



Quarterly Financial Report

For the Three and Six Months Ended
September 30, 2014



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**CANADIAN AIR TRANSPORT SECURITY AUTHORITY
MANAGEMENT'S NARRATIVE DISCUSSION
FOR THE THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2014**

Management's Narrative Discussion outlines the significant activities and initiatives, risks and financial results of the Canadian Air Transport Security Authority (CATSA) for the three and six months ended September 30, 2014. This Narrative Discussion should be read in conjunction with CATSA's unaudited condensed interim financial statements for the three and six months ended September 30, 2014, which have been prepared in accordance with the recognition and measurement standards applicable under the International Financial Reporting Standards (IFRS). This Narrative Discussion should also be read in conjunction with CATSA's Management Discussion and Analysis and audited annual financial statements for the year ended March 31, 2014, and the Quarterly Financial Report for the three months ended June 30, 2014. The information in this report is expressed in thousands of Canadian dollars and is current to November 26, 2014, unless otherwise stated.

Forward-looking statements

Readers are cautioned that this report includes certain forward-looking information and statements. These forward-looking statements contain information that is generally stated to be anticipated, expected or projected by CATSA. They involve known and unknown risks, uncertainties and other factors which may cause the actual results and performance of the organization to be materially different from any future results and performance expressed or implied by such forward-looking information.

Materiality

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 economic decisions of CATSA's stakeholders.

CORPORATE OVERVIEW

CATSA is an agent Crown corporation mandated to provide effective and efficient screening of persons who access aircraft or restricted areas through screening points, the property in their possession or control and the belongings or baggage that they give to an air carrier for transport. CATSA is also responsible for ensuring consistency in the delivery of screening across Canada and for air transport security functions that the Minister of Transport may assign to it, subject to any terms and conditions that the Minister may establish. In carrying out its responsibilities, CATSA must do so in the public interest, having due regard to the interest of the travelling public. CATSA's mission is to protect the public by securing critical elements of the air transportation system as assigned by the Government of Canada.

To achieve this, CATSA conducts screening in the following four areas:

- Pre-Board Screening (PBS): the screening of passengers, their carry-on baggage and their personal belongings;
- Hold Baggage Screening (HBS): the screening of checked baggage;
- Non-Passenger Screening (NPS): the screening of non-passengers on a random basis; and
- Restricted Area Identity Card (RAIC) Program: the administration of access control to airport restricted areas through biometric identifiers.

In addition to its mandated activities, CATSA has an agreement with Transport Canada to conduct screening of cargo at smaller airports. This program was designed to screen limited amounts of cargo during off-peak periods and involves using existing technology and resources.

OPERATING ENVIRONMENT

The following section provides information on significant changes in the operating environment that have occurred since June 30, 2014.

PASSENGER GROWTH AND SCREENING CONTRACTOR BILLING RATES

CATSA's operating funding profile does not fully address rising passenger volumes and increases in screening contractor billing rates.

Statistics from CATSA's Boarding Pass Security System for the three-month period ended September 30, 2014 indicate that screened traffic increased by 7.9% over the same period in 2013. In addition, CATSA's purchasing power for screening hours has decreased as a result of annual contractual increases in screening contractor billing rates.

As a consequence, CATSA has witnessed longer wait times for passengers. It continues to work with Transport Canada to address the impact on its operations and the travelling public.

ORGANIZATIONAL CHANGES

Lise Patry, Vice President, Legal and Corporate Secretary, left CATSA on October 31, 2014. Chuck Gudgeon, Director, Procurement & Contracting, has assumed Ms. Patry's duties on an interim basis.

RISKS AND UNCERTAINTIES

There have been no significant changes to the corporate risk profile as previously disclosed in the *2014 Annual Report*.

QUARTERLY AND YEAR-TO-DATE FINANCIAL INFORMATION

The following table provides key highlights of the Statement of Comprehensive Income for the three and six months ended September 30, 2014 and September 30, 2013:

| Key Financial Highlights - Statement of Comprehensive Income | Three Months Ended | | | | Six Months Ended | | | |
|---|--------------------|-------------------|------------------|--------------|-------------------|-------------------|------------------|---------------|
| | September 30 | | | | September 30 | | | |
| | 2014 | 2013 | \$ Change | % Change | 2014 | 2013 | \$ Change | % Change |
| (Thousands of Canadian dollars) | (unaudited) | (unaudited) | | | (unaudited) | (unaudited) | | |
| Expenses¹ | | | | | | | | |
| Screening services and other related costs | \$ 102,594 | \$ 85,130 | \$ 17,464 | 21% | \$ 198,473 | \$ 170,579 | \$ 27,894 | 16% |
| Program support and corporate services | 17,839 | 17,676 | 163 | 1% | 37,564 | 38,555 | (991) | (3%) |
| Depreciation and amortization | 13,805 | 15,355 | (1,550) | (10%) | 28,054 | 31,626 | (3,572) | (11%) |
| Equipment operating and maintenance | 12,060 | 10,425 | 1,635 | 16% | 23,645 | 21,366 | 2,279 | 11% |
| Total expenses | \$ 146,298 | \$ 128,586 | \$ 17,712 | 14% | \$ 287,736 | \$ 262,126 | \$ 25,610 | 10% |
| Total other expenses (income) | 139 | 538 | (399) | (74%) | (63) | 969 | (1,032) | (107%) |
| Financial performance before government funding | \$ 146,437 | \$ 129,124 | \$ 17,313 | 13% | \$ 287,673 | \$ 263,095 | \$ 24,578 | 9% |
| Government funding | | | | | | | | |
| Parliamentary appropriations for operating expenses | \$ 131,521 | \$ 111,610 | \$ 19,911 | 18% | \$ 255,562 | \$ 226,100 | \$ 29,462 | 13% |
| Amortization of deferred government funding related to capital expenditures | 14,018 | 16,027 | (2,009) | (13%) | 28,261 | 32,802 | (4,541) | (14%) |
| Total government funding | \$ 145,539 | \$ 127,637 | \$ 17,902 | 14% | \$ 283,823 | \$ 258,902 | \$ 24,921 | 10% |
| Financial performance and total comprehensive loss | \$ (898) | \$ (1,487) | \$ 589 | (40%) | \$ (3,850) | \$ (4,193) | \$ 343 | 8% |

