Canadian Air Transport Security Authority
Administration canadienne de la sûreté du transport aérien

Quarterly Financial Report

For the Three Months Ended
June 30, 2012

Canada

CATSA ACSTA

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

MANAGEMENT'S NARRATIVE DISCUSSION

FOR THE THREE MONTHS ENDED JUNE 30, 2012

Management's Narrative Discussion outlines the financial results, risks and significant activities and initiatives of the Canadian Air Transport Security Authority (CATSA) for the three months ended June 30, 2012. This Narrative Discussion should be read in conjunction with CATSA's unaudited condensed interim financial statements for the three months ended June 30, 2012 and audited annual financial statements for the year ended March 31, 2012. CATSA's *2012 Annual Report* has not been tabled in Parliament at the time of publishing this document. Until it is tabled in Parliament and made public, CATSA will not be in a position to provide the Management Discussion and Analysis for the year ended March 31, 2012. As a result, certain information from the *2012 Annual Report* has been provided in this Management Narrative. The information in this report is current to August 24, 2012, unless otherwise stated.

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.

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 considered probable that its omission or misstatement, judged in the surrounding circumstances, would influence the economic decisions of CATSA's stakeholders.

The financial information reported herein has been prepared in accordance with the recognition and measurement standards applicable under International Financial Reporting Standards (IFRS), and is expressed in Canadian dollars, unless otherwise stated.

Certain comparative figures contained in this Narrative Discussion have been restated as a result of an accounting policy change related to the transition to IFRS that was adopted subsequent to the issuance of the unaudited condensed interim financial statements for the three months ended June 30, 2011. The accounting policy change is disclosed in note 19 of the unaudited condensed interim financial statements for the three months ended June 30, 2012, and in further detail in note 20 of the audited annual financial statements for the year ended March 31, 2012. Certain comparative figures have also been restated to conform to the presentation adopted in the current period.

CORPORATE OVERVIEW

CATSA is a Crown corporation mandated with protecting the public through effective and efficient screening of air travellers and their baggage. CATSA's mission is to protect the public by securing critical elements of the air transportation system as assigned by the Government of Canada. The goal of the organization is to provide an effective, efficient and consistent level of security screening across the country, at or above the standards set by its regulator, Transport Canada.

To achieve this, CATSA is mandated to conduct security 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): the administration of access control to airport restricted areas through biometric identifiers.

In meeting this mandate, CATSA strives to maintain equivalency with its key international partners, both in terms of technologies and security screening processes. CATSA delivers on this commitment in accordance with the resources assigned to it by the Government of Canada and as approved by Parliament.

LEGISLATIVE FRAMEWORK

CATSA was established as a Crown corporation pursuant to the *Canadian Air Transport Security Authority Act* on April 1, 2002. CATSA is an agent Crown corporation, fully funded by parliamentary appropriations and accountable to parliament through the Minister of Transport, Infrastructure and Communities.

In Canada, the federal government is responsible for the security of the aviation sector, with Transport Canada serving as the lead department for Canada's aviation security program. As CATSA's regulator, Transport Canada is responsible for developing, administering and overseeing aviation security policies, legislation, programs and procedures, pursuant to standards established by the International Civil Aviation Organization.

CATSA is subject to domestic legislation, regulations and procedures in the way that it conducts its business and screening activities. These acts and regulations include: the *Canadian Air Transport Security Authority Act*; the *Financial Administration Act*; the *Aeronautics Act*; *Canadian Aviation Security Regulations*, as well as *Security Screening Orders* and other standard operating procedures.

Effective June 29, 2012, the *Canadian Air Transport Security Authority Act* was amended requiring that the Chief Executive Officer of CATSA be appointed by the Governor in Council and that an employee of CATSA may not replace the Chief Executive Officer for more than 90 days without the approval of the Governor in Council. This change was outlined in Bill C-38, the *Jobs, Growth and Long-term Prosperity Act.*

OPERATING ENVIRONMENT

GOVERNMENT FUNDING

Funding Announcements

Budget 2011 allocated additional funding to CATSA, totalling $156.7 million over five years for HBS equipment upgrades. The organization also received an increase in ongoing annual reference levels of $33.0 million starting in 2016/17 to address the lifecycle management of its HBS system.

With long-term funding commitments, CATSA was able to award new long-term agreements for airport screening services across Canada in 2011/12, and establish a long-term capital lifecycle management plan for its Explosives Detection System equipment.

In 2011/12, CATSA participated in the Government of Canada's Economic Action Plan 2012 Spending Review. The organization reviewed its direct program spending and identified proposals for reductions in its operating expenditures. Emphasis was placed on generating savings from operating expenses and improving productivity, while also examining the relevance and effectiveness of programs. As announced in Budget 2012, the organization will achieve annual cost savings of $59.7 million by 2014/15.

2011/12 Appropriations

With total approved funding for 2011/12 of $519.2 million, CATSA was able to maintain screening capacities similar to the prior year with fewer operating resources. This was a result of the implementation of operational efficiencies identified through the 2009 Strategic Review and CATSA Review 2010. Furthermore, CATSA continued with the lifecycle management of its PBS equipment with multi-view technology and commenced the conversion of its HBS system to Computed Tomography technology at some of the busiest airports.

CATSA's total parliamentary appropriations used for operating and capital expenditures for 2002/03 to 2011/12 are summarized below:

Parliamentary Appropriations Used					
(Millions of dollars)	**7-Year Total 2002/03 - 2008/09**	**2009/10**	**2010/11**	**2011/12**	**Total**
Operating	$ 2,078.2	$ 472.3	$ 512.3	$ 486.4	$ 3,549.2
Capital	739.7	115.9	54.9	23.2	933.7
Total	**$ 2,817.9**	**$ 588.2**	**$ 567.2**	**$ 509.6**	**$ 4,482.9**

SECURITY THREAT ENVIRONMENT

In the wake of the tenth anniversary of the 9/11 terrorist attacks, the world continues to be reminded of the threats against the aviation industry. Domestic and international intelligence suggest that civil aviation remains a favoured target of terrorist attacks and that Canada continues to be on active terrorist target lists.

As a security organization that was created in the aftermath of 9/11, CATSA has experienced ongoing change over the past ten years to keep pace with new threats, evolving technologies and improved international security standards. Security incidents experienced in recent years emphasize the continually evolving nature of threats to Canada's aviation system and demonstrate how terrorists continue to adapt their weapons, targets and/or means of access to known vulnerabilities. What remains unchanged since CATSA's inception is the importance of its role in ensuring the security of air travellers in Canada.

The seriousness of threats to Canada's civil aviation system is such that CATSA has been required in the past, and may be required in the future, to respond instantly to unforeseen challenges. Unanticipated threats and resulting regulatory changes can have a significant impact on operational and financial resources. As a result, it is important that CATSA have the financial and/or human resources capacity to allow the organization to respond to new requirements or exceptional events.

SERVICE DELIVERY

Service Delivery Model

CATSA uses a third-party service delivery model whereby the organization does not directly employ screening officers, but rather appoints third party screening contractors to perform its mandated activities.

On August 8, 2011, CATSA awarded new five-year Airport Screening Services Agreements (ASSAs). Effective November 1, 2011, the following companies have been appointed as screening contractors at designated airports in Canada:

- Pacific Region – G4S Secure Solutions (Canada) Ltd.;
- Prairies Region – Garda Security Screening Inc.;
- Central Region – Garda Security Screening Inc.; and
- East Region – Securitas Transport Aviation Security Ltd.

Further details were disclosed in the *Quarterly Financial Report* for the three months ended December 31, 2011.

Labour Relations

The transition to new ASSAs coincided with the collective bargaining process between screening contractors and the unions representing screening officers. The majority of collective bargaining agreements for screening officers expired on March 31, 2012. At the busiest airports where there was a change in screening contractor (Montreal, Vancouver, Ottawa and Halifax), the transition resulted in an open period where the unions were required to apply for certification by November 1, 2011. Screening contractors worked with the unions to ensure that working conditions that were in place before November 1, 2011 were maintained until March 31, 2012. For the busiest airports where the screening contractor did not change (Edmonton, Calgary, Toronto and Winnipeg), the collective bargaining agreements remained valid until March 31, 2012.

