change	2012	2011	$ change	% change
Revenues	7,807	3,113	4,694	(151%)	10,800	3,748	7,052	188%
Expenses	(12,926)	(11,930)	(996)	(8%)	(148,491)	(152,467)	3,976	3%
Government funding	33,000	32,657	343	1%	158,127	161,618	(3,491)	(2%)
Net results for the period	**27,881**	**23,840**	**4,041**	17%	**20,436**	**12,899**	**7,537**	58%

Overview of the Third Quarter Net Results

Net results for the quarter were $27.9M, an increase of $4.0M over the third quarter of the previous fiscal year. This increase reflects the following changes in revenues, expenses and government funding which are also explained in more detail in the Financial Results section:

- Revenues for the third quarter were $4.7M higher compared to last year. This increase is due to an increase of $4.8M in investment income compared to the same period last year which is detailed in Note 9 to the quarterly financial statements.
- Expenses in the quarter were slightly higher than comparative period last year which is mostly due to timing in grant expenses.
- Government funding in the quarter was consistent with the prior year.

The Council will continue to monitor its financial results with the aim of achieving the target projections set out during the mid-year budget review exercise which projects a year-end surplus modestly above budget.

IMPORTANT CHANGES

Programs

The Council continues to advance on its major review of operating grant programs (which make up 62% of the Council's granting budget), including conducting national, disciplinary consultations. The review and resulting program modifications will be completed by the end of this planning cycle (2016) with the first revised programs rolling out in early 2013. These modifications will result in more equitable access to operating grant support and a greater movement in funds over time.

Operational Activities

- **Mid-Year Budget Review**

The mid-year review is forecasting that the Council will be slightly ahead of the 2012-13 budgeted surplus presented to the Board in January 2012. The 2013-14 budget proposal was completed and was approved by the Board at the January 2013 meeting.

- **Move to 150 Elgin Street**

The Council's move to a new, more cost-efficient green building is proceeding according to schedule.

The net effect of the use of new technology, modern construction techniques, favorable interest rates, joint fit-up collaboration with the landlord and a reduced environmental footprint is a direct cost saving to the Council such that it will take up to five years for ongoing accommodation costs to reach the 2012-13 level.

- **Systems Modernization**

The Council is undergoing significant changes to its suite of information systems. The Council has selected Bell/e-performance as the vendor for the new Customer Relationship Management system, with development and implementation set to begin in 2013-14. The new system will be more efficient and client-focused and allow for better tracking and monitoring.

A new interactive website will be launched in spring 2013 and will provide the Council with a more vibrant and connected public interface.

Leadership and Governance

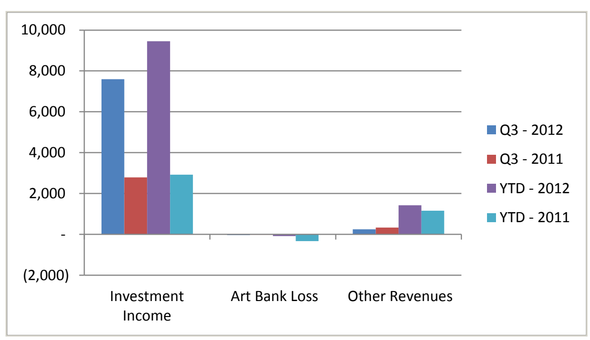
The Minister of Canadian Heritage and Official Languages announced the appointment of Mrs. Brenda Stehelin of Whitehorse, Yukon to the Board of the Canada Council effective November 2012. Mrs. Stehelin's biography can be found on the Council's website.

The Board approved the appointments of John Montalbano and Mark Jenkins as members of the Investment Committee effective January 2013.

FINANCIAL RESULTS

The following section provides further detail and explanation of financial results presented in the quarterly financial statements:

Revenues



Investment Income

- The increase of $4.8M over last year's third quarter is mainly due to a $9.1M loss from the sale of investments recorded in the same period last year. This increase was offset by a stronger Canadian dollar against other currencies which generated a $1.0M gain in the third quarter of 2011-12 versus a loss of $0.7M for the same period this year and also a reduction of $1.8M in income transferred from externally restricted endowments. Details are provided in Note 9 to the quarterly financial statements.

Art Bank Loss

- The major variance between this year-to-date's and last year-to-date's results for the Art Bank is due to the purchase of artworks for $294K last year (recorded as an expense, as per Public Sector Accounting Standards) compared to only $8K for the current year. No major purchases are expected for this fiscal year.

Other Revenues

- The cumulative increase of $0.3M compared to the same period last year is mainly due to a return on the brokerage commission from the real estate service firm.