¹ The Statement of Comprehensive Income presents operating expenses by program activity, whereas operating expenses above are presented by major expense category, as disclosed in note 10 of the unaudited condensed interim financial statements for the three and six months ended September 30, 2014.

The following table provides key highlights of the Statement of Financial Position as at September 30, 2014 and March 31, 2014:

| Key Financial Highlights - Statement of Financial Position | September 30, | | March 31, | |
|---|-------------------|-------------------|--------------------|--------------|
| | 2014 | | 2014 | |
| | (unaudited) | (unaudited) | (audited) | (audited) |
| (Thousands of Canadian dollars) | | | | |
| Total assets | \$ 397,468 | \$ 439,601 | \$ (42,133) | (10%) |
| Total liabilities | \$ 410,448 | \$ 448,731 | \$ (38,283) | (9%) |

ANALYSIS OF FINANCIAL PERFORMANCE

The following section provides information on key variances within the Statement of Comprehensive Income for the three and six months ended September 30, 2014, compared to the same periods of the prior fiscal year.

Screening services and other related costs

Screening services and other related costs increased by \$17,464 (21%) and by \$27,894 (16%) for the three and six months ended September 30, 2014 respectively, compared to the same periods in 2013. This is mainly attributable to an increase in screening hours purchased for the enhanced NPS program, as disclosed in the *2014 Annual Report*.

The increase is also attributable to a slightly higher number of screening hours purchased for PBS checkpoints during the quarter. The additional hours purchased helped reduce increases in passenger wait times due to rising passenger volume at Canada's eight busiest airports.

In addition, annual contractual increases in screening contractor billing rates contributed to higher screening costs.

Depreciation and amortization

Depreciation and amortization decreased by \$1,550 (10%) and by \$3,572 (11%) for the three and six months ended September 30, 2014, respectively, compared to the same periods in 2013. The decrease is primarily due to a revision of the estimated useful life of certain HBS equipment during fiscal year 2013/14. This equipment is being replaced in support of the multi-year, HBS life-cycle management program. The decrease is also due to certain computers, integrated software and electronic equipment becoming fully amortized.

Equipment operating and maintenance

Equipment operating and maintenance increased by \$1,635 (16%) and by \$2,279 (11%) for the three and six months ended September 30, 2014, respectively, compared to the same periods in 2013. The increase is primarily due to higher spare parts usage, annual contractual increases for maintenance services and the expiry of warranty for certain Explosives Detection System equipment. The increase is also attributable to higher training and certification costs associated with the deployment of new Explosives Detection System equipment.

Parliamentary appropriations for operating expenses

Parliamentary appropriations for operating expenses increased by \$19,911 (18%) and by \$29,462 (13%) for the three and six months ended September 30, 2014, respectively, compared to the same periods in 2013. The increase is primarily due to increased spending for screening services and other related costs, as previously discussed.

Amortization of deferred government funding related to capital expenditures

Amortization of deferred government funding related to capital expenditures decreased by \$2,009 (13%) and by \$4,541 (14%) for the three and six months ended September 30, 2014, respectively, compared to the same periods in 2013. The decrease is primarily due to decreased depreciation and amortization, as previously discussed.

ANALYSIS OF FINANCIAL POSITION

The following section provides information on key variances within the Statement of Financial Position as at September 30, 2014, compared to March 31, 2014.

TOTAL ASSETS

Total assets decreased by \$42,133 (10%) primarily due to the following:

- Decrease in trade and other receivables by \$28,958 primarily due to a decrease in parliamentary appropriations receivable, as a result of the timing of cash requests made to the Consolidated Revenue Fund; and
- Decrease in property and equipment and intangible assets by \$6,032 primarily due to depreciation and amortization, partially offset by the acquisition and installation of capital assets.

TOTAL LIABILITIES

Total liabilities decreased by \$38,283 (9%) primarily due to the following:

- Decrease in trade and other payables by \$30,190 primarily due to timing of disbursements associated with obligations outstanding with suppliers;
- Decrease in deferred government funding related to capital expenditures by \$6,032 due to amortization exceeding parliamentary appropriations earned; and
- Decrease in deferred government funding related to operating expenditures by \$2,965 due to a reduction in inventories and prepaid expenses balances.