Since the awarding of the new ASSAs in August 2011, CATSA has been working closely with the screening contractors to monitor the labour situation. There have been some isolated labour incidents, most notably the events over the 2011 Thanksgiving weekend at Toronto Pearson International Airport, where a limited number of screening officers engaged in an illegal work action, leading to extended wait times for passengers.

CATSA has certain responsibilities with regard to the screening officers' work, such as developing standard operating procedures and certifying screening officers. However, the organization has no direct role in labour relations and relies upon the screening contractors to establish collective bargaining agreements and manage labour conflict with their unions. Given the negative impact that screening labour unrest can potentially have on the aviation industry, CATSA, along with its screening contractors, monitors screening services closely for signs of work slowdowns, as well as legal and illegal labour action. In addition, as part of the new ASSAs, screening contractors are required to enhance their capability for maintaining effective labour relations. However, given the service delivery model, CATSA's ability to directly influence the return to normal service levels is limited.

Stakeholder Relations

The Canadian economy relies heavily on the air transportation industry. An attack or serious threat to civil aviation would affect thousands of Canadian businesses that rely on the aviation transportation system for domestic and international trade.

To execute its mandate, CATSA works closely with Transport Canada, screening contractors, other government organizations, law enforcement authorities and the aviation industry. Within the aviation industry, key partners and stakeholders include airport authorities, air carriers, industry associations, various elements of the travel and tourism industries, and international security partners such as the United States (US) and the European Union (EU). The very nature of CATSA's operations and its day-to-day success in performing security screening is contingent upon relationships with these partners and stakeholders.

In line with recommendations from CATSA Review 2010, the organization is taking a more proactive and collaborative approach to managing relationships with its screening contractors and airport authorities. CATSA will continue to work collaboratively with both of these operational partners on information sharing with the common goal of continually improving operational effectiveness and efficiency, enhancing the passenger experience and creating stronger alliances. Specifically, the sharing of wait time information and the alignment of screening officers' schedules with flight departure data have served to improve the use of resources and enhance the passenger experience.

Customer-Focused Security

As airlines rely more on the use of technology (e.g., self check-ins, the use of electronic boarding passes, etc.), CATSA's screening checkpoints are increasingly becoming the first point of human contact for the travelling public at Canadian airports. Therefore, passenger facilitation through the screening process is an essential element of CATSA's frontline operations. Since February 2012, passengers travelling to the US have been able to use NEXUS cards to expedite screening at Canada's eight busiest airports using designated screening lanes at PBS checkpoints, as a result of the Canada-US Perimeter Security and Economic Competitiveness Declaration.

CATSA remains committed to informing the travelling public about new or changing screening technologies and/or processes, while addressing any concerns about privacy and the screening process. Privacy is of paramount importance to CATSA. Before implementing any new program or technology, CATSA considers the extent to which the privacy of travellers could be affected, and whether there are less intrusive methods to achieve the same results.

REGULATORY ENVIRONMENT

CATSA, as a member of the international civil aviation industry, is affected by regulatory changes implemented by major security partners, such as the US and EU. When regulatory changes are implemented by international partners, there is pressure on Canada to follow suit to minimize the disruption to passengers flying internationally. Furthermore, as a signatory country, Canada has an obligation to follow the International Civil Aviation Organization conventions on aviation security and protocols.

In 2011/12, CATSA continued to focus on implementing efficiencies from CATSA Review 2010, including changes to Transport Canada's *Prohibited Items List*. The changes to Canada's *Prohibited Items List* allowed CATSA to focus its resources on higher-threat items such as explosives, thereby improving aviation security and making the passenger screening process more effective, efficient and convenient for air travellers. These changes also helped Canada to align with many of its international partners, including the US and the EU, which made similar changes in past years. Similarly, the long-term capital funding received through Budget 2010 and Budget 2011 has afforded CATSA the opportunity to maintain a long-term lifecycle management plan and, as a result, maintain Explosives Detection System equivalency with international partners.

CATSA works closely with Transport Canada to monitor regulatory changes with its international partners in order to assess the operational and financial impact any possible future regulatory changes could have on Canada's aviation security system.

EXECUTIVE CHANGES

Senior Management Committee

On January 3, 2012, Angus Watt began serving as CATSA's president and Chief Executive Officer for a five-year term. The appointment follows the retirement of former president and Chief Executive Officer, Kevin McGarr on December 31, 2011.

During the quarter, CATSA restructured its senior management team. As a result, the organization reduced its number of vice-presidents from six to five. The responsibilities of the former senior vice-president, People have been re-allocated to the vice-presidents of the remaining branches.

Board of Directors

The Chair of the Board of Directors, D. Ian Glen, Q.C., ended his term in June 2012. Mr. Glen had been serving in this position since June 2007. A formal search for his replacement is ongoing. In the interim, the Vice-Chairperson, H. Glenn Rainbird, is assuming the functions of the Chairperson.

During the quarter, Allan Rowe was appointed to CATSA's Board of Directors, as a nominee of the National Airlines Council of Canada. Mr. Rowe will assume Denis Jacob's former positions on the Strategy Committee and the Audit Committee.

ECONOMIC ENVIRONMENT

Recovery from one of the worst global recessions in history continued to be slow in 2011/12. However, in recent months, the outlook for the global economy improved. Europe is expected to emerge slowly from the recession in the second half of 2012, although risks around this outlook remain high. The profile for US growth is slightly stronger, reflecting the balance of slightly improved labour markets, financial conditions and market confidence.

Growth in the Canadian economy is expected to be moderate, with economic expansion being driven by growth in private domestic demand. Net exports are expected to contribute only marginally to overall growth, which is reflective of modest recovery in foreign activity and Canada's ongoing competitiveness challenges, including the persistent strength of the Canadian dollar. Real gross domestic product in Canada grew by 2.4% in 2011, representing a decline from growth of 3.2% in 2010. In addition, real gross domestic product is expected to grow by 2.4% in both 2012 and 2013.[1]

PASSENGER GROWTH AND COST OF INFLATION

Transport Canada statistics show that passenger traffic at Canadian airports increased by 3.2% in 2011 compared to 2010, and is expected to grow each year over the next five years. For the three-month period from March 2012 to May 2012, they show that passenger volumes at Canada's eight busiest airports increased by 3.8% over the same period in 2011.[2]

Passenger traffic forecasts are based on average annual growth across Canada. However, growth does not occur uniformly at all airports. Changes in passenger traffic occur largely on a regional and site-specific basis and without much warning, often as a result of changes in flight schedules and/or the introduction of new services by the airlines. Change in passenger traffic results in a higher demand for screening hours and increased operating expenditures.

During the quarter, CATSA managed passenger wait times by purchasing additional screening hours and benefitting from increased operational efficiencies generated by the new ASSAs. In addition, CATSA realized further efficiencies from the implementation of screening optimization tools, which led to more effective resource scheduling and better performance management by screening contractors. During the remainder of the fiscal year, CATSA will continue to manage the deployment of screening hours while working within the available funding envelope.

In addition to passenger growth, screening contractor billing rates are currently expected to increase by an average of 2.9% annually. The new five-year ASSAs include an inflationary cap, which will help CATSA forecast its screening costs over the next several years. However, while CATSA has taken steps to limit increasing cost pressures in the new ASSAs, the rate increase is still greater than the increase in operating funding available in its reference levels.

CAPABILITY TO DELIVER

Integral to aviation security is the screening of passengers, their baggage and their personal belongings to detect the presence items that are prohibited from being brought onto aircraft and/or into restricted airport areas.

[1] Bank of Canada, *Monetary Policy Report*, April 2012.
[2] Air traffic statistics for the three-month period from April 2012 to June 2012 were not available at the time of printing.

CRITICAL SCREENING ACTIVITIES

Two elements which are critical to the delivery of CATSA's mandate are the screening workforce and the capital program.

Screening Workforce

Screening officers play a key role in identifying threats to aviation security. In recognition of this, significant resources are dedicated to strengthening the screening workforce.

Leveraging new technology, CATSA implemented three initiatives in 2011/12 that will enhance the base screening knowledge and ongoing competency development of screening officers, as well as achieve efficiencies in initial and recurrent training. These include:

- the transformation of the oversight program from a procedure-monitoring program to a more comprehensive oversight and quality assurance program. In alignment with the new ASSAs, the program focuses on process and performance improvements;
- significant enhancements to the standards of professional conduct for screening officers, with the objective of supporting the transition of a screening officer role from pure interdiction to passenger facilitation; and
- the deployment of a new technologically advanced Screening Officer Foundations program. The program contains both e-learning and lab-based practical training components, representing a departure from traditional classroom-based training. This allows for a more flexible training schedule and a greater focus on passenger facilitation.