Expenses

	Three months ending December 31				Nine months ending December 31			
(in thousands of dollars)	2012	2011	$ change	% change	2012	2011	$ change	% change
Grants	3,947	3,428	(519)	(15%)	122,288	125,982	3,694	3%
Program delivery costs	4,343	4,140	(203)	(5%)	12,752	13,104	352	3%
Canadian Commission for UNESCO	474	449	(25)	(6%)	1,382	1,538	156	10%
General administration	4,162	3,913	(249)	(6%)	12,069	11,843	(226)	(2%)
Net results for the period	**12,926**	**11,930**	**(996)**	(8%)	**148,491**	**152,467**	**3,976**	3%

Grant expenses are slightly higher than the same period last year due to the timing of competition deadlines which differ from prior years. On a cumulative basis, grant expenses are consistent with the prior year.

No other major variances were noted in the expenses.

Grants and other expenses are forecast to be close to budget.

Financial Assets

(in thousands of dollars)	As at December 31 2012	2011	$ change
Cash and cash equivalent	14,932	18	14,914
Accounts receivable	6,573	2,290	4,283
Derivatives	41	25	16
Portfolio investment	278,296	270,522	7,774
Total	**299,842**	**272,855**	**26,987**

Cash and Cash Equivalent

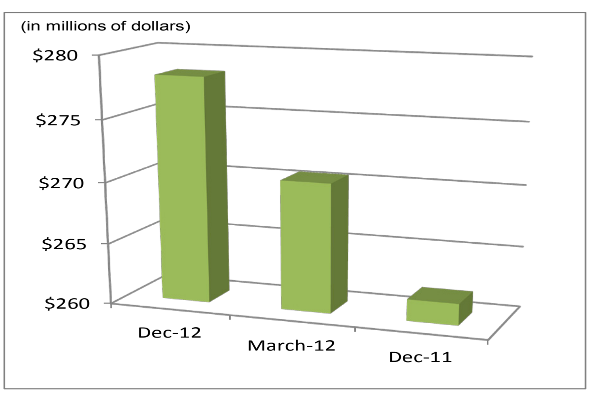
The increase of $14.9M in Cash Equivalent is primarily the result of the difference in the timing of the drawing down of Council's Parliamentary appropriation which is recognized as the appropriation is received and the cash flow requirements of grant payments. Council also received its January 2013 Parliamentary appropriation drawdown of $6.5M in the current quarter which is recorded as deferred revenue in the liability section as at December 2012.

Accounts Receivable

The increase of $4.3M arises primarily from the net distribution of $5.3M in investment income in the period not yet received as at December 31, 2012.

Portfolio Investments

The total market value of the portfolio as at December 31, 2012 was $278.3M of which $74.1M was externally restricted. This represents an increase of $7.8M since March 31, 2012 and $16.6M since December 31, 2011 as a results of positive returns.



The total fund generated an absolute return of 3.2% for the quarter which was higher than the benchmark return by 1.5% and all asset classes had positive returns. The main contributors to the returns for that period were the performance of the Global Equity and the Infrastructure managers. During the last quarter of 2012, the improvement of the global financial conditions has generated positive returns and our value managers are seeing growth prospects and opportunities.

For the year-to-date, the total fund generated an absolute return of 10.2% which was higher than the benchmark return by 1.8%. The main contributors for year-to-date return were the performance of the Global and Canadian Equity managers.

Liabilities

(in thousands of dollars)	December 31 2012	March 31 2012	$ change	% change
Bank indebtedness	-	1,581	1,581	100%
Grants payable	27,646	27,760	114	0%
Accounts payable and accrued liablities	2,009	3,710	1,701	46%
Deferred parliamentary appropriations	6,480	-	(6,480)	0%
Deferred revenues	1,827	1,827	-	0%
Derivatives	33	62	29	47%
Employee future benefits	2,576	4,237	1,661	39%
Externally restricted contributions	26,307	23,594	(2,713)	(11%)
Total	**66,878**	**62,771**	**(4,107)**	(7%)

Grants payable

The majority of multi-year grants expensed at the start of the year had been paid by the end of the nine-month period. This explains the return to a more comparative balance at the end of the current period against the March 31, 2012 balance.

Accounts payable and accrued liabilities

The decrease of $1.7M in comparison to the value as at March 31, 2012 is mainly due to a reduction of $1.0M in commercial invoices due to the timing of the payment schedule and a payment of $0.5M to Canadian Heritage for unspent funds for the National Translation Program for Book Publishing which was recorded as a payable as at March 31, 2012.

