CATSA ACSTA

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

QUARTERLY FINANCIAL REPORT

For the Three and Nine Months Ended December 31, 2011

CANADIAN AIR TRANSPORT SECURITY AUTHORITY
MANAGEMENT'S NARRATIVE DISCUSSION
FOR THE THREE AND NINE MONTHS ENDED DECEMBER 31, 2011

Management's Narrative Discussion outlines the financial results and operational changes of the Canadian Air Transport Security Authority (CATSA) for the three and nine months ended December 31, 2011. This Narrative Discussion should be read in conjunction with CATSA's unaudited condensed interim financial statements for the three and nine months ended December 31, 2011 and the Management Discussion and Analysis and audited financial statements for the year ended March 31, 2011. The information in this report is current to February 27, 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 involving 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 the stakeholders of CATSA.

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

CORPORATE OVERVIEW

CATSA is a Crown corporation charged 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 a professional, effective and consistent level of security service at 89 designated airports across the country, at or above the standards set by its regulator, Transport Canada.

To achieve this, CATSA is mandated to conduct screening services 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, pursuant to direction from the Minister of Transport, Infrastructure and Communities; 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 compatibility 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.

OPERATING ENVIRONMENT

The following section provides information on significant changes in the operating environment that have occurred since September 30, 2011.

SERVICE DELIVERY

As disclosed in the previous *Quarterly Financial Report*, CATSA's new Airport Screening Services Agreements (ASSAs) came into effect on November 1, 2011. The five-year agreements are now held by the following companies in each region:

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

Leading up to November 1, 2011 and throughout the remainder of the third quarter, CATSA worked closely with both the new and incumbent screening contractors to manage the transition. During this period, security screening at Canadian airports continued to be delivered at or above the standards set by Transport Canada, while meeting CATSA's commitment to the industry to increase passenger throughput. CATSA continues to work closely with the screening contractors as they progress through the transition phase.

While planning for the new ASSAs, CATSA also reviewed its existing systems and procedures to identify opportunities for continuous improvement. As a result, CATSA introduced a new Integrated Time Tracking and Invoice Processing tool on November 1, 2011 that improves the request and approval process and reduces manual inputs.

LABOUR RELATIONS

As disclosed in the previous *Quarterly Financial Report*, there were a limited number of Screening Officers that engaged in an illegal work action in early October 2011, leading to extended wait times for passengers at Toronto Pearson International Airport. Since that time, there continues to be a heightened risk of labour issues which CATSA is actively monitoring.

The majority of collective bargaining agreements for Screening Officers are scheduled to expire on March 31, 2012. At major 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 are working with the unions to maintain the working conditions that were in place before November 1, 2011 until new collective bargaining agreements are established. For major airports where the screening contractor did not change (Edmonton, Calgary, Toronto, and Winnipeg), the collective bargaining agreements will remain valid until March 31, 2012.

PERIMETER SECURITY AND ECONOMIC COMPETITIVENESS ACTION PLANS ANNOUNCEMENT

In late December 2011, the Government of Canada announced improvements for air travel to the U.S., following the *Beyond the Border* announcement made by Prime Minister Stephen Harper and U.S. President Barack Obama earlier that month.

Beginning in February 2012, passengers travelling to the U.S. have been able to use NEXUS cards to expedite screening at Canada's eight largest airports using designated screening lanes at PBS checkpoints.

In addition, air travellers will benefit from the elimination of duplicate baggage screening, resulting from the use of Computed Tomography technology for U.S.-bound baggage to be deployed over the next three years. Passengers flying from Canadian airports with U.S. pre-clearance facilities will no longer have their baggage screened on departure from Canada and again at the connecting U.S. airport. This change will make connections through U.S. cities easier, while maintaining a high level of aviation security.

PASSENGER GROWTH

Transport Canada statistics for the three-month period from September 2011 to November 2011 indicate that passenger volumes at Canada's eight largest airports increased by 3% over the same period in 2010. The impact of increased passenger volumes was partially absorbed by the implementation of operational efficiencies which were identified in CATSA Review 2010.

SUBSEQUENT EVENTS

Executive changes

Effective January 3, 2012, Angus Watt[1] 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, effective December 31, 2011.

In addition, the Chair of the Board of Directors, D. Ian Glen, Q.C., will end his term in June 2012. Mr. Glen has been serving in this position since June 2007. A formal search for his replacement commenced in early 2012.

Enhanced collaboration with Canadian airport authorities

In fiscal year 2011/12, as part of the recommendations from CATSA Review 2010 and CATSA's corresponding action plan for security screening process improvements, CATSA has undertaken to work closely with major Canadian airport authorities to share information and enhance collaboration on operational matters with a view to achieving more efficient and effective screening and to improve the passenger experience.

RISK AND UNCERTAINTIES

The following section provides information on key risks CATSA observed during the quarter.

SERVICE DELIVERY THROUGH THIRD PARTIES RISK

Labour disruptions

CATSA outsources its screening services to third-party screening contractors who rely on a unionized workforce of Screening Officers to deliver services. There is a risk that legal or illegal labour disruptions may occur at some airports.

To address this risk, CATSA has a labour relations expert to assist in monitoring labour developments. In addition, there are established internal and external communication protocols, as well as contingency plans, to respond to labour relations issues as they arise.

Service delivery model

CATSA is working closely with its screening contractors to manage the ongoing transition to the new ASSAs. There is a risk that a screening contractor may not be able to meet the commitments or performance targets outlined in the agreement.

To address this risk, CATSA developed and implemented a new performance program, which includes the *Contract Compliance Program* and the *Service Excellence Program*. The program provides incentive to screening contractors to deliver on commitments and meet performance targets. The new ASSAs also contain clauses to address the risk of loss arising from failures in contract performance. In addition, CATSA is developing a *Relationship Management Plan* with the screening contractors to implement process improvements and to address issues relating to contract management and/or performance.

[1] Mr. Watt's biography is available on CATSA's website at www.catsa-acsta.gc.ca.

CAPACITY RISK

Level of service delivery

CATSA is not funded for passenger growth, and is not fully funded for inflation. These pressures, which are anticipated to grow in importance in 2013/14, will eventually result in a decrease in screening hours purchased and/or an increase in passenger wait times.

To address this risk, CATSA has implemented various operational efficiencies identified in both the 2009 Strategic Review and CATSA Review 2010. In addition, it is anticipated that CATSA will better streamline its operations and reduce expenditures under the new ASSAs. CATSA also continues to work with Transport Canada to find other solutions to alleviate pressures caused by passenger growth and inflation.

MANDATED SERVICES RISK

Threat and risk information

CATSA is exposed to an evolving aviation security threat environment. There is a risk that CATSA may not 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 continues to actively monitor and analyze threat and risk information from internal and external sources and has an integrated response strategy in place to act upon the information in accordance with established protocol.

MANAGEMENT SYSTEMS/CONTROL SYSTEMS RISK

Organizational preparedness for emergencies

CATSA requires an integrated business continuity plan, as well as resources in place, to respond to emergencies. There is a risk that CATSA's business continuity plan may not be integrated, tested or understood in order to effectively respond to and recover from emergencies and maintain operations.

To address this risk, CATSA has recently updated its Business Continuity and Emergency Response Plans and has conducted tabletop exercises with its screening contractors and stakeholders.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

As discussed in CATSA's *Annual Report 2011* and the previous quarterly reports issued during fiscal year 2011/12, CATSA will prepare its first annual financial statements in accordance with International Financial Reporting Standards (IFRS) for the fiscal year ending March 31, 2012. The Treasury Board of Canada Secretariat's *Standard on