Capital Program

In order to carry out its mandated screening activities, CATSA must have reliable and sophisticated equipment to scan for prohibited items. A capital program is in place to support the systematic, risk-based replacement and upgrading of equipment with new, more effective and efficient technologies.

In recent years, CATSA has directed a significant portion of its capital funds towards the lifecycle management of its PBS equipment. Consequently, the majority of its PBS single-view x-ray units at designated airports have been replaced with more advanced multi-view technology, which has contributed to an increase in CATSA's explosive detection capabilities. Furthermore, CATSA has deployed Full Body Scanners at all PBS trans-border checkpoints with US bound flights in response to the US security measures implemented after the failed terrorist attack of December 25, 2009.

More recently, CATSA commenced the replacement of its HBS equipment as older equipment is reaching the end of its useful life. Through Budget 2011, CATSA received additional long-term capital funding for the lifecycle management of its HBS system, which will allow CATSA to convert its existing system at designated airports. This will allow for enhanced screening capabilities for HBS, and ensure HBS technological equivalency with key international partners, while maintaining the highest possible levels of baggage throughput.

In 2011/12, CATSA successfully completed the conversion of the HBS system at one of the eight busiest airports, and initiated the conversion at some of Canada's other busiest airports.

IN SUPPORT OF BUSINESS

To implement its business strategies, CATSA requires robust internal systems and flexible internal resources to support all aspects of its critical screening activities.

Human Capital

CATSA's success is heavily dependent on the performance of its people. CATSA continually invests in its human capital by providing them with the necessary training and tools to work effectively and efficiently. These investments serve to increase employee retention and improve job satisfaction.

In 2011/12, CATSA's approved full time equivalency (FTE) headcount was reduced by 25 FTEs from 538 to 513. In 2012/13, CATSA's FTE headcount has been further reduced by 55 from 513 to 458. CATSA will continue to streamline internal processes in order to maximize the use of existing resources.

Corporate Management Systems and Practices

CATSA continuously reviews and re-assesses its internal policies and practices to improve the efficiency with which it processes information. These reviews also increase the quality of reporting and the effectiveness of communications with external stakeholders.

While planning for the new ASSAs, existing systems and procedures were reviewed to identify opportunities for continuous improvement. As a result, CATSA implemented a new Integrated Time Tracking and Invoice Processing tool that provides a more accurate picture of weekly screening hours, improves the request and approval process and reduces manual reconciliations. This tool allows for more efficient and effective processing of critical screening information.

Business Continuity Plan

In the event of a serious business disruption or system failure at headquarters, in the regions or at an airport, CATSA has developed and implemented a comprehensive Business Continuity Plan that is regularly updated, and is reviewed and approved by senior management. The Business Continuity Plan outlines critical services, establishes minimum service levels and contains a comprehensive strategy that includes command and control, supplier performance, infrastructure restart and information recovery considerations.

During 2011/12, various security exercises were conducted to ensure CATSA and screening contractor preparedness in the event of a major incident or event. These exercises included participation from all directorates within CATSA, screening contractors, Transport Canada, airport authorities and local law enforcement. CATSA is also working to develop comprehensive contingency plans for the most likely emergency scenarios, which include namely terrorism threats to aviation and natural disasters.

RISKS AND UNCERTAINTIES

CATSA is exposed to a variety of aviation security risks and uncertainties within the context of its operating environment. CATSA's major risks are summarized in the following categories: capacity, service delivery through third-party, mandated services, reputational, management systems/control systems and foreign exchange.

Capacity Risk

Level of service delivery

CATSA's reference levels do not fully accommodate increases in screening contractors' billing rates, and do not accommodate passenger growth. There is a risk that CATSA may lack the financial resources to maintain its current level of service delivery.

During 2011/12 CATSA has completed the implementation of operational efficiencies, which partially alleviate this risk. Key changes include improvements to CATSA's service delivery model, operations and training delivery, as well as the re-engineering of PBS checkpoints and the streamlining of PBS processes.

Service Delivery Through Third-Party Risk

Labour disruptions

CATSA outsources its services to third-party screening contractors who rely on a unionized screening officer workforce to perform security screening. There is a risk that illegal and/or legal labour disruptions may occur at some airports as a result of union activity and/or the collective bargaining process.

To address this risk, CATSA closely monitors labour developments between unions representing screening officers and screening contractors. CATSA has contingency plans in place to work with screening contractors and Transport Canada to respond to labour disruptions. However, given the service delivery model, CATSA's ability to directly influence the return to normal service levels is limited.

Screening contractors' performance

Following the transition to the new ASSAs, CATSA continues to work closely with its screening contractors to ensure efficient and effective security screening. There is a risk that a screening contractor may not be able to meet the commitments or contract performance targets outlined in their service agreement.

To address this risk, CATSA has developed and implemented a new performance program for screening contractors, which provides incentives to deliver on commitments and to meet performance targets.

Mandated Services Risk

Detection capability

CATSA's mandated activities include detecting and intercepting prohibited items, as defined by its regulator. There is a risk that CATSA may not detect all prohibited items, which may result in a threat to the civil aviation system or security breaches at airports.

To address this risk, CATSA maintains programs focused on controlling human factors as well as improving the underlying screening processes and technologies. In recent years, CATSA has made significant investments in its Explosives Detection System equipment that have improved its ability to detect prohibited items. Furthermore, CATSA has implemented several initiatives to enhance the base and ongoing training of screening officers.

Threat and risk information

The ever-changing threat environment and aviation security trends may challenge CATSA's ability to stay current with emerging threats and risks. CATSA may not be able to respond to threat and risk information in a timely manner or may not exercise adequate due diligence when information is received.

To address this risk, CATSA actively monitors and analyzes threat and risk information received from Transport Canada and disseminates this information to the appropriate decision makers. Detailed integrated response strategies are in place to respond to this threat and risk information based on CATSA's standard operating procedures.

Reputational Risk

Stakeholder engagement

Some stakeholders have raised concerns about CATSA's operations on a variety of issues and have questioned whether CATSA's mandated services provide value for money. There is a risk that CATSA's reputation may be damaged.

To address this risk, CATSA is improving the passenger experience by deploying a new lane design at designated checkpoints, responding to customer complaints in a timely manner and promoting a customer service-oriented culture. CATSA regularly liaises with industry stakeholders and has implemented a variety of communications strategies to engage its stakeholder groups and passengers.

Management Systems/Control Systems Risk

Management of sensitive, secret or personal information

CATSA produces, collects and maintains a multitude of sensitive, secret and personal documentation and information. There is a risk that this information, in both physical and electronic format, may be lost or disclosed inappropriately.

To address this risk, CATSA has a variety of physical security and information technology controls in place. CATSA has also established privacy related policies and procedures that promote best practices in relation to the collection, use, disclosure and disposal of personal information in accordance with applicable legislation.

Organizational preparedness for emergencies

An integrated business continuity and emergency management plan is essential to ensure continuity of operations and recovery from major incidents or emergencies. As with any organization, there is a risk that CATSA's Business Continuity Plan may not be fully integrated, tested and understood in order to effectively respond to and recover from emergencies and maintain operations.

To address this risk, CATSA has recently completed a comprehensive review of its Business Continuity Plan, as previously discussed, and will test it through a series of exercises during the year.

Foreign Exchange Risk

CATSA is exposed to foreign exchange risk as a result of purchasing a significant amount of equipment and services from vendors in the US. A significant fluctuation in foreign exchange rates impacts capital and operating budgets as planned expenditures are determined using estimated rates. Accordingly, fluctuation in rates can result in the cost of foreign denominated transactions being significantly different from what was initially budgeted.

To address this risk, CATSA will explore hedging strategies to minimize foreign exchange risk beginning 2012/13.