FINANCIAL PERFORMANCE AGAINST CORPORATE PLAN

CATSA's operations are funded by parliamentary appropriations from the Government of Canada. The amount of parliamentary appropriations used is reported on a near-cash accrual basis of accounting. Accordingly, the table below serves to reconcile operating expenses reported under IFRS and operating appropriations used:

| Reconciliation of Total Expenses to Operating Appropriations Used | Three Months Ended September 30 | | Six Months Ended September 30 | |
|--|------------------------------------|-------------------|----------------------------------|-------------------|
| | 2014 | 2013 | 2014 | 2013 |
| (Thousands of Canadian dollars) | (unaudited) | (unaudited) | (unaudited) | (unaudited) |
| Total expenses | \$ 146,298 | \$ 128,586 | \$ 287,736 | \$ 262,126 |
| Finance income, finance cost and foreign exchange gain/loss | (74) | (134) | (259) | (133) |
| Non-cash operating expenses | | | | |
| Depreciation and amortization | (13,805) | (15,355) | (28,054) | (31,626) |
| Employee benefits expense ¹ | (1,307) | (1,836) | (3,144) | (3,335) |
| Employee cost accruals ² | 347 | 292 | (830) | (971) |
| Spare parts expense funded from capital ³ | - | - | (11) | (75) |
| Deferred lease incentives ⁴ | 62 | 57 | 124 | 114 |
| Parliamentary appropriations for operating expenses | \$ 131,521 | \$ 111,610 | \$ 255,562 | \$ 226,100 |
| Other items affecting funding | | | | |
| Net change in prepaids and inventories ⁵ | (1,411) | (837) | (2,965) | (1,193) |
| Total operating appropriations used | \$ 130,110 | \$ 110,773 | \$ 252,597 | \$ 224,907 |

¹ Employee benefits are accounted for in the Statement of Comprehensive Income in accordance with IFRS. Based on the Treasury Board of Canada Secretariat's *Directive on the Use of the Consolidated Revenue Fund for Crown Corporations*, CATSA is permitted to draw funds from the Consolidated Revenue Fund based on its short-term needs. The amount of funding to be drawn down is determined by a solvency and going concern valuation performed by CATSA's actuary in accordance with the *Pension Benefits Standard Act*. The drawdown of funding for employee benefits is not necessarily equal to the expense for accounting purposes under IFRS, creating a reconciling item.

² Employee cost accruals are accounting expenses to record variable pay and accrued vacation expenses incurred to September 30, 2014. These costs are funded by appropriations at year-end, creating a reconciling item.

³ Spare parts expense funded from capital represents items that were funded from capital appropriations in prior years but were used as spare parts and expensed during the current year, creating a reconciling item.

⁴ Deferred lease incentives is a non-cash accounting adjustment to record the benefit derived from favourable lease terms, including significantly reduced rent and free common area costs. Rental costs are funded by appropriations when paid, creating a reconciling item.

⁵ Prepaids and inventories are expensed as the benefit is derived from the asset by CATSA. They are funded by appropriations when purchased, creating a reconciling item.

The table below serves to reconcile capital asset acquisitions reported under IFRS and capital appropriations used:

| Reconciliation of Capital Acquisitions to Capital Appropriations Used | Three Months Ended September 30 | | Six Months Ended September 30 | |
|---|---------------------------------|---------------------|-------------------------------|---------------------|
| | 2014 (unaudited) | 2013 (unaudited) | 2014 (unaudited) | 2013 (unaudited) |
| (Thousands of Canadian dollars) | | | | |
| Explosives Detection System | \$ 13,131 | \$ 9,014 | \$ 21,876 | \$ 11,468 |
| Non-Explosives Detection System | 341 | 481 | 376 | 1,370 |
| Total capital asset acquisitions | \$ 13,472 | \$ 9,495 | \$ 22,252 | \$ 12,838 |
| Proceeds on disposal of property and equipment | (2) | (16) | (23) | (16) |
| Total capital appropriations used | \$ 13,470 | \$ 9,479 | \$ 22,229 | \$ 12,822 |

APPROPRIATIONS USED COMPARED TO CORPORATE PLAN

Parliamentary appropriations used for operating expenses are in line with the approved *2014/15 Corporate Plan* operating budget for the six months ended September 30, 2014.

Parliamentary appropriations used for capital expenditures for the six months ended September 30, 2014 represent 19% of the approved *2014/15 Corporate Plan* capital budget, which is lower than planned. This is mainly due to delays in capital spending associated with the life-cycle management of HBS systems at certain airports, resulting from changes in airport project plans which are beyond CATSA's control.

CATSA is on track to meet the operating goals, objectives and financial results for the current year as outlined in the approved *2014/15 Corporate Plan*, after considering the delays discussed above.

STATEMENT OF MANAGEMENT RESPONSIBILITY

Management is responsible for the preparation and fair presentation of these condensed interim financial statements in accordance with the Treasury Board of Canada Secretariat's *Standard on Quarterly Financial Reports for Crown Corporations*, and for such internal controls as management determines are necessary to enable the preparation of condensed interim 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 condensed interim financial statements.

Based on our knowledge, these unaudited condensed interim financial statements present fairly, in all material respects, the financial position, results of comprehensive income, changes in equity and cash flows of CATSA, as at the date of and for the periods presented in the condensed interim financial statements.