Employee future benefits

The decrease of $1.7M in comparison to the value as at March 31, 2012 is mainly due to some employees taking the option for early cashout of their severance benefits which ceased to accrue as of June 30, 2012.

Non-Financial Assets

	December 31	March 31		
(in thousands of dollars)	2012	2012	$ change	% change
Tangible capital assets	2,051	2,156	(105)	(5%)
Works of arts and musical instruments	1	1	-	0%
Prepaid expenses	802	273	529	194%
Total	**2,854**	**2,430**	**424**	17%

Works of art and musical instruments

The Council owns approximately 17,000 works of contemporary Canadian art within its Art Bank collection. The Council also operates a Musical Instrument Bank and it currently owns a fine cello bow and eight quality musical instruments. In addition, the Council manages 11 instruments on loan, 9 of which are lent by anonymous donors. At December 31, 2012 the appraised value of the Council's works of art was approximately $70M and the appraised value of its musical instruments was $28M USD. These are included on the Statement of Financial Position at a nominal value. The Council insures the works of arts and the musical instruments for their fair value.

Cash Flow

	Three months ending December 31			
(in thousands of dollars)	2012	2011	$ change	% change
Beginning of period	**13,724**	**20,392**	**(6,668)**	**(33%)**
Cash from operating activitIes	3,732	(9,883)	13,615	138%
Cash for capital assets	(210)	(140)	(70)	(50%)
Cash from investing activities	(2,314)	(1,501)	(813)	54%
Net Change	1,208	(11,524)	12,732	110%
Ending balance for the period	**14,932**	**8,868**	**6,064**	68%

Operating Transactions

The change in cash from operations of $13.6M is mostly accounted for by an inflow of $18.4M in the net change in other non-cash items, detailed in Note 12 to the quarterly financial statements. This inflow was partially offset by the $9.1M loss on disposal of portfolio investments recorded in last year's period.

Investing Transactions

The transactions that took place during the quarter in the portfolio are re-investments of income received through dividends and the settlements of forward contracts. There was no major variance from the same period last year even though last year's transactions, if you refer to the Statement of Cash Flow in the quarterly financial statements, were much more significant due to a change in the manager structure in the Global Equity asset class.

RISK MANAGEMENT

Corporate Risk

In line with good governance practices, the Council updates and revises its Corporate Risk Profile on an ongoing basis, identifying and including any changes in the Council's risk environment. In order to address the risks within the Council's corporate risk profile that are outside the Council's appetite for risk, effective risk mitigation strategies and action plans are developed, under the oversight of assigned members of executive management, to reduce the risk exposure to an acceptable and manageable level.

The Audit and Finance Committee endorsed the Risk Mitigation Strategies Plan presented by Executive management at its January 2013 meeting. Executive management will continue to monitor progress of the implementation of these mitigation strategies and will be reporting results to the Audit and Finance Committee on a regular basis.

Financial Risk

The Council is exposed to a variety of financial risks as a result of its activities. The Council's Parliamentary appropriation for 2012-13 is not affected by the government's Deficit Reduction Action Plan. This significantly reduces the revenue uncertainty from its primary source of revenue and liquidity risk. The Council's investment portfolio is primarily exposed to price risk, interest rate risk and currency risk. The Investment Committee completed its annual review of the Council's investment policy during the third quarter and decided to remain with the current asset mix allocation. This policy sets out the long term investment objectives and guidelines under which the portfolio is to be invested.

USE OF PARLIAMENTARY 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 an appropriation voted by Parliament. The Council records the Parliamentary appropriation received in the period as revenue in the Statement of Operations. The Council submits a monthly cash flow analysis to the Department of Canadian Heritage to justify its monthly drawdown cash requirements. The cash-flow requirements may not necessarily match the timing of expenses reported in the Statement of Operations. 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 third quarter was as follows:

	December	
(in thousands of dollars)	2012	2011
Approved Annual Operating funding		
Vote 10 - Operating costs	181,761	181,761
Supplementary Estimates	107	157
Reduction to non-recurring funding for programming initiatives	(500)	(500)
	181,368	181 418
Parliamentary appropriations for operating expenses recorded in the Statement of Operations for the nine month period	(158,127)	(161,618)
Balance of operating funding to be received	23,241	19,800

Quarterly Financial Statements

Connections Engagement Public Arts Change Technology Communities Transparency Adaptability Flexibility Leadership Trust Responsiveness Synergy Artists Partnership Equity Knowledge Experience

These financial statements for the quarter ended December 31, 2012 have not been audited or reviewed by our Auditor

STATEMENT OF MANAGEMENT RESPONSIBILITY

Management is responsible for the preparation and fair presentation of these quarterly financial statements in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations and for such internal controls as management determines is necessary to enable the preparation of quarterly financial statements that are free from material misstatement. Management is also responsible for ensuring all other information in this quarterly financial report is consistent, where appropriate, with the quarterly financial statements.