QUARTERLY FINANCIAL INFORMATION

The following table provides key highlights of the Statement of Comprehensive Income for the three months ended June 30, 2012 and June 30, 2011:

Key Financial Highlights - Statement of Comprehensive Income	Three Months Ended June 30			
(Millions of dollars)	2012 (unaudited)	2011 (unaudited and restated)	$ Change	% Change
Expenses[1]:				
Screening services and other related costs	$ 88.3	$ 89.7	$ (1.4)	(2%)
Direct administrative costs and corporate services	19.6	20.4	(0.8)	(4%)
Depreciation and amortization	16.7	20.7	(4.0)	(19%)
Equipment operating and maintenance	9.9	9.4	0.5	5%
Total expenses	**$ 134.5**	**$ 140.2**	**$ (5.7)**	**(4%)**
Total other income	**$ (0.1)**	**$ (1.4)**	**$ (1.3)**	**(93%)**
Financial performance before government funding	**$ 134.4**	**$ 138.8**	**$ (4.4)**	**(3%)**
Government funding:				
Parliamentary appropriations for operating expenses	$ 115.6	$ 118.5	$ (2.9)	(2%)
Amortization of deferred government funding related to capital	16.8	20.9	(4.1)	(20%)
Total government funding	**$ 132.4**	**$ 139.4**	**$ (7.0)**	**(5%)**
Total comprehensive income (loss)	**$ (2.0)**	**$ 0.6**	**$ (2.6)**	**(433%)**

[1] The Statement of Comprehensive Income presents operating expenses by mandated activity, whereas operating expenses above are presented by major expense type as disclosed in note 13 of the unaudited condensed interim financial statements for the three months ended June 30, 2012.

The following table provides key highlights of the Statement of Financial Position as at June 30, 2012 and March 31, 2012:

Key Financial Highlights - Statement of Financial Position (Millions of dollars)	June 30, 2012 (unaudited)	March 31, 2012	$ Change	% Change
Total assets	**$ 385.5**	**$ 417.3**	**$ (31.8)**	**(8%)**
Total liabilities	**$ 415.0**	**$ 444.7**	**$ (29.7)**	**(7%)**

ANALYSIS OF FINANCIAL PERFORMANCE

The following section provides information on key variances within the Statement of Comprehensive Income for the three months ended June 30, 2012, compared to the same periods of the prior fiscal year.

SCREENING SERVICES AND OTHER RELATED COSTS

Screening services and other related costs decreased slightly for the three months ended June 30, 2012, compared to the same period in 2011. The decrease was primarily due to an overall reduction in screening hours purchased (as discussed below), offset by additional costs associated with higher average billing rates.

Screening hours purchased decreased as a result of the implementation of operational efficiencies identified in CATSA Review 2010. The impact of these efficiencies was partially offset by the purchase of additional screening hours associated with passenger growth.

Average billing rates were higher primarily due to annual contractual increases established under the new ASSAs that came into effect on November 1, 2011.

DIRECT ADMINISTRATIVE COSTS AND CORPORATE SERVICES

Direct administrative costs and corporate services decreased slightly for the three months ended June 30, 2012, compared to the same period in 2011. The decrease was due to lower employee costs resulting from a reduction in the number of staffed positions, and lower administrative costs. The decrease was offset by higher current benefit costs associated with CATSA's defined benefit plans as a result of a change in the methodology used to establish the discount rate for its accounting valuation. Further details of this change in methodology were disclosed in note 12 of the audited annual financial statements for the year ended March 31, 2012.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased by $4.0 million (19%) for the three months ended June 30, 2012, compared to the same period in 2011. The decrease was primarily due to a revision of the estimated useful lives of certain screening equipment from seven to ten years. Further details of this revision were disclosed in note 7 of the audited annual financial statements for the year ended March 31, 2012.

TOTAL OTHER INCOME

Total other income decreased by $1.3 million (93%) for the three months ended June 30, 2012, compared to the same period in 2011. The decrease was primarily due to an equipment sales agreement that CATSA entered into with a third-party vendor, which resulted in a gain on disposal of property and equipment of $1.3 million in the three months ended June 30, 2011.

AMORTIZATION OF DEFERRED GOVERNMENT FUNDING RELATED TO CAPITAL

Amortization of deferred government funding related to capital decreased by $4.1 million (20%) for the three months ended June 30, 2012, compared to the same period in 2011. The decrease was primarily due to the revision of the estimated useful lives of certain screening equipment that were subject to depreciation in the current quarter.

ANALYSIS OF FINANCIAL POSITION

The following section provides information on key variances within the Statement of Financial Position as at June 30, 2012, compared to March 31, 2012.

TOTAL ASSETS

Total assets decreased by $31.8 million (8%) primarily due to the following:

- Trade and other receivables decreased by $21.2 million primarily due to the receipt of parliamentary appropriations relating to the prior fiscal year which had been accrued at March 31, 2012. The decrease was also due to the receipt of recoverable sales tax refunds during the quarter; and
- Property and equipment and intangible assets decreased by $14.5 million primarily due to depreciation and amortization of $16.7 million, partially offset by the acquisition and installation of equipment of $2.3 million.

TOTAL LIABILITIES

Total liabilities decreased by $29.7 million (7%) primarily due to the following:

- Trade and other payables decreased by $22.2 million primarily due to the payment of obligations outstanding with suppliers which were accrued at March 31, 2012; and
- Total deferred government funding decreased by $7.6 million due to the recognition of government funding for operating expenses of $115.6 million and amortization of deferred government funding related to capital of $16.8 million, partially offset by parliamentary appropriations invoiced of $124.8 million.

FINANCIAL PERFORMANCE AGAINST CORPORATE PLAN

CATSA's *2012/13 Summary of the Corporate Plan* has not been tabled in Parliament at the time of publishing this document. Until it is tabled in Parliament and made public, CATSA will not be in a position to provide a variance analysis between its financial results and the budget in the Corporate Plan.

PARLIAMENTARY APPROPRIATIONS USED

The amount of parliamentary appropriations used is reported on a near-cash accrual basis of accounting. Accordingly, the table below serves to reconcile IFRS operating expenses to operating appropriations used:

Operating Appropriations Used	**Three Months Ended June 30**	
	2012	**2011**
(Millions of dollars)	(unaudited)	(unaudited and restated)
Total expenses (IFRS)	$ 134.5	$ 140.2
Interest income and net foreign exchange gain/loss	(0.1)	(0.1)
Non-cash operating expenses:		
Depreciation and amortization	(16.7)	(20.7)
Employee benefits expense[1]	(1.4)	(0.2)
Deferred lease incentives expense[2]	-	(0.1)
Employee cost accruals[3]	(0.7)	(0.6)
Parliamentary appropriations for operating expenses	115.6	118.5
Other items affecting funding:		
Net change in prepaids and inventories[4]	(0.1)	(1.0)
Total operating appropriations used	**$ 115.5**	**$ 117.5**

[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] Deferred lease incentives expense is a non-cash accounting expense 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.

[3] Employee cost accruals are accounting expenses to record the variable pay, accrued and unused vacation and accrued overtime expenses incurred at June 30, 2012. These costs are funded by appropriations when paid, creating a reconciling item.

[4] Prepaids and inventories are funded by appropriations when purchased, creating a reconciling item. The net change in prepaids and inventories includes a transfer from property and equipment to inventories.

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

Capital Appropriations Used	**Three Months Ended June 30**	
	2012	**2011**
(Millions of dollars)	(unaudited)	(unaudited)
Total capital asset acquisitions (IFRS)	$ 2.3	$ 2.6
Proceeds on disposal of property and equipment	(0.5)	(1.6)
Total capital appropriations used	**$ 1.8**	**$ 1.0**

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	Mario Malouin, CPA, CA Vice-President and Chief Financial Officer Ottawa, Canada
August 24, 2012	August 24, 2012

Condensed Interim Financial Statements of

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Three months ended June 30, 2012 and 2011

(Unaudited)

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Condensed Interim Statement of Financial Position
(Unaudited)

(In thousands of Canadian dollars)