Angus Watt
President and Chief Executive Officer
Ottawa, Canada

November 26, 2014



Mario Malouin, CPA, CA, MA
Vice-President and Chief Financial Officer
Ottawa, Canada

November 26, 2014

Condensed Interim Financial Statements of

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Three and six months ended September 30, 2014 and 2013

(Unaudited)

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Condensed Interim Statement of Financial Position
(Unaudited)

(In thousands of Canadian dollars)

| | September 30, 2014 | March 31, 2014 |
|--|-----------------------|-------------------|
| Assets | | |
| Current assets | | |
| Cash | \$ 4,129 | \$ 6,191 |
| Trade and other receivables (note 4) | 83,682 | 112,640 |
| Inventories (note 5) | 15,290 | 17,065 |
| Prepaid expenses | 1,698 | 2,888 |
| | <u>104,799</u> | <u>138,784</u> |
| Non-current assets | | |
| Employee benefits (note 9) | 5,904 | 8,020 |
| Property and equipment (note 6) | 283,807 | 288,040 |
| Intangible assets (note 7) | 2,958 | 4,757 |
| | <u>292,669</u> | <u>300,817</u> |
| | <u>\$ 397,468</u> | <u>\$ 439,601</u> |
| Liabilities and Equity | | |
| Current liabilities | | |
| Trade and other payables | \$ 88,641 | \$ 118,831 |
| Deferred government funding related to operating expenses (note 8) | 16,988 | 19,953 |
| | <u>105,629</u> | <u>138,784</u> |
| Non-current liabilities | | |
| Deferred lease incentives | 929 | 1,053 |
| Deferred government funding related to capital expenditures (note 8) | 286,765 | 292,797 |
| Employee benefits (note 9) | 17,125 | 16,097 |
| | <u>304,819</u> | <u>309,947</u> |
| Equity | | |
| Accumulated deficit | (12,980) | (9,130) |
| | <u>\$ 397,468</u> | <u>\$ 439,601</u> |

Commitments (note 12) and contingent liabilities (note 14)

The accompanying notes are an integral part of these condensed interim financial statements.

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Condensed Interim Statement of Comprehensive Income
(Unaudited)

(In thousands of Canadian dollars)

| | Three months ended | | Six months ended | |
|--|--------------------|------------|------------------|------------|
| | September 30 | | September 30 | |
| | 2014 | 2013 | 2014 | 2013 |
| Expenses | | | | |
| Pre-Board Screening | \$ 81,221 | \$ 76,076 | \$ 159,655 | \$ 155,803 |
| Hold Baggage Screening | 35,531 | 33,989 | 71,407 | 68,609 |
| Non-Passenger Screening | 18,198 | 6,562 | 33,565 | 11,393 |
| Corporate services | 10,370 | 11,018 | 21,394 | 24,561 |
| Restricted Area Identity Card Program | 978 | 941 | 1,715 | 1,760 |
| Total expenses (note 10) | 146,298 | 128,586 | 287,736 | 262,126 |
| Other expenses (income) | | | | |
| Write-off of intangible assets (note 7) | 148 | 521 | 148 | 521 |
| Loss on property and equipment | 65 | 151 | 48 | 580 |
| Finance cost | - | - | 1 | 1 |
| Finance income | (133) | (118) | (250) | (222) |
| Foreign exchange loss (gain) | 59 | (16) | (10) | 89 |
| Total other expenses (income) | 139 | 538 | (63) | 969 |
| Financial performance before government funding | 146,437 | 129,124 | 287,673 | 263,095 |
| Government funding | | | | |
| Parliamentary appropriations for operating expenses (note 8) | 131,521 | 111,610 | 255,562 | 226,100 |
| Amortization of deferred government funding related to capital expenditures (note 8) | 14,018 | 16,027 | 28,261 | 32,802 |
| Total government funding | 145,539 | 127,637 | 283,823 | 258,902 |
| Financial performance and total comprehensive loss | \$ (898) | \$ (1,487) | \$ (3,850) | \$ (4,193) |

The accompanying notes are an integral part of these condensed interim financial statements.

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Condensed Interim Statement of Changes in Equity
(Unaudited)

(In thousands of Canadian dollars)

For the three months ended September 30:

| | Accumulated deficit |
|--|------------------------|
| Balance, June 30, 2013 | \$ (21,178) |
| Financial performance and total comprehensive loss that will not be reclassified to financial performance | (1,487) |
| Balance, September 30, 2013 | \$ (22,665) |
| Balance, June 30, 2014 | \$ (12,082) |
| Financial performance and total comprehensive loss that will not be reclassified to financial performance | (898) |
| Balance, September 30, 2014 | \$ (12,980) |

For the six months ended September 30:

| | Accumulated deficit |
|--|------------------------|
| Balance, March 31, 2013 | \$ (18,472) |
| Financial performance and total comprehensive loss that will not be reclassified to financial performance | (4,193) |
| Balance, September 30, 2013 | \$ (22,665) |
| Balance, March 31, 2014 | \$ (9,130) |
| Financial performance and total comprehensive loss that will not be reclassified to financial performance | (3,850) |
| Balance, September 30, 2014 | \$ (12,980) |

The accompanying notes are an integral part of these condensed interim financial statements.