Based on our knowledge, these unaudited quarterly financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the corporation, as at the date of and for the periods presented in the quarterly financial statements.

February 28, 2013

Director and Chief Executive Officer
Robert Sirman

Acting Chief Financial Officer
Carole Boileau, CA

STATEMENT OF FINANCIAL POSITION

(Unaudited)

(in thousands of dollars)

	December 31 2012	March 31 2012
FINANCIAL ASSETS		
Cash and cash equivalents	$ 14,932	$ 18
Accounts receivable	6,573	2,290
Derivatives (Note 3)	41	25
Portfolio investments (Note 4)	278,296	270,522
TOTAL FINANCIAL ASSETS	299,842	272,855
LIABILITIES		
Bank indebtedness	-	1,581
Grants payable	27,646	27,760
Accounts payable and accrued liabilities	2,009	3,710
Deferred parliamentary appropriations	6,480	-
Deferred revenues	1,827	1,827
Derivatives (Note 3)	33	62
Employee future benefits (Note 6)	2,576	4,237
Deferred revenues - Externally restricted contributions (Note 7)	26,307	23,594
TOTAL LIABILITIES	66,878	62,771
NET FINANCIAL ASSETS	232,964	210,084
NON-FINANCIAL ASSETS		
Tangible capital assets	2,051	2,156
Works of art and musical instruments	1	1
Prepaid expenses	802	273
TOTAL NON-FINANCIAL ASSETS	2,854	2,430
ACCUMULATED SURPLUS (Note 8)	**$ 235,818**	**$ 212,514**
Accumulated surplus is comprised of:		
Accumulated surplus from operations	233,095	212,659
Accumulated remeasurement gains and losses	2,723	(145)
ACCUMULATED SURPLUS	**$ 235,818**	**$ 212,514**

CONTRACTUAL OBLIGATIONS AND COMMITMENTS (Note 14)

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

STATEMENT OF OPERATIONS

(Unaudited)

(in thousands of dollars)	Yearly Budget 2012	Three months ended December 31 2012	Three months ended December 31 2011	Nine months ended December 31 2012	Nine months ended December 31 2011
Revenue					
Net investment income (Note 9)	$ 9,353	$ 7,597	$ 2,795	$ 9,452	$ 2,920
Net Art Bank Income (loss) (Note 10)	6	(39)	(18)	(78)	(332)
Other revenue	1,277	249	336	1,426	1,160
Total revenue	10,636	7,807	3,113	10,800	3,748
Expenses					
Programs					
Grants	153,391	3,947	3,428	122,288	125,982
Administration	13,687	3,250	3,194	9,454	9,470
Services	6,683	1,093	946	3,298	3,634
	173,761	8,290	7,568	135,040	139,086
Canadian Commission for UNESCO (Note 11)	2,329	474	449	1,382	1,538
General administration	15,792	4,162	3,913	12,069	11,843
Total expenses	191,882	12,926	11,930	148,491	152,467
Deficit from operations before parliamentary appropriations for the period	(181,246)	(5,119)	(8,817)	(137,691)	(148,719)
Parliamentary appropriations	181,261	33,000	32,657	158,127	161,618
SURPLUS FROM OPERATIONS FOR THE PERIOD	15	27,881	23,840	20,436	12,899
ACCUMULATED SURPLUS FROM OPERATIONS, BEGINNING OF PERIOD	212,659	205,214	208,176	212,659	219,117
ACCUMULATED SURPLUS FROM OPERATIONS, END OF PERIOD	**$ 212,674**	**$ 233,095**	**$ 232,016**	**$ 233,095**	**$ 232,016**

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

STATEMENT OF CHANGE IN NET FINANCIAL ASSETS

(Unaudited)

(in thousands of dollars)

	Three months ended December 31		Nine months ended December 31	
	2012	2011	2012	2011
SURPLUS FROM OPERATIONS FOR THE PERIOD	$ 27,881	$ 23,840	$ 20,436	$ 12,899
Acquisition of tangible capital assets	(210)	(140)	(627)	(304)
Amortization of tangible capital assets	244	249	732	747
	34	110	105	443
Acquisition of prepaid expenses	(802)	(726)	(1,355)	(1,130)
Use of prepaid expenses	285	203	826	676
	(517)	(523)	(529)	(454)
Net remeasurement gains (losses)	(182)	3,881	2,868	(7,576)
INCREASE IN NET FINANCIAL ASSETS	27,216	27,308	22,880	5,312
NET FINANCIAL ASSETS, BEGINNING OF PERIOD	205,748	194,617	210,084	216,612
NET FINANCIAL ASSETS, END OF PERIOD	**$ 232,964**	**$ 221,925**	**$ 232,964**	**$ 221,924**