	June 30, 2012	March 31, 2012
Assets		
Current assets:		
Cash	$ 10,483	$ 5,907
Trade and other receivables (note 5)	56,307	77,489
Inventories (note 6)	19,278	18,935
Prepaid expenses	3,721	4,165
Equipment held for sale (note 8)	–	540
	89,789	107,036
Non-current assets:		
Employee benefits (note 12)	146	207
Property and equipment (note 7)	284,805	298,162
Intangible assets (note 9)	10,799	11,889
	295,750	310,258
	$ 385,539	$ 417,294
Liabilities and Equity		
Current liabilities:		
Trade and other payables	$ 58,962	$ 81,228
Provisions (note 10)	1,068	2,203
Deferred government funding related to operating (note 11)	27,265	23,100
	87,295	106,531
Non-current liabilities:		
Provisions (note 10)	2,299	2,304
Deferred lease incentives	1,435	1,481
Deferred government funding related to capital (note 11)	298,290	310,120
Employee benefits (note 12)	25,649	24,307
	327,673	338,212
Equity:		
Retained earnings	(29,429)	(27,449)
	$ 385,539	$ 417,294

Commitments (note 15) and contingent liabilities (note 18)

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 June 30	
	2012	2011
		(restated – note 19)
Expenses:		
Pre-Board Screening	$ 82,512	$ 87,181
Hold Baggage Screening	34,278	36,824
Corporate services	12,304	11,012
Non-Passenger Screening	4,415	4,116
Restricted Area Identity Card Program	936	1,116
Total expenses (note 13)	134,445	140,249
Other (income) expenses:		
Finance income	(119)	(103)
Gain on settlement of decommissioning liabilities (note 10)	(1)	(2)
Gain on disposal of property and equipment	–	(1,344)
Foreign exchange loss	31	–
Finance cost	10	15
Total other (income) expenses	(79)	(1,434)
Financial performance before government funding	134,366	138,815
Government funding:		
Parliamentary appropriations for operating expenses (note 11)	115,607	118,475
Amortization of deferred government funding related to capital (note 11)	16,779	20,966
Total government funding	132,386	139,441
Financial performance and total comprehensive income (loss)	$ (1,980)	$ 626

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)

		Retained earnings (restated – note 19)
Balance, March 31, 2011	$	513
Financial performance and total comprehensive income		626
Balance, June 30, 2011	$	1,139

		Retained earnings
Balance, March 31, 2012	$	(27,449)
Financial performance and total comprehensive loss		(1,980)
Balance, June 30, 2012	$	(29,429)

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 June 30	
	2012	2011 (restated – note 19)
Cash flows provided by (used in):		
Operating activities:		
Financial performance	$ (1,980)	$ 626
Items not involving cash:		
Depreciation of property and equipment (note 13)	15,225	19,664
Amortization of intangible assets (note 13)	1,438	993
Net decrease in employee benefits	1,403	236
Unwinding of discount on decommissioning liabilities (note 10)	10	15
Gain on disposal of property and equipment	–	(1,344)
Amortization of deferred government funding related to capital	(16,779)	(20,966)
Increase (decrease) in deferred lease incentives	(46)	109
Gain on settlement of decommissioning liabilities	(1)	(2)
Net change in non-cash working capital balances (note 17)	9,862	4,414
	9,132	3,745
Investing activities:		
Parliamentary appropriations received for capital funding	6,000	16,000
Purchase of property and equipment	(10,208)	(19,360)
Purchase of intangible assets	(348)	(801)
	(4,556)	(4,161)
Increase (decrease) in cash	4,576	(416)
Cash, beginning of period	5,907	7,335
Cash, end of period	$ 10,483	$ 6,919

Supplementary cash flow information (note 17)

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

1. Authority, mandate and programs

The Canadian Air Transport Security Authority (CATSA) was established under the *Canadian Air Transport Security Authority Act* (the *CATSA Act*), which came into force 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 deliver effective and efficient screening of individuals and their baggage before accessing aircraft or restricted areas through screening points at designated airports within Canada. CATSA is also responsible for ensuring consistency in the delivery of screening activities in the public interest and has four mandated activities:

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

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.

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 International Financial Reporting Standards (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 months ended June 30, 2012.

3. Summary of significant accounting policies

(a) Basis of measurement

These interim financial statements were prepared under the historical cost convention except for the defined benefit pension plan assets which are recognized as the net total of the fair value of the plan assets and the present value of the defined benefit obligation.

(b) Use of estimates and judgments

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next three months are:

- note 3(d)(f)(g), note 7 and note 9 – Property and equipment and intangible assets

  Key estimates used for property and equipment and intangible assets include the useful lives of assets and valuation of work-in-progress.

- note 3(e) and note 8 – Equipment held for sale

  The key estimate used for equipment held for sale is the fair value of the asset less costs to sell.

- note 3(k)(i) and note 10(a) – Decommissioning liabilities

  Key estimates used for decommissioning liabilities include the rate of inflation, the expected years to settlement and market risk premiums for unforeseeable circumstances.

- note 3(j) and note 12 – Employee benefits
  Key estimates used for employee benefits include expected rates of return, discount rates, inflation and the long-term rate of compensation increase.

Underlying assumptions and estimates are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Judgments made by management in the application of IFRS that have a significant effect on the financial statements are:

- note 3(f) and note 9 – Intangible assets
  Judgments are required in determining when internally generated intangible assets enter the development phase.

- note 3(k)(ii), note 10(b) and note 18 – Disputed claims
  Judgments are required in assessing the probability of disputed claims resulting in settlement.

3. Summary of significant accounting policies (continued)

(b) Use of estimates and judgments (continued)

- note 3(k), note 10(b) and note 18 – Provisions and contingent liabilities

  Judgments are required in determining the existence of a legal or constructive obligation and in assessing the probability that a claim will result in an outflow of future economic benefits.

(c) Inventories

Inventories consist of spare parts acquired for equipment maintenance, RAIC and screening officer uniforms. Inventories are stated at the lower of cost and net realizable value. Cost is determined using a weighted average cost formula and net realizable value is defined as replacement cost.

(d) Property and equipment

Property and equipment consists of screening equipment, RAIC equipment, computers, integrated software and electronic equipment, office furniture and equipment, leasehold improvements and work-in-progress.

(i) Recognition and measurement

Property and equipment are recorded at cost less accumulated depreciation, except for work-in-progress, which is recorded at cost but not depreciated until the asset is available for use. Cost includes expenditures that are directly attributable to the acquisition and installation of the assets, including integration costs related to the installation of the assets at the airports to ensure they are in a condition necessary for their intended use, and decommissioning costs associated with the disposal of certain screening equipment (note 3(k)(i)).

Work-in-progress includes costs relating to integration projects that remain incomplete at period-end. The valuation of work-in-progress at period-end is determined based on estimates performed by independent engineers or management, depending on management's assessment of risk.

When significant parts of an item of property and equipment have different useful lives, they are depreciated separately.

Gains and losses on disposal of an item of property and equipment are determined by comparing proceeds with the carrying amount and are recognized in financial performance for the period.

3. Summary of significant accounting policies (continued)

(d) Property and equipment (continued)

(ii) Subsequent costs

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to CATSA and that the cost of the item can be measured reliably. The cost of day-to-day servicing of property and equipment is recognized in financial performance for the period.

(iii) Depreciation

Depreciation is calculated using the straight-line method and is applied over the estimated useful lives of the assets:

Asset	Useful life
PBS equipment	3-10 years
HBS equipment	7-10 years
NPS equipment	7-10 years
RAIC equipment	3-7 years
Computers, integrated software and electronic equipment	3 years
Office furniture and equipment	5 years

Leasehold improvements are depreciated on a straight-line basis over the shorter of the related lease term or estimated useful life.

Depreciation methods, estimated useful lives and residual values are reviewed at each reporting date.

(e) Equipment held for sale

Equipment held for sale consists of screening equipment for which its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

Equipment held for sale is measured at the lower of carrying value and fair value less costs to sell. Prior to the initial classification of the equipment as held for sale, the carrying amount of the assets are measured in accordance with 3(d)(i)(ii) and (iii) as noted. An impairment loss upon initial and subsequent write-down of the asset is recognized in financial performance.

Depreciation is not recorded while an asset is classified as held for sale.

(f) Intangible assets

Separately acquired computer software licences are capitalized based on the costs incurred to acquire and bring the licences to use.

3. Summary of significant accounting policies (continued)

(f) Intangible assets (continued)

Certain costs incurred in connection with the development of software to be used internally or for providing screening services are capitalized once a project has progressed beyond a conceptual, preliminary stage to that of application development. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by CATSA are recognized as intangible assets when the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use it;
- there is an ability to use the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development of the software product and to use it are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Costs that qualify for capitalization include both internal and external costs, but are limited to those that are directly related to the specific project. All other costs associated with developing or maintaining computer software programs are expensed as incurred.