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Condensed Interim Statement of Cash Flows
(Unaudited)

(In thousands of Canadian dollars)

| | Three months ended | | Six months ended | |
|--|--------------------|------------|------------------|------------|
| | September 30 | | September 30 | |
| | 2014 | 2013 | 2014 | 2013 |
| Cash flows provided by (used in) | | | | |
| Operating activities | | | | |
| Financial performance | \$ (898) | \$ (1,487) | \$ (3,850) | \$ (4,193) |
| Items not involving cash | | | | |
| Depreciation of property and equipment (note 10) | 13,022 | 14,072 | 26,370 | 29,010 |
| Increase in net employee benefits liability | 1,307 | 1,836 | 3,144 | 3,335 |
| Amortization of intangible assets (note 10) | 783 | 1,283 | 1,684 | 2,616 |
| Write-off of intangible assets (note 7) | 148 | 521 | 148 | 521 |
| Loss on property and equipment | 65 | 151 | 48 | 580 |
| Other non-cash transaction | - | - | - | 25 |
| Amortization of deferred government funding related to capital expenditures (note 8) | (14,018) | (16,027) | (28,261) | (32,802) |
| Decrease in deferred lease incentives | (62) | (57) | (124) | (114) |
| Net change in non-cash working capital balances (note 13) | (22,802) | (2,335) | 9,935 | 4,976 |
| | (22,455) | (2,043) | 9,094 | 3,954 |
| Investing activities | | | | |
| Parliamentary appropriations received for capital funding | 13,239 | 6,398 | 52,239 | 16,398 |
| Purchase of property and equipment | (22,562) | (2,007) | (63,362) | (16,978) |
| Purchase of intangible assets | (21) | (363) | (33) | (721) |
| | (9,344) | 4,028 | (11,156) | (1,301) |
| Increase (decrease) in cash | (31,799) | 1,985 | (2,062) | 2,653 |
| Cash, beginning of period | 35,928 | 9,744 | 6,191 | 9,076 |
| Cash, end of period | \$ 4,129 | \$ 11,729 | \$ 4,129 | \$ 11,729 |

Supplementary cash flow information (note 13)

The accompanying notes are an integral part of these condensed interim financial statements.

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Notes to Condensed Interim Financial Statements
(Unaudited)

For the three and six months ended September 30, 2014 and 2013
(In thousands of Canadian dollars)

1. Authority, mandate and programs

CATSA was established pursuant to the *CATSA Act* on April 1, 2002. CATSA is a Crown corporation listed under Part I, Schedule III of the *Financial Administration Act* and is an agent of Her Majesty in right of Canada.

CATSA's mandate is to provide effective and efficient screening of persons who access aircraft or restricted areas through screening points, the property in their possession or control and the belongings or baggage that they give to an air carrier for transport. CATSA is also responsible for ensuring consistency in the delivery of screening across Canada and for air transport security functions that the Minister of Transport may assign it, subject to any terms and conditions that the Minister may establish. In carrying out its responsibilities, CATSA must do so in the public interest, having due regard to the interest of the travelling public.

To achieve this, CATSA conducts screening in the following four areas:

1. PBS – the screening of passengers, their carry-on baggage and their personal belongings;
2. HBS – the screening of checked baggage;
3. NPS – the screening of non-passengers on a random basis; and
4. RAIC Program – the administration of access control to airport restricted areas through biometric identifiers.

In addition to its mandated activities, CATSA has an agreement with Transport Canada to conduct screening of cargo at smaller airports. This program was designed to screen limited amounts of cargo during off-peak periods and involves using existing technology and resources.

CATSA is not subject to income tax under the provisions of the *Income Tax Act (Canada)*. CATSA is subject to the *Excise Tax Act (Canada)*, which includes the federal Goods and Services Tax (GST) and Harmonized Sales Tax (HST). CATSA is also subject to all provincial sales taxes (PST) applied by the provinces and territories in which it operates.

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Notes to Condensed Interim Financial Statements
(Unaudited)

For the three and six months ended September 30, 2014 and 2013
(In thousands of Canadian dollars)

2. Basis of preparation

The condensed interim financial statements have been prepared in accordance with the *Standard on Quarterly Financial Reports for Crown Corporations* as published by the Treasury Board of Canada Secretariat (TBS Standard). These statements have not been audited or reviewed by CATSA's external auditors.

The TBS Standard requires interim financial statements be prepared based on the recognition and measurement standards used in the preparation of the audited annual financial statements. Accordingly, the interim financial statements have been prepared based on recognition and measurement standards applicable under IFRS. The interim financial statements do not contain all necessary disclosures to conform, in all material respects, with IFRS disclosure requirements applicable to annual and quarterly financial statements. They should be read in conjunction with the most recent audited annual financial statements and the narrative discussion included within the Quarterly Financial Report for the three and six months ended September 30, 2014.

3. Summary of significant accounting policies

Significant accounting policies used in these condensed interim financial statements are disclosed in note 3 of CATSA's audited annual financial statements for the year ended March 31, 2014, except for the application of the new standards effective April 1, 2014 described in note 3(q) of the audited annual financial statements.