STATEMENT OF REMEASUREMENT GAINS AND LOSSES

(Unaudited)

(in thousands of dollars)

	Three months ended December 31		Nine months ended December 31	
	2012	2011	2012	2011
ACCUMULATED REMEASUREMENT GAINS (LOSSES), BEGINNING OF PERIOD	$ 2,905	$ (11,457)	$ (145)	$ -
Unrealized gains (losses) attributable to:				
Derivatives	(9)	(182)	34	(322)
Portfolio investments	(274)	(2,844)	2,920	(13,821)
Amounts reclassified to the Statement of Operations:				
Derivatives	101	480	(147)	140
Portfolio investment	-	6,427	61	6,427
NET MEASUREMENT GAINS (LOSSES) FOR THE PERIOD	(182)	3,881	2,868	(7,576)
ACCUMULATED REMEASUREMENT GAINS (LOSSES), END OF PERIOD	**$ 2,723**	**$ (7,576)**	**$ 2,723**	**$ (7,576)**

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

STATEMENT OF CASH FLOWS

(Unaudited)

(in thousands of dollars)

	Three months ended December 31		Nine months ended December 31	
	2012	2011	2012	2011
OPERATING TRANSACTIONS				
Surplus for the period	$ 27,881	$ 23,840	$ 20,436	$ 12,899
Losses from disposal of portfolio investments (Note 9)	-	9,068	82	9,065
Unrealized gains (losses) on change in derivatives fair value	140	-	(200)	(468)
Amortization of tangible capital assets	244	249	732	747
Decrease in prepaid expenses	(517)	(523)	(529)	(454)
Increase (decrease) in employee future benefits	(1,661)	66	(1,661)	174
Income transferred from (to) Deferred revenues -				
Externally restricted contributions (Note 7)	2,654	780	2,014	(1,646)
Transfer to other revenues	-	-	(363)	-
Net change in other non-cash items (Note 12)	(25,009)	(43,363)	382	(7,226)
Cash provided by (used by) operating activities	3,732	(9,883)	20,893	13,091
CAPITAL TRANSACTIONS				
Cash used to acquire tangible capital assets	(210)	(140)	(627)	(304)
INVESTING TRANSACTIONS				
Acquisition of portfolio investments	(2,983)	(54,305)	(6,420)	(58,514)
Disposal of portfolio investments	669	52,804	2,649	56,829
Cash provided by (used by) investing activities	(2,314)	(1,501)	(3,771)	(1,685)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,208	(11,524)	16,495	11,102
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	13,724	20,392	(1,563)	(2,234)
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$ 14,932**	**$ 8,868**	**$ 14,932**	**$ 8,868**
Represented by:				
Cash and cash equivalents	$ 14,932	$ 8,868	$ 14,932	$ 8,868
Bank indebtedness	-	-	-	-
	$ 14,932	**$ 8,868**	**$ 14,932**	**$ 8,868**

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

Notes to the Financial Statements

For the period ended December 31, 2012
(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 represent costs incurred for non-grant activities in fulfillment of the Council's mandate and costs associated with the adjudication of 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. SIGNIFICANT ACCOUNTING POLICIES

BASIS OF ACCOUNTING

These unaudited interim financial statements have been prepared in accordance with Public Sector Accounting Standards (PSAS) pursuant to the *Standard on Quarterly Financial Reports for Crown Corporation* issued by the Treasury Board.

BASIS OF PREPARATION

These interim financial statements are intended to provide an update on the latest complete set of audited annual financial statements for the year ended March 31, 2012. Accordingly, they should be read in conjunction with the audited annual financial statements. The interim financial statements are unaudited for all periods presented. The accounting policies used in the preparation of these interim condensed financial statements are consistent with those disclosed in the Council's last audited annual financial statements.

MEASUREMENT UNCERTAINTY

The preparation of financial statements in accordance with Canadian PSAS 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 year. 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.

BUDGETED FIGURES

Budgeted figures have been provided for comparison purposes and have been derived from the estimates approved by the Board.