Intangible assets are amortized using the straight-line method over their estimated useful lives of three to five years.

(g) Impairment

At the end of each reporting period, CATSA reviews its property and equipment and intangible assets to determine whether there is any indication of impairment.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash inflows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. CATSA does not generate cash inflows from the use of its assets, as its operations are funded by Government appropriations on a break-even basis. Therefore, value in use will always be zero. Furthermore, there is no active market for most of CATSA's major assets due to their specialized nature. As a result, fair value less costs to sell cannot be reliably estimated.

3. Summary of significant accounting policies (continued)

(g) Impairment (continued)

As the recoverable amount of an asset cannot be determined, the estimated useful lives of CATSA's assets are reviewed at the end of each reporting period when an indication of impairment is observed. Any changes in estimated useful lives are recorded on a prospective basis in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

(h) Leases

Leases in which substantially all of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Expenses incurred under operating leases are recognized in financial performance on a straight-line basis over the term of the lease.

(i) Financial instruments

(i) Non-derivative financial assets

Non-derivative financial assets are comprised of cash. Trade and other receivables are not classified as non-derivative financial assets because they are not contractual rights but rather created as a result of statutory requirements imposed by federal and provincial governments.

CATSA classifies non-derivative financial assets into the category of loans and receivables. These financial assets are recognized initially at fair value. Subsequent to initial recognition, these financial assets are measured at amortized cost using the effective interest rate method.

(ii) Non-derivative financial liabilities

Non-derivative financial liabilities are comprised of trade and other payables. Non-derivative financial liabilities are recognized initially on the trade date at which CATSA becomes a party to the contractual provisions of the instrument.

CATSA derecognizes a financial liability when its contractual obligations are discharged, cancelled or expired.

CATSA classifies non-derivative liabilities into the category of financial liabilities measured at amortized cost. These financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest rate method.

3. Summary of significant accounting policies (continued)

(j) Employee benefits

(i) Post-employment benefit plans

CATSA maintains two funded defined benefit pension plans to provide retirement benefits to its employees. These include a registered pension plan and a supplementary retirement plan. CATSA also sponsors an unfunded post-employment benefits plan, the Other Defined Benefits Plan, which includes life insurance and eligible health and dental benefits. Pension benefits are based on the average of the best five consecutive years of pensionable salary and are indexed to the rate of inflation. Employees are required to contribute a percentage of their pensionable salary to the pension plans, with CATSA providing the balance of funding, as required, based on actuarial valuations, with payments being made monthly.

CATSA's net position in respect of these three plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years. The future benefit is then discounted to determine its present value. To the extent applicable, the fair value of any plan assets and any unrecognized past service costs are deducted from the present value of the future benefit. The discount rate is the yield at the reporting date on high quality bonds that have maturity dates approximating the terms of CATSA's obligations and that are denominated in the same currency in which the benefits are expected to be paid.

The calculation is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to CATSA, the recognized asset is limited to the total of any unrecognized past service costs and the present value of the economic benefits in the form of any future refunds from the plans or reductions in future contributions to the plans. In order to calculate the present value of the economic benefits, consideration is given to minimum funding requirements that apply to any plan. An economic benefit is available to CATSA if it is realizable during the life of the plan, or on settlement of the plan liabilities.

On a quarterly basis, CATSA's net asset or liability 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. However, 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.

3. Summary of significant accounting policies (continued)

(j) Employee benefits (continued)

(i) Post-employment benefit plans (continued)

When past service costs arise from plan improvements, the portion of the increased benefit relating to past service is recognized in financial performance on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognized immediately in financial performance for the period.

CATSA recognizes all actuarial gains and losses from post-employment benefits plans in other comprehensive income. Expenses related to post-employment benefits plans are recognized as employee costs in determining financial performance for the period.

CATSA recognizes gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss on curtailment comprises any resulting change in the fair value of plan assets, change in the present value of defined benefit obligation and any related actuarial gains or losses and past service cost that had not previously been recognized.

(ii) Termination benefits

Termination benefits are generally payable when employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. CATSA recognizes termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without realistic possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy. If benefits are payable more than 12 months after the reporting period, the liability is determined by discounting the obligation to its present value.

(iii) Short-term employee benefits

Short-term employee benefit obligations, such as salaries, annual leave, and bonuses, are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized in trade and other payables for the amount expected to be paid when CATSA has a present legal or constructive obligation to pay the amount as a result of past service provided by the employee and the obligation can be estimated reliably.

3. Summary of significant accounting policies (continued)

(k) Provisions

A provision is recognized if, as a result of a past event, CATSA has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(i) Decommissioning liabilities

CATSA recognizes a provision for future decommissioning liabilities associated with the cost of disposing certain screening equipment in an environmentally responsible manner, and the cost to restore leased premises to an agreed upon standard at the end of the lease. In the period of acquisition of the screening equipment or upon signing of the facilities lease, the decommissioning liability is calculated based on an estimate of the discounted future cash outflows. The decommissioning liability is capitalized as part of the carrying amount of the related asset and depreciated over the asset's estimated useful life.

The decommissioning liability is reviewed each reporting period to consider changes in the estimated outflow of resources embodying the economic benefit required to settle the obligation, changes in the current market-based discount rate (which includes changes in the time value of money and the risks specific to the liability) and increases that reflect the passage of time. The effect of a change in estimate is recognized prospectively and depreciated over the remaining lives of the assets to which they relate.

The unwinding of the discount is recognized as a finance cost, while changes resulting from the timing or amount of the initial estimate of future cash flows or market-based discount rate are recognized in the related decommissioning liability and carrying amount of the related asset.

(ii) Disputed claims

In the normal course of operations, CATSA receives claims requesting monetary compensation from various parties. A provision is accrued to the extent management believes a disputed claim arising from a past event results in a present legal or constructive obligation that can be estimated reliably, and it is probable that the claim will be settled, resulting in an outflow of economic benefits. If the timing of the cash outflows associated with the disputed claim can be reasonably determined to be more than 12 months after the reporting period, the provision is determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and the risks specific to the liability.

3. Summary of significant accounting policies (continued)

(k) Provisions (continued)

(iii) Onerous contracts

A provision for onerous contracts is recognized when the expected benefits to be derived by CATSA from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, CATSA recognizes any impairment loss on the assets associated with that contract.

(l) Government funding

CATSA's primary source of funding is parliamentary appropriations received from the Government of Canada. Parliamentary appropriations are accounted for as Government of Canada grants and are recognized in financial performance on a systematic basis over the periods in which CATSA recognizes as expenses the related costs for which the grants are intended to compensate. Parliamentary appropriations are not recognized in financial performance for the period until there is reasonable assurance that CATSA will comply with the conditions attached to them and that the grants will be received.

Appropriations related to expenses of future periods are recorded as deferred government funding related to operating and are recognized in financial performance in the period in which the related expenses are incurred. Appropriations used for the purchase of property and equipment and intangible assets are recorded as deferred government funding related to capital and are amortized on the same basis as the related assets.

Upon the disposal of funded depreciable assets, the related remaining deferred government funding is recognized in financial performance in the period of disposal.

Unused parliamentary appropriations at year-end are lapsed.

(m) Finance income

Finance income is comprised primarily of interest income derived from cash balances and is recognized in financial performance in the period it is earned.

(n) Finance cost

Finance cost is comprised primarily of the unwinding of the discount on the provision for decommissioning liabilities and is recognized in financial performance in the period it is incurred.

3. Summary of significant accounting policies (continued)

(o) Deferred lease incentives

Lease incentives represent a rent-free period of common area costs as well as a period of significantly reduced rent related to leased premises. The lease incentives are deferred and recognized as part of operating lease expenses in financial performance on a straight-line basis over the term of the lease, which expires on November 30, 2017.

(p) Foreign currency translation

Foreign currency transactions are translated using exchange rates prevailing at the dates of the transactions. Foreign currency gains and losses resulting from the settlement of such transactions and from the translation, using period-end exchange rates, of monetary assets and liabilities denominated in foreign currencies are recognized in financial performance for the period. Non-monetary assets and liabilities are translated using exchange rates prevailing at the dates the assets are acquired or the obligations are incurred.