4. Trade and other receivables

Trade and other receivables are comprised of:

| | September 30, 2014 | March 31, 2014 |
|------------------------------|-----------------------|-------------------|
| Parliamentary appropriations | \$ 70,826 | \$ 96,677 |
| GST and HST recoverable | 11,518 | 14,146 |
| PST recoverable | 1,338 | 1,741 |
| Other | - | 76 |
| | <hr/> | <hr/> |
| | \$ 83,682 | \$ 112,640 |

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Notes to Condensed Interim Financial Statements
(Unaudited)

For the three and six months ended September 30, 2014 and 2013
(In thousands of Canadian dollars)

5. Inventories

Inventories are comprised of:

| | September 30, 2014 | March 31, 2014 |
|-------------|-----------------------|-------------------|
| Spare parts | \$ 14,567 | \$ 15,381 |
| RAIC | 534 | 224 |
| Uniforms | 189 | 1,460 |
| | <hr/> | <hr/> |
| | \$ 15,290 | \$ 17,065 |

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Notes to Condensed Interim Financial Statements
(Unaudited)

For the three and six months ended September 30, 2014 and 2013
(In thousands of Canadian dollars)

6. Property and equipment

A reconciliation of property and equipment is as follows:

| | PBS equipment | HBS equipment | NPS equipment | RAIC equipment | Computers, integrated software and electronic equipment | Office furniture and equip- ment | Leasehold improve- ments | Work-in- progress | Total |
|---------------------------------|------------------|------------------|------------------|-------------------|---|--|--------------------------------|----------------------|------------|
| Cost | | | | | | | | | |
| Balance, | | | | | | | | | |
| March 31, 2014 | \$ 121,416 | \$ 653,491 | \$ 5,183 | \$ 4,538 | \$ 23,444 | \$ 95 | \$ 10,119 | \$ 75,344 | \$ 893,630 |
| Additions | 112 | 175 | 20 | - | 11 | - | - | 21,901 | 22,219 |
| Disposals | (1,160) | (4,224) | - | - | - | - | - | - | (5,384) |
| Write-offs | (132) | (257) | - | (97) | (36) | - | (6) | - | (528) |
| Reclassifications | 4,516 | 11,997 | 1,717 | - | 102 | - | - | (18,332) | - |
| Balance, | | | | | | | | | |
| September 30, 2014 | \$ 124,752 | \$ 661,182 | \$ 6,920 | \$ 4,441 | \$ 23,521 | \$ 95 | \$ 10,113 | \$ 78,913 | \$ 909,937 |
| Accumulated depreciation | | | | | | | | | |
| Balance, | | | | | | | | | |
| March 31, 2014 | \$ 63,353 | \$ 506,994 | \$ 2,841 | \$ 3,270 | \$ 19,976 | \$ 95 | \$ 9,061 | \$ - | \$ 605,590 |
| Depreciation | 4,613 | 20,358 | 239 | 334 | 639 | - | 187 | - | 26,370 |
| Disposals | (1,145) | (4,193) | - | - | - | - | - | - | (5,338) |
| Write-offs | (131) | (246) | - | (93) | (16) | - | (6) | - | (492) |
| Balance, | | | | | | | | | |
| September 30, 2014 | \$ 66,690 | \$ 522,913 | \$ 3,080 | \$ 3,511 | \$ 20,599 | \$ 95 | \$ 9,242 | \$ - | \$ 626,130 |
| Carrying amounts | | | | | | | | | |
| As at March 31, 2014 | \$ 58,063 | \$ 146,497 | \$ 2,342 | \$ 1,268 | \$ 3,468 | \$ - | \$ 1,058 | \$ 75,344 | \$ 288,040 |
| As at September 30, 2014 | \$ 58,062 | \$ 138,269 | \$ 3,840 | \$ 930 | \$ 2,922 | \$ - | \$ 871 | \$ 78,913 | \$ 283,807 |

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7. Intangible assets

A reconciliation of intangible assets is as follows:

| | Externally acquired software | Internally developed software | Under development | Total |
|------------------------------------|------------------------------------|-------------------------------------|----------------------|------------------|
| Cost | | | | |
| Balance, March 31, 2014 | \$ 4,188 | \$ 18,186 | \$ 64 | \$ 22,438 |
| Additions | - | 19 | 14 | 33 |
| Write-offs | (417) | (224) | - | (641) |
| Reclassifications | - | 64 | (64) | - |
| Balance, September 30, 2014 | \$ 3,771 | \$ 18,045 | \$ 14 | \$ 21,830 |
| Accumulated amortization | | | | |
| Balance, March 31, 2014 | \$ 2,872 | \$ 14,809 | \$ - | \$ 17,681 |
| Amortization | 330 | 1,354 | - | 1,684 |
| Write-offs | (417) | (76) | - | (493) |
| Balance, September 30, 2014 | \$ 2,785 | \$ 16,087 | \$ - | \$ 18,872 |
| Carrying amounts | | | | |
| At March 31, 2014 | \$ 1,316 | \$ 3,377 | \$ 64 | \$ 4,757 |
| At September 30, 2014 | \$ 986 | \$ 1,958 | \$ 14 | \$ 2,958 |

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8. Deferred government funding

A reconciliation of the deferred government funding liability is as follows:

| | September 30, 2014 | March 31, 2014 |
|--|-----------------------|-------------------|
| Deferred government funding related to operating expenses | | |
| Balance, beginning of period | \$ 19,953 | \$ 20,442 |
| Parliamentary appropriations billed | 254,627 | 475,438 |
| Parliamentary appropriations to be used in future periods | (2,030) | - |
| Parliamentary appropriations recognized as government funding for operating expenses | (255,562) | (475,927) |
| Balance, end of period | \$ 16,988 | \$ 19,953 |
| Deferred government funding related to capital expenditures | | |
| Balance, beginning of period | \$ 292,797 | \$ 274,523 |
| Parliamentary appropriations billed | 30,968 | 81,239 |
| Parliamentary appropriations to be used in future periods | (8,739) | - |
| Amortization of deferred government funding related to capital expenditures | (28,261) | (62,965) |
| Balance, end of period | \$ 286,765 | \$ 292,797 |
| Total deferred government funding, end of period | \$ 303,753 | \$ 312,750 |

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9. Employee benefits

On a quarterly basis, CATSA's net asset or liability for the defined benefit component of the registered pension plan (RPP), the supplementary retirement plan (SRP) and the other defined benefits plan (ODBP) is updated for differences between estimated net benefit cost, as determined in the most recent annual actuarial valuations, and actual employer contributions to the plans. The net asset or liability is only updated for significant market fluctuations at the end of every fiscal year, with the assistance of the pension plans' actuary.