3. 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 investment portfolio, except for the emerging market component which was unhedged and represented approximately 0.8% (March 31, 2012 – 0.9%) of the investment portfolio. The hedge strategy allows hedging of the designated assets within a range of 30% to 70% of the foreign exposure.

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 December 31, 2012, the Council held foreign currency forward contracts, for settlement on February 4, 2013, with a total notional amount of $42,262,000 (March 31, 2012 - $40,721,000) as follows:

(in thousands fo dollars)	December 31 2012			March 31 2012		
	Forward rate %	Notional amount[1] $	Fair value $	Forward rate %	Notional amount[1] $	Fair value $
US dollar	1.004	19,916	4	1.000	18,841	15
Euro	0.762	6,726	17	0.751	6,334	(14)
Switzerland Francs	0.919	5,233	13	0.904	4,694	(17)
British Pound	0.618	4,633	(31)	0.626	4,516	(24)
Japanese Yen	86.838	2,381	6	82.271	3,006	9
Other currencies - assets	6.688	1,500	1	4.510	1,489	1
Other currencies - liabilities	2.594	1,873	(2)	4.440	1,841	(7)

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

4. PORTFOLIO INVESTMENTS

(in thousands of dollars)				December 31 2012			March 31 2012	
	Cost $	Unrealized losses $	Unrealized gains $	Fair Value $	%	Cost $	Fair Value $	%
Canada Council Endowment and Special Funds								
Pooled funds								
Equity	102,951	-	2,031	104,982	47.31	100,890	99,787	46.3
Fixed income	73,314	1,773	-	71,541	32.24	73,311	72,448	33.6
Alternatives	20,017	-	2,547	22,564	10.17	20,017	21,856	10.1
Money market	5,742	-	-	5,742	2.59	5,589	5,589	2.6
Real estate	8,336	-	946	9,282	4.18	8,666	9,267	4.3
Infrastructure	8,266	487	-	7,779	3.51	7,208	6,757	3.1
	218,626	2,260	5,524	221,890	100.00	215,681	215,704	100.0
Killam Funds								
Pooled funds								
Equity	26,311	-	519	26,830	47.57	25,785	25,503	46.6
Fixed income	18,607	467	-	18,140	32.16	18,606	18,370	33.5
Alternatives	5,150	-	650	5,800	10.28	5,149	5,618	10.3
Money market	750	-	-	750	1.33	737	737	1.3
Real estate	2,235	-	265	2,500	4.43	2,318	2,487	4.5
Infrastructure	2,527	141	-	2,386	4.23	2,243	2,103	3.8
	55,580	608	1,434	56,406	100.00	54,838	54,818	100.0
Total investments	**$ 274,206**	**$ 2,868**	**$ 6,958**	**$ 278,296**		**$ 270,519**	**$ 270,522**	

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. Annually, the Council assesses each of its investment instruments against specific criteria to determine whether there is objective evidence that the adjusted cost may not be recovered and is therefore impaired. Nothing in the current period would lead to consider these investments to be other-than-temporarily impaired.

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 7.99% (March 31, 2012 - 8.15%) of that Fund with a total fair value of $17,729,000 (March 31, 2012 - $17,580,000). The total fair value of the externally restricted investment including the Killam Fund is $74,135,000 (March 31, 2012 - $72,398,000).

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 two infrastructure funds. 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 January 2012. The benchmarks allow asset class allocations to vary between a minimum and a maximum.

Asset Classes	Actual Market Value	Minimum	Benchmark	Maximum
Canadian equities	10%	5%	10%	15%
Global equities	37%	25%	35%	45%
Fixed income	32%	25%	35%	40%
Alternatives	10%	5%	10%	15%
Real estate	5%	0%	5%	7%
Infrastructure	4%	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. The money market pooled funds had a balance of $6,492,000 (March 31, 2012 - $6,326,000).

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 funds include two portfolios of diversified infrastructure investments. These investments are measured against the Consumer Price Index plus 4.5%.

5. FINANCIAL RISKS AND FAIR VALUE

The measurement categories of the Council's financial instruments, as well as their carrying amounts and fair values are as follows:

(in thousands of dollars)		December 31 2012	March 31 2012
Financial assets and liabilities classifications	**Measurement categories**	**Carrying Amount and Fair Value ($)**	**Carrying Amount and Fair Value ($)**
Cash and cash equivalents	Fair value	14,932	18
Accounts receivable	Amortized cost	6,573	2,290
Derivatives net	Fair value	8	(37)
Portfolio Investments[1]	Fair value	278,296	270,522
Bank indebtedness	Fair value	-	1,581
Grants payable	Amortized cost	27,646	27,760
Accounts payable and accrued liabilities	Amortized cost	2,009	3,710

1 The detailed fair value for the investments is listed in Note 4.

a) Establishing fair value

The carrying values of 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 the current market spot and the forward exchange rates at period end (see Note 4).

The fair values of the investments are determined as follows:

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.

The Alternatives are pooled fund investments which are valued at the unit values supplied by the pooled fund managers. The fund manager manages multiple funds strategies within the fund and determines the unit's fair value using the closing market prices for some strategies when available or using valuation model with non-observable data for other strategies.

Real estate investment values are supplied by the fund managers using manager's estimated 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).
- 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:

Financial assets at fair value

(in thousands of dollars)	December 31 2012				March 31 2012			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash equivalents	9,010	5,922	-	14,932	-	18	-	18
Derivatives	-	41	-	41	25	-	-	25
	9,010	5,963	-	14,973	25	18	-	43
Portfolio Investments								
Canada Council Endowment and Special Funds								
Pooled Funds								
Equity	-	104,982	-	104,982	-	99,787	-	99,787
Fixed Income	-	71,541	-	71,541	-	72,448	-	72,448
Alternatives	-	-	22,564	22,564	-	-	21,856	21,856
Money Market	-	5,742	-	5,742	-	5,589	-	5,589
Real Estate	-	-	9,282	9,282	-	-	9,267	9,267
Infrastructure	-	-	7,779	7,779	-	-	6,757	6,757
Killam Funds								
Pooled Funds								
Equity	-	26,830	-	26,830	-	25,503	-	25,503
Fixed Income	-	18,140	-	18,140	-	18,370	-	18,370
Alternatives	-	-	5,800	5,800	-	-	5,618	5,618
Money Market	-	750	-	750	-	737	-	737
Real Estate	-	-	2,500	2,500	-	-	2,487	2,487
Infrastructure	-	-	2,386	2,386	-	-	2,103	2,103
	-	227,985	50,311	278,296	-	222,434	48,088	270,522
Total	**9,010**	**233,948**	**50,311**	**293,269**	**25**	**222,452**	**48,088**	**270,565**

Liabilities at fair value

(in thousands of dollars)	December 31 2012				March 31 2012			
	Level 1	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Bank indebtedness	-	-	-	-	1,581	-	-	1,581
Derivatives	-	33	-	33	62	-	-	62
Total	**-**	**33**	**-**	**33**	**1,643**	**-**	**-**	**1,643**

During the period, there were no significant transfers of amounts between levels.

6. EMPLOYEE FUTURE BENEFITS

a) Severance benefits

The Council provided severance benefits to its employees based on years of service and final salary. These benefits were not pre-funded and thus had no assets, resulting in a plan deficit equal to the accrued benefit obligation. These benefits stopped accruing as per the new collective agreement signed in February 2012.

(in thousands of dollars)	December 31 2012
Benefit obligation	
Beginning of period	$ 2,845
Benefits paid during the period	(1,696)
End of period	**$ 1,149**

b) Retirees benefits

The Council has defined post-retirement benefit plans covering certain employee groups. These plans provide extended health and dental benefits to retired employees. Retirees pay 50% of the extended health care premium and 100% of the dental premium. In 2011-12, the Council obtained its first estimated actuarial valuation therefore there are no actuarial gains and losses for the current year.

Reconciliation of Accrued Benefit Obligation

(in thousands of dollars)	December 2012
Beginning of period	**$ 1,392**
Current Service Cost	32
Interest Cost	23
Benefits Paid	(22)
Participant Contributions	32
End of period	**$ 1,427**

7. DEFERRED REVENUES - EXTERNALLY RESTRICTED CONTRIBUTIONS

The deferred revenues from externally restricted contributions consist of accumulated income received which has been deferred until the resources for the purpose or purposes specified by the endowment have been used. The restricted endowment principal of $37,569,000 is required to be maintained intact and is reported under accumulated surplus from operations (see Note 8).

(in thousands of dollars)		December 31 2012		March 31 2012
Balance, beginning of period	$	23,594	$	26,349
Transferred to investment income (Note 9)				
Net investment income		3,094		717
Use of funds		(1,080)		(2,719)
		2,014		(2,002)
Transfer to other revenues		(363)		(520)
Unrealized gains (losses) on portfolio investment		1,083		(2,700)
Unrealized gains on derivatives		12		39
Reclassified to statement of operations				
Portfolio investment		22		2,428
Derivatives		(55)		-
Balance at end of period	**$**	**26,307**	**$**	**23,594**

The unrealized gains and losses on portfolio investment and derivatives are related to the change in fair value of those assets during the period.

8. ACCUMULATED SURPLUS

(in thousands of dollars)			December 31 2012			March 31 2012
Accumulated surplus from operations						
Endowment - original contribution		$	50,000		$	50,000
Endowment Principal – Externally restricted contributions			37,569			37,569
Reserve for excess investment income						
Balance at beginning of the period	118,445			121,445		
Appropriated to the accumulated surplus during the period	-			(3,000)		
Balance at end of the period			118,445			118,445
Surplus						
Balance at beginning of the period	6,645			10,105		
Appropriated from the reserve for excess investment income during the period	-			3,000		
Surplus (deficit) for the period	20,436			(6,460)		
Balance at end of the period			27,081			6,645
Total accumulated surplus from operations			**233,095**			**212,659**
Accumulated remeasurement gains (losses)						
Balance at beginning of the period	(145)			533		
Change in fair value	2,868			(678)		
Balance at end of the period			**2,723**			**(145)**
Balance of accumulated surplus at end of period		**$**	**235,818**		**$**	**212,514**

Included in accumulated surplus 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.

9. NET INVESTMENT INCOME

(in thousands of dollars)	Three months ended December 31 2012	Three months ended December 31 2011	Nine months ended December 31 2012	Nine months ended December 31 2011
Losses from disposal of portfolio investments	$ -	$ (9,068)	$ (82)	$ (9,065)
Realized gains on portfolio investments	680	-	680	-
Income transferred from (to) Deferred revenues- Externally restricted contributions (Note 7)	(2,653)	(780)	(2,014)	1,647
Net gains (losses) on derivatives	(650)	1,035	505	(929)
Interest and dividend income	10,597	11,921	11,377	12,479
Investment portfolio management costs	(377)	(313)	(1,014)	(1,212)
	$ 7,597	**$ 2,795**	**$ 9,452**	**$ 2,920**

10. NET ART BANK INCOME (LOSS)

(in thousands of dollars)	Three months ended December 31 2012	Three months ended December 31 2011	Nine months ended December 31 2012	Nine months ended December 31 2011
Rental revenue	$ 372	$ 435	$ 1,121	$ 1,393
Other income	37	13	112	38
Artwork purchases	-	(14)	(8)	(304)
Administration expense	(441)	(446)	(1,283)	(1,442)
Amortization of other capital assets	(7)	(6)	(20)	(17)
	$ (39)	**$ (18)**	**$ (78)**	**$ (332)**

11. CANADIAN COMMISSION FOR UNESCO

(in thousands of dollars)	Three months ended December 31 2012	Three months ended December 31 2011	Nine months ended December 31 2012	Nine months ended December 31 2011
Program expenses	$ 245	$ 121	$ 533	$ 563
Program - contributions received	(96)	-	(96)	-
Administration expense	325	328	945	975
	$ 474	**$ 449**	**$ 1,382**	**$ 1,538**

12. NET CHANGE IN OTHER NON-CASH ITEMS

(in thousands of dollars)	Three months ended December 31 2012	Three months ended December 31 2011	Nine months ended December 31 2012	Nine months ended December 31 2011
Increase in accounts receivable	$ (5,830)	$ (8,895)	$ (4,283)	$ (7,282)
Increase (Decrease) in grants payable	(26,351)	(22,915)	(114)	3,710
Increase (Decrease) in accounts payable and accrued liabilities	373	(1,482)	(1,701)	(3,285)
Increase (Decrease) in deferred parliamentary appropriations	6,480	(10,000)	6,480	-
Increase (Decrease) in deferred revenues	319	(71)	-	(369)
Net change	**$ (25,009)**	**$ (43,363)**	**$ 382**	**$ (7,226)**

13. 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 cnsideration established and agreed to by the related parties.

14. CONTRACTUAL OBLIGATIONS AND COMMITMENTS

a) Grants

The future payments of grant commitments as of December 31, 2012 are as follows:

(in thousands of dollars)	
2013	$ 12,266
2014	27,374
2015	520

b) Rent

The future payments of operating lease as of December 31, 2012 are as follows:

(in thousands of dollars)	
2013	$ 1,146
2014	4,533
2015	4,603
2016	4,672
2017	4,717
2018-2034	79,884

c) Capital commitments

The Council has signed agreements with real estate and infrastructure investment managers and committed capital in limited partnership funds. Because it takes time for those funds to be fully invested, the balance of committed capital not yet drawn at December 31, 2012 is $4,739,000 ($6,158,000 – March 31, 2012). The outstanding balance of committed capital is currently invested in short-term pooled funds.