(q) Future accounting changes

Certain new accounting standards and amendments have been published which are not required to be adopted for the current reporting period. As at the date of these condensed interim financial statements, the applicable standards and amendments issued but not yet effective which may have a significant impact on future financial statements are:

- IAS 1, *Presentation of Financial Statements*, was amended to require items in other comprehensive income to be classified by nature, and grouped into those that will not be reclassified subsequently to financial performance, and those that will be reclassified subsequently to financial performance when specific conditions are met. The amendment is effective for annual periods beginning on or after July 1, 2012;
- IAS 19, *Employee Benefits*, was amended to eliminate the option to defer the recognition of actuarial gains and losses, modify the presentation of changes in defined benefit obligations and plan assets in the Statement of Comprehensive Income, require net interest to be calculated by using a high quality corporate bond yield, as well as to improve disclosure about the risks arising from defined benefit plans. The amendment is effective for annual periods beginning on or after January 1, 2013;
- IFRS 9, *Financial Instruments*, was issued to deal with classification and measurement requirements for financial assets and financial liabilities. The standard is effective for annual periods beginning on or after January 1, 2015; and
- IFRS 13, *Fair Value Measurement*, was issued to provide a single source for guidance on measuring and disclosing fair values, clarify the definition of fair value and how it is determined, and mandate disclosures over fair value measurements. The standard is effective for annual periods beginning on or after January 1, 2013.

CATSA is currently assessing the impact of these standards on the financial statements.

(In thousands of Canadian dollars)

4. Financial instruments

As part of its operations, CATSA enters into transactions with financial risks exposure such as market and liquidity risks.

(a) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. CATSA's key market risk relates to currency risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Currency risk arises from trade and other payables denominated in a currency other than the Canadian dollar, which is the functional currency of CATSA. Although management monitors exposure to fluctuations in foreign exchange rates, it does not employ external hedging strategies to offset the impact of these fluctuations.

The following table provides the trade and other payables denominated in the United States dollar (USD) and the Canadian dollar (CAD) equivalent:

	USD	CAD
June 30, 2012	$ 1,172	$ 1,193
March 31, 2012	4,217	4,206

(b) Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. CATSA manages its liquidity risk by preparing and monitoring detailed forecasts of cash flows from operations and anticipated investing and funding activities. The liquidity risk is low since CATSA does not have debt instruments to service and receives regular funding from the Government of Canada.

Trade and other payables and the current portion of provisions represent the maximum liquidity risk exposure for CATSA. The following table summarizes the contractual maturities of these financial liabilities:

	Less than 3 months	3 to less than 6 months	6 months to 1 year	Total
June 30, 2012	$ 57,858	$ 750	$ 1,422	$ 60,030
March 31, 2012	80,332	676	2,423	83,431

(In thousands of Canadian dollars)

5. Trade and other receivables

Trade and other receivables are comprised of:

	June 30, 2012	March 31, 2012
Parliamentary appropriations	$ 48,290	$ 59,569
GST and HST recoverable	5,517	16,648
PST recoverable	1,863	1,188
Other	637	84
	$ 56,307	$ 77,489

6. Inventories

Inventories are comprised of:

	June 30, 2012	March 31, 2012
Spare parts	$ 17,875	$ 17,533
Uniforms	502	1,062
RAIC	901	340
	$ 19,278	$ 18,935

(In thousands of Canadian dollars)

7. 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, 2012	$ 127,137	$ 658,389	$ 5,429	$ 6,511	$ 25,363	$ 637	$ 12,779	$ 10,401	$ 846,646
Additions	(5)	(9)	–	–	1	–	–	2,020	2,007
Disposals	(1,126)	(3,556)	–	–	(166)	–	–	(61)	(4,909)
Reclassifications	840	457	–	–	176	–	–	(1,473)	–
Revisions to decommissioning liabilities estimates	(6)	(7)	(1)	–	–	–	(2)	–	(16)
Balance, June 30, 2012	$ 126,840	$ 655,274	$ 5,428	$ 6,511	$ 25,374	$ 637	$ 12,777	$ 10,887	$ 843,728
Accumulated depreciation									
Balance, March 31, 2012	$ 60,276	$ 456,553	$ 2,307	$ 3,885	$ 15,250	$ 557	$ 9,656	$ –	$ 548,484
Depreciation	2,206	10,414	100	239	1,793	20	453	–	15,225
Disposals	(1,126)	(3,494)	–	–	(166)	–	–	–	(4,786)
Balance, June 30, 2012	$ 61,356	$ 463,473	$ 2,407	$ 4,124	$ 16,877	$ 577	$ 10,109	$ –	$ 558,923
Carrying amounts									
At March 31, 2012	$ 66,861	$ 201,836	$ 3,122	$ 2,626	$ 10,113	$ 80	$ 3,123	$ 10,401	$ 298,162
At June 30, 2012	65,484	191,801	3,021	2,387	8,497	60	2,668	10,887	284,805

8. Equipment held for sale

A reconciliation of equipment held for sale is as follows:

	June 30, 2012	March 31, 2012
Balance, beginning of period	$ 540	$ –
Reclassification from property and equipment	–	540
Disposals	(540)	–
Balance, end of period	$ –	$ 540

(In thousands of Canadian dollars)

9. Intangible assets

A reconciliation of intangible assets is as follows:

	Externally acquired software	Internally developed software	Under development	Total
Cost				
Balance, March 31, 2012	$ 5,177	$ 19,680	$ 722	$ 25,579
Additions	–	–	348	348
Disposals	(39)	–	–	(39)
Reclassifications	475	–	(475)	–
Balance, June 30, 2012	$ 5,613	$ 19,680	$ 595	$ 25,888
Accumulated amortization				
Balance, March 31, 2012	$ 4,113	$ 9,577	$ –	$ 13,690
Amortization	189	1,249	–	1,438
Disposals	(39)	–	–	(39)
Balance, June 30, 2012	$ 4,263	$ 10,826	$ –	$ 15,089
Carrying amounts				
At March 31, 2012	$ 1,064	$ 10,103	$ 722	$ 11,889
At June 30, 2012	1,350	8,854	595	10,799

10. Provisions

Provisions are comprised of:

	June 30, 2012	March 31, 2012
Decommissioning liabilities	$ 2,299	$ 2,304
Disputed claims	1,068	2,203
	3,367	4,507
Less current portion	(1,068)	(2,203)
Non-current portion	$ 2,299	$ 2,304

(In thousands of Canadian dollars)

10. Provisions (continued)

(a) Decommissioning liabilities

In determining the carrying value of the decommissioning liabilities associated with certain screening equipment and lease agreements, management has applied certain assumptions which are disclosed in note 10 of the audited annual financial statements for the fiscal year ended March 31, 2012.

A reconciliation of the decommissioning liability is as follows:

	June 30, 2012	March 31, 2012
Balance, beginning of period	$ 2,304	$ 2,174
Revision in estimated cash flows including change in discount rate	(16)	121
Gain on settlement of liabilities	(1)	(76)
Unwinding of discount	10	50
Additional provision due to property and equipment acquired during the period	2	35
Balance, end of period	$ 2,299	$ 2,304

(b) Disputed claims

Management has accrued a provision for disputed claims as a result of CATSA receiving claims from various parties requesting monetary compensation. A provision has been recognized on the basis that management believes a present legal or constructive obligation exists and it is probable the claim will be settled. The provision was established by management taking into account legal assessments, information presently available and other recourse. The timing of the cash outflows associated with the disputed claims cannot be reasonably determined. As a result, the total amount of the provision was classified as a current liability and the expected future cash flows have not been discounted.

A reconciliation of the provision for disputed claims is as follows:

	June 30, 2012	March 31, 2012
Balance, beginning of period	$ 2,203	$ 18
Additional provision made in the period	13	2,203
Proceeds paid out in settlement	(1,148)	–
Provision released in the period	–	(18)
Balance, end of period	$ 1,068	$ 2,203

(In thousands of Canadian dollars)

10. Provisions (continued)

(c) Onerous contracts

No onerous contracts have been identified during the three months ended June 30, 2012 and the year ended March 31, 2012.