The following table provides the expense and contributions relating to these plans for the three and six months ended September 30:

| | Three months ended | | Six months ended | |
|----------------------|--------------------|-----------------|------------------|-----------------|
| | September 30 | | September 30 | |
| | 2014 | 2013 | 2014 | 2013 |
| Expense | | | | |
| RPP | \$ 2,122 | \$ 2,375 | \$ 4,245 | \$ 4,750 |
| SRP | 38 | 55 | 76 | 110 |
| ODBP | 557 | 622 | 1,115 | 1,244 |
| | <u>\$ 2,717</u> | <u>\$ 3,052</u> | <u>\$ 5,436</u> | <u>\$ 6,104</u> |
| Contributions | | | | |
| RPP | \$ 1,366 | \$ 1,182 | \$ 2,204 | \$ 2,701 |
| SRP | 1 | - | 1 | - |
| ODBP | 43 | 34 | 87 | 68 |
| | <u>\$ 1,410</u> | <u>\$ 1,216</u> | <u>\$ 2,292</u> | <u>\$ 2,769</u> |

The current service cost and the benefit obligation of these plans are actuarially determined on an annual basis. The significant assumptions used to determine CATSA's obligations are disclosed in note 10 of the audited annual financial statements for the fiscal year ended March 31, 2014.

For the three and six months ended September 30, 2014, CATSA recognized an expense in the amount of \$14 (2013 – \$3) and \$28 (2013 – \$3), respectively, in relation to the defined contribution component of the RPP.

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10. Expenses

The Statement of Comprehensive Income presents operating expenses by program activity. The following table presents operating expenses by major expense type for the three and six months ended September 30:

| | Three months ended September 30 | | Six months ended September 30 | |
|--|------------------------------------|------------|----------------------------------|------------|
| | 2014 | 2013 | 2014 | 2013 |
| Screening services and other related costs | | | | |
| Payments to screening contractors | \$ 101,213 | \$ 83,664 | \$ 195,246 | \$ 167,856 |
| Uniforms and other screening costs | 929 | 1,011 | 2,246 | 1,881 |
| Trace and consumables | 452 | 455 | 981 | 842 |
| | 102,594 | 85,130 | 198,473 | 170,579 |
| Program support and corporate services | | | | |
| Employee costs | 13,279 | 13,625 | 28,626 | 29,017 |
| Operating leases | 1,549 | 1,557 | 2,850 | 3,067 |
| Office and computer expenses | 1,023 | 586 | 2,045 | 1,941 |
| Professional services and other business related costs | 765 | 856 | 1,815 | 2,272 |
| Other costs | 925 | 920 | 1,771 | 1,908 |
| Communications | 298 | 132 | 457 | 350 |
| | 17,839 | 17,676 | 37,564 | 38,555 |
| Depreciation and amortization | | | | |
| Depreciation of property and equipment | 13,022 | 14,072 | 26,370 | 29,010 |
| Amortization of intangible assets | 783 | 1,283 | 1,684 | 2,616 |
| | 13,805 | 15,355 | 28,054 | 31,626 |
| Equipment operating and maintenance | | | | |
| Equipment maintenance and spare parts | 11,585 | 10,002 | 22,216 | 20,614 |
| Training and certification | 145 | 155 | 968 | 306 |
| RAIC | 330 | 268 | 461 | 446 |
| | 12,060 | 10,425 | 23,645 | 21,366 |
| | \$ 146,298 | \$ 128,586 | \$ 287,736 | \$ 262,126 |

Other business related costs include travel expenses, conference fees, membership and association fees, meeting expenses and training material expenses. Other costs include insurance, network and telephone expenses.

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11. Government funding

Parliamentary appropriations approved and amounts used by CATSA during the six months ended September 30 are as follows:

| | 2014 | 2013 |
|--|-------------------|------------------|
| Parliamentary appropriations approved for the fiscal year | \$ 665,011 | \$ 578,310 |
| Re-profiled parliamentary appropriations to future years | - | (7,566) |
| Parliamentary appropriations used for operating expenses | (252,597) | (475,438) |
| Parliamentary appropriations used for capital expenditures | (22,229) | (81,239) |
| Unused parliamentary appropriations | \$ 390,185 | \$ 14,067 |

The following table reconciles parliamentary appropriations that were received and receivable in relation to operating expenses, to the amount of appropriations used during the three and six months ended September 30:

| | Three months ended | | Six months ended | |
|---|--------------------|-------------------|-------------------|-------------------|
| | September 30 | | September 30 | |
| | 2014 | 2013 | 2014 | 2013 |
| Parliamentary appropriations received and receivable | \$ 151,387 | \$ 120,665 | \$ 310,065 | \$ 263,900 |
| Amounts received and receivable related to prior periods | (22,925) | (6,287) | (55,438) | (36,287) |
| Amounts to be billed (used) in future periods | 1,648 | (3,605) | (2,030) | (2,706) |
| Parliamentary appropriations used for operating expenses | \$ 130,110 | \$ 110,773 | \$ 252,597 | \$ 224,907 |

Parliamentary appropriations related to operating expenses to be billed (used) in future periods are a result of forecasted expenditures lower (higher) than actual operating expenditures. These amounts are expected to be billed (used) and recognized in financial performance within the next fiscal quarter.

