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Gwaii Trust Society
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Attention: Peter Lantin, Chairperson

VIA EMAIL – wfoster@qcislands.net
Warren Foster
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VIA EMAIL – johnt606@hotmail.com
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cc: VIA MAIL
Ken Rea, Former Chairperson
P.O. Box 543
Old Masset, BC V0T 1M0

August 6, 2010

Dear Trustees:

Re: Gwaii Forest Charitable Trust (“GFCT”)

We write in our capacity as “Protector” pursuant to the Deed of Trust (the “Deed”) made on the 29th day of March 2007 by the Gwaii Trust Society (“GTS”), to provide the Protector’s determination as to whether there may have been a Breach under the Deed during the fiscal year ended December 31, 2009. For purposes of this reporting letter, all defined names, unless otherwise defined herein, have the meaning as set out in the Deed.

Our comments are organized under the following subject headings:

- (1) Breach Determination and Review of Reporting Material
- (2) Other Disclosure Matters
- (3) Protector Determination

BREACH DETERMINATION AND REVIEW OF REPORTING MATERIAL

In accordance with Section 38 of the Deed, the Protector is required annually within ninety days of the Receipt of the Financial Statements and Operations Report, to determine whether the Trustees are in breach of their obligations under the Deed or Applicable Law or whether there are reasonable grounds to believe that any or all of the Trust Property has been used, with the knowledge and acquiescence of the Trustees, for one or more purposes that are other than one or more of the Purposes during the Year just ended.

In considering whether there has been a Breach under the Deed, the Protector has performed a review of the Reporting Material and conducted such enquiries as deemed necessary. As a result of the Protector’s review, the following items have been identified as not being in compliance with the requirements set out in the Deed:



(a) Reporting of Trustee Changes.

- A new Trustee executed a Trustee Declaration on January 8, 2009 and a copy of this document was not delivered to the Protector. The Protector became aware of the appointment of this new Trustee on June 23, 2009, when a copy of the Trustee Declaration was found on the Website. It is unknown when the Trustee Declaration was posted to the Website.
- Pursuant to Section 55 of the Deed, a Trustee must execute a Trustee Declaration and deliver it to the Community and the Protector.

OTHER DISCLOSURE MATTERS

In considering whether there may have been a Breach under the Deed, the Protector has identified and generally discussed with the Trustees the following matters which may not all have been contemplated when the Deed was prepared:

(a) Requirement to Preserve Capital.

- Pursuant to Section 27 of the Deed, the Trustees have a duty to “manage the value of the Trust Property in order to maintain the value of the Capital from erosion by inflation”.
- Section 27 provides further that the Trustees may make distributions of Income or Capital in furtherance of the Purposes, but distribution of Capital for the Purposes may only be made if:
 - i) such distributions are approved by unanimous approval of the Trustees;
 - ii) there has been appropriate consultation with the Community Representatives prior to the distribution; and
 - iii) the Trustees have determined with the advice of the Professional Advisors that such encroachment on the Capital can be restored within a reasonable period of time.
- As defined in the Deed, Capital means, at a particular time, the original value of certain contributions to the Trust, adjusted for changes in inflation prior to the particular time.
- In the Protector’s letter to the Trustees dated October 19, 2009 (the “2008 Breach Determination Letter”), it was reported that, due to a downturn in the financial markets, the value of the Trust Property at the end of 2008 was \$22,884,118, \$1,547,882 less than the \$24,432,000 required Capital as of December 31, 2008. It was further noted in the 2008 Breach Determination Letter that the Trustees therefore determined that no further distributions would be made from the Trust for Eligible Projects until the value of the Trust Property exceeds the amount of the required Capital by not less than \$3,000,000 (the “Stated Reserve”).



- During the first six months of 2009, the value of the Trust Property remained below the \$24,725,184 required Capital for 2009. However, commencing in or about July 2009 the value of the Trust Property exceeded the required Capital for 2009 and, at December 31, 2009, was \$26,399,074, \$1,673,890 in excess of the required Capital.
- In accordance with the Stated Reserve, however, no new Eligible Projects had been funded as at December 31, 2009 and none were approved for funding during 2010.
- During the year ended December 31, 2009, no repayments had been made in respect of the amount outstanding on the loan from GTS, the balance of which was \$800,000 as at December 31, 2009.
- As stated in the 2008 Breach Determination Letter, it remains the view of the Protector that no distributions should be made from the Trust for Eligible Projects that would have the effect of reducing the value of the net assets of the Trust below the amount that is the total of:
 - i) the amount of the Capital;
 - ii) the amount outstanding on the loan from GTS; and
 - iii) the amount of any other liabilities of the Trust outstanding at the time.

The Protector cautions that any distributions for Eligible Projects that would have the effect of reducing the value of the Trust Property below the amount calculated in the above formula will constitute a breach.

(b) Planned Withdrawals from Capital.