11. Deferred government funding

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

	June 30, 2012	March 31, 2012
Deferred government funding related to operating		
Balance, beginning of period	$ 23,100	$ 25,140
Parliamentary appropriations billed	119,772	486,431
Parliamentary appropriations recognized as government funding for operating expenses	(115,607)	(488,471)
Balance, end of period	27,265	23,100
Deferred government funding related to capital		
Balance, beginning of period	$ 310,120	$ 382,911
Parliamentary appropriations billed	4,949	23,138
Amortization of deferred government funding related to capital	(16,779)	(95,929)
Balance, end of period	298,290	310,120
Total deferred government funding, end of period	$ 325,555	$ 333,220

(In thousands of Canadian dollars)

12. Employee benefits

The following table provides the expense and contributions relating to the registered pension plan (RPP), the supplementary retirement plan (SRP) and the Other Defined Benefits Plan (ODBP) for the 3 months ended June 30:

	2012	2011
Expense:		
RPP	$ 2,287	$ 996
SRP	61	45
ODBP	578	397
	$ 2,926	$ 1,438
Contributions:		
RPP	$ 1,491	$ 1,172
SRP	–	–
ODBP	31	30
	$ 1,522	$ 1,202

The current service cost and the benefit obligation of the plans are actuarially determined on an annual basis. The significant assumptions used to determine CATSA's obligations are disclosed in note 12 of the audited annual financial statements for the fiscal year ended March 31, 2012.

(In thousands of Canadian dollars)

13. Expenses

CATSA conducts its operations using a functional organizational structure. The Statement of Comprehensive Income presents operating expenses by mandated activity. The following table presents operating expenses by major expense type for the three months ended June 30:

	2012	2011
Screening services and other related costs:		
Payments to screening contractors	$ 86,822	$ 87,907
Uniforms and other screening costs	988	1,234
Trace and consumables	489	601
	88,299	89,742
Direct administrative costs and corporate services:		
Employee costs	14,552	14,530
Operating leases	1,669	1,746.
Other administrative costs	1,360	1,530
Professional services and other business related costs	971	1,603
Office and computer expenses	792	912
Communications	238	162
	19,582	20,483
Depreciation and amortization:		
Depreciation of property and equipment	15,225	19,664
Amortization of intangible assets	1,438	993
	16,663	20,657
Equipment operating and maintenance:		
Equipment maintenance and spare parts	9,528	8,668
RAIC	208	264
Training and certification	165	435
	9,901	9,367
	$ 134,445	$ 140,249

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

(In thousands of Canadian dollars)

14. Government funding

CATSA's *2012/13 Summary of the Corporate Plan* has not yet been tabled in Parliament and, therefore, the total amount of parliamentary appropriations available for the current year is not yet public. As a result, disclosure of parliamentary appropriations approved compared to parliamentary appropriations used has not been provided.

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 months ended June 30:

	2012	2011
Parliamentary appropriations received and receivable	$ 169,203	$ 154,478
Amounts received and receivable related to prior periods	(49,431)	(33,856)
Amounts to be used in future periods	(4,265)	(3,116)
Parliamentary appropriations used for operating expenses	$ 115,507	$ 117,506

Parliamentary appropriations related to operating expenses to be used in future periods are a result of forecasted expenditures exceeding actual operating expenditures. These amounts are expected to be used and recognized in financial performance for the period 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 months ended June 30:

	2012	2011
Parliamentary appropriations received and receivable	$ 15,086	$ 22,890
Amounts received and receivable related to prior periods	(10,137)	(18,327)
Amounts to be used in future periods	(3,136)	(3,544)
Parliamentary appropriations used for capital expenditures	$ 1,813	$ 1,019

Parliamentary appropriations related to capital expenditures to be used in future periods are a result of forecasted expenditures exceeding actual capital expenditures and CATSA disposing of certain assets which generated proceeds that were used to finance capital expenditures during the period. These amounts are expected to be used within the next fiscal quarter.

(In thousands of Canadian dollars)

15. Commitments

(a) Operating leases

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

	June 30, 2012	March 31, 2012
No later than 1 year	$ 9,074	$ 10,634
Later than 1 year and no later than 5 years	21,068	20,739
Later than 5 years	2,767	3,923

The operating lease for the office space at headquarters contains an option to renew for five additional years, subject to the same terms and conditions as the original lease. 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.

There are decommissioning liabilities associated with the operating lease for the office space at headquarters that represent the cost required to restore the premises to an agreed upon standard.

(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 the minimum commitments under these contractual obligations:

	June 30, 2012	March 31, 2012
No later than 1 year	$ 483,592	$ 500,055
Later than 1 year and no later than 5 years	1,581,712	1,654,648
Later than 5 years	25,114	26,235

(In thousands of Canadian dollars)

16. Capital management

As a federal Crown corporation, CATSA is subject to the *Financial Administration Act* which, in general, restricts it from borrowing money. As a result, CATSA relies upon appropriations from Parliament to support its financial obligations and strategic requirements.

The primary objective in managing capital is to provide sufficient liquidity to support CATSA's financial obligations and its operating and strategic plans. CATSA manages its capital in accordance with the Treasury Board of Canada Secretariat's *Directive on the Use of the Consolidated Revenue Fund for Crown Corporations*, in that appropriated funds are drawn from the Consolidated Revenue Fund for the purpose of meeting short-term funding requirements.

Capital is comprised of the following:

	June 30, 2012	March 31, 2012
Cash	$ 10,483	$ 5,907
Trade and other receivables	56,307	77,489
Trade and other payables	(58,962)	(81,228)
Current portion of provisions	(1,068)	(2,203)
Parliamentary appropriations to be used in future periods	(4,265)	–
	$ (2,495)	$ (35)

CATSA's objectives, policies, and processes for managing capital have not changed since March 31, 2012. CATSA is not subject to externally imposed capital requirements.

17. 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 months ended June 30:

	2012	2011 (restated – note 19)
Decrease in trade and other receivables	$ 20,671	$ 18,897
Decrease (increase) in inventories	(220)	711
Decrease in prepaid expenses	444	258
Decrease in trade and other payables	(14,063)	(17,599)
Decrease in current portion of provisions	(1,135)	–
Increase in current portion of deferred government funding related to operating	4,165	2,147
	$ 9,862	$ 4,414

17. Net change in non-cash working capital balances and supplementary cash flow information (continued)

Interest income received and recognized during the three months ended June 30, 2012 totalled $116 (2011 – $103).

Interest expense paid and expensed during the three months ended June 30, 2012 totalled Nil (2011 – Nil).

The change in trade and other receivables excludes an amount of $1,051 (2011 – $11,436) in relation to government funding related to capital. Furthermore, the change in trade and other receivables excludes an amount of $540 (2011 – Nil) in relation to capital credit notes, as the amounts relate to investing activities.

The change in inventories excludes an amount of $123 (2011 – Nil) in relation to a transfer of spare parts from capital assets to inventory, as the amount relates to a non-cash transaction.

The change in trade and other payables excludes an amount of $8,203 (2011 – $19,142) in relation to the acquisition of property and equipment and intangible assets, as the amount relates to investing activities.

During the three months ended June 30, 2012, CATSA received non-cash proceeds of $540 and Nil (2011 – Nil and $1,548) relating to the disposal of equipment held for sale and property and equipment, respectively, in the form of credit notes from a supplier.

18. Contingent liabilities

During the three months ended June 30, 2012, there have been no changes to the outstanding legal actions involving CATSA. Refer to a description of those legal claims in note 19 of the audited annual financial statements for the year ended March 31, 2012.

19. Restatement

CATSA's financial statements were previously prepared in accordance with Canadian generally accepted accounting principles. CATSA issued its first annual financial statements in accordance with IFRS for the year ended March 31, 2012.

The condensed interim financial statements for the three months ended June 30, 2011 were prepared in accordance with the accounting policies that CATSA expected to adopt in its March 31, 2012 annual financial statements. These accounting policies were not known with certainty at the time of preparing the condensed interim financial statements for the three months ended June 30, 2011. Subsequent to the issuance of these condensed interim financial statements, the transition to IFRS resulted in an additional accounting policy change related to government funding. The adjustment is disclosed in note 20 of the audited annual financial statements for the year ended March 31, 2012. As a result, the comparative figures for the three months ended June 30, 2011 have been restated accordingly.

19. Restatement (continued)

The effect of the change in accounting policy is an increase to parliamentary appropriations for operating expenses for the three months ended June 30, 2011 of $969 and a decrease in retained earnings as at April 1, 2011 and June 30, 2011 of $25,140 and $24,171, respectively.

20. Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.