The following table reconciles parliamentary appropriations that were received and receivable in relation to capital expenditures, to the amount of appropriations used during the three and six months ended September 30:

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For the three and six months ended September 30, 2014 and 2013
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| | Three months ended | | Six months ended | |
|---|--------------------|-----------------|------------------|------------------|
| | September 30 | | September 30 | |
| | 2014 | 2013 | 2014 | 2013 |
| Parliamentary appropriations received and receivable | \$ 20,270 | \$ 3,705 | \$ 72,207 | \$ 23,309 |
| Amounts received and receivable related to prior periods | (10,998) | (4,398) | (41,239) | (9,398) |
| Amounts to be billed (used) in future periods | 4,198 | 10,172 | (8,739) | (1,089) |
| Parliamentary appropriations used for capital expenditures | \$ 13,470 | \$ 9,479 | \$ 22,229 | \$ 12,822 |

Parliamentary appropriations related to capital expenditures to be billed (used) in future periods are a result of forecasted expenditures lower (higher) than actual capital expenditures. These amounts are expected to be billed (used) and recorded within the next fiscal quarter.

12. Commitments

(a) Operating leases

CATSA is committed under non-cancellable operating leases for the rental of equipment and office space. The following table provides the minimum lease payments under the terms of these leases:

| | September 30, 2014 | March 31, 2014 |
|---|-----------------------|-------------------|
| No later than 1 year | \$ 7,387 | \$ 7,575 |
| Later than 1 year and no later than 5 years | 25,159 | 25,481 |
| Later than 5 years | 15,699 | 18,042 |

CATSA's most significant non-cancellable operating lease is the lease for office space at headquarters. The lease expires on November 30, 2017 and the option to renew for five additional years was exercised in the prior year. The renewal terms incorporated lease incentives not included in the original agreement, and an option to further extend the lease for an additional five years, subject to the same terms and conditions. There is no further right to extend after the expiry of the extension term and the future rent will be based on the prevailing market rate at that time.

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(b) Contractual obligations

Contractual obligations include various contracts for equipment purchases, screening services and equipment maintenance. These contractual obligations are subject to authorized appropriations and termination rights which allow CATSA to terminate the contracts without penalty at its discretion.

The following table provides minimum commitments under these contractual obligations:

| | September 30, 2014 | March 31, 2014 |
|---|-----------------------|-------------------|
| No later than 1 year | \$ 580,140 | \$ 552,815 |
| Later than 1 year and no later than 5 years | 936,172 | 1,113,254 |
| Later than 5 years | 5,976 | 9,197 |

13. Net change in non-cash working capital balances and supplementary cash flow information

The following table presents the net change in non-cash working capital balances for the three and six months ended September 30:

| | Three months ended September 30 | | Six months ended September 30 | |
|---|------------------------------------|------------|----------------------------------|----------|
| | 2014 | 2013 | 2014 | 2013 |
| Decrease (increase) in trade and other receivables | \$ (43,492) | \$ 7,775 | \$ (1,052) | \$ 4,124 |
| Decrease in inventories | 437 | 372 | 1,786 | 190 |
| Decrease in prepaid expenses | 974 | 465 | 1,190 | 1,053 |
| Increase (decrease) in trade and other payables | 20,690 | (10,110) | 10,976 | 802 |
| Decrease in deferred government funding related to operating expenses | (1,411) | (837) | (2,965) | (1,193) |
| | \$ (22,802) | \$ (2,335) | \$ 9,935 | \$ 4,976 |

Interest income received and recognized during the three and six months ended September 30, 2014 totalled \$133 (2013 – \$116) and \$250 (2013 – \$220), respectively.

Interest expense paid and expensed during the three and six months ended September 30, 2014 totalled \$Nil (2013 – \$Nil) and \$1 (2013 – \$1), respectively.

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For the three and six months ended September 30, 2014, the change in trade and other receivables excludes amounts of \$231 (2013 – \$8,180) and \$30,010 (2013 – \$3,576) respectively, in relation to government funding related to capital expenditures, as the amount relates to investing activities.

For the three and six months ended September 30, 2014, the change in inventories excludes amounts of \$Nil (2013 – \$Nil) and \$11 (2013 – \$50), respectively, in relation to a transfer of spare parts from capital assets to inventory, as the amount relates to a non-cash transaction.

For the three and six months ended September 30, 2014, the change in trade and other payables excludes amounts of \$9,113 (2013 – \$7,109) and \$41,166 (2013 – \$4,877), respectively, in relation to the acquisition of property and equipment and intangible assets, as the amount relates to investing activities.

During the three and six months ended September 30, 2014, CATSA received non-cash proceeds in the form of credit notes from a supplier, totalling \$2 (2013 – \$16) and \$23 (2013 – \$16) related to the disposal of property and equipment.

14. Contingent liabilities

During the three months ended September 30, 2014, there have been no material changes to the outstanding legal actions involving CATSA. For a description of those legal claims, refer to note 17 of the audited annual financial statements for the year ended March 31, 2014.