- As discussed above, Section 27 of the Deed places restrictions on the Trustees' ability to fund Eligible Projects from Capital. The Deed, however, appears to be silent in respect of their ability to fund GFCT administration costs from Capital. The Protector is of the view that it is not unreasonable, therefore, that reasonable GFCT administration costs should be paid from Capital, if necessary.
- Pursuant to Decision Record #09-001, dated May 15, 2009, the Trustees decided that all administrative expenses, including amounts due to GTS in respect of administrative expenses they had previously funded, would be repaid from Capital on a quarterly basis.
- Amounts due to GTS (excluding the long term loan due to GTS) increased to \$384,732 as at December 31, 2009, from the June 30, 2009 balance of \$331,355.
- In 2009, no withdrawals from Capital were made to fund administrative costs or to pay amounts due to GTS.
- In March 2009, GFCT borrowed \$190,000 from GTS under the long term loan arrangements entered into between these parties in 2008. These funds were advanced to the Forest Society in April 2009 in respect of further funding for the



approved 2008 Eligible Projects and related administration costs of the Forest Society.

- In June 2009, the Forest Society returned approximately \$120,000 of unused funding to GFCT.
- During August 2009, GFCT paid \$100,000 to GTS as a repayment of short term debt, using a portion of the long term borrowings advanced in March 2009.
- It is the view of the Protector that, pursuant to Decision Record #09-001, GFCT should commence paying all current administrative expenses and also repay the full balance of the amounts "Due to Gwaii Trust Society" in a timely manner, such payments to be funded by withdrawals from Capital as determined by the Trustees.

(c) Reporting on Approved 2008 Eligible Projects.

- Pursuant to Section 22 of the Deed, the Trustees have a duty to monitor each Eligible Project which received funding from the Trust Property by receiving reports from the Forest Society in such intervals as the Trustees deem appropriate.
- As at the date of the 2008 Breach Determination Letter, the Protector understood that the Trustees had not completed their review of the Forest Society's final reports and accounting in respect of the 2008 Eligible Projects. Accordingly, the Protector stated that, once this review had been completed, a revised Operations Report for 2008 should be prepared and delivered to the Protector and to the Community within 60 days from the date of the 2008 Breach Determination Letter.
- A revised 2008 Operations Report was not delivered to the Protector. Instead, the 2009 Operations Report (in sections "A" and "B" thereof) includes generally the same information about the approved 2008 Eligible Projects as was included in the 2008 Operations Report, but supplemented (under Appendix "B") by copies of various reports that were provided by the Forest Society in respect of the 2008 Eligible Projects but which were not previously available via the Website. These reports are not physically appended to the 2009 Operations Report and readers are directed to the Website to review them.
- There is no summary analysis of the outcome of the approved 2008 Eligible Projects and related Forest Society administration costs provided in either the 2009 Operations Report or the Financial Statements for the year ended December 31, 2009. The Protector is of the view that more detailed disclosure should be provided as to the breakdown of the \$801,012 that was funded to the Forest Society during the fiscal years ended December 31, 2008 and 2009 (the "Cumulative GFS Funding").
- The Protector raised the issue of additional disclosure regarding the Cumulative GFS Funding with GFCT and received a draft revised 2009 Operations Report on March 24, 2010, which included some additional information. GFCT also provided a preliminary draft schedule detailing disbursements; however, a full reconciliation for the \$801,012 of Cumulative GFS Funding has not yet been provided. Further communications and discussions were held with GFCT about this matter up to



August 5, 2010; however, a final form of revised 2009 Operations Report has not been delivered to the Protector.

- The Protector is of the view that the 2009 Operations Report should be revised to include an analysis of the \$801,012 of Cumulative GFS Funding, detailing the budgeted and actual funding for each of the approved 2008 Eligible Projects, including a brief explanation for any material variances, as well as the costs of the Forest Society's administration of those projects. This revised 2009 Operations Report should be prepared and delivered to the Protector and the Community within 60 days from the date of this letter. The Protector now understands that GFCT is planning to provide this additional reporting in the short term.
- The Protector is also of the view that, as and when funding for Eligible Projects resumes, the Trustees should establish more rigorous processes for receiving and reviewing project reporting and provide additional disclosure in the Operations Report as to the quantitative and qualitative outcomes for all approved Eligible Projects.

PROTECTOR DETERMINATION

As discussed above, the Protector in its review of the Reporting Material and other such enquires, has identified one item that was not in compliance with the requirements set out in the Deed. Pursuant to the requirements of the Deed, this item could technically be considered as a Breach. However, this item had been resolved prior to the date of this letter. Consequently, the Protector does not believe that further action is warranted at this time.

Accordingly, pursuant to Section 38(a) of the Deed, the Protector has found no reportable Breach of the Deed for the fiscal year ended December 31, 2009.

Should you have any questions or concerns with respect to the foregoing, please do not hesitate to contact either Peter Gibson on (604) 691-3223, pgibson@kpmg.ca, or Anthony Tillman on (604) 646-6332, atillman@kpmg.ca.

Yours very truly,
KPMG Inc., in its
capacity as Protector
and not in its personal capacity

Peter D. Gibson
Senior Vice-President

Anthony Tillman
Senior Manager

Mark Kemp-Gee
Manager

cc Anthony Knox, Knox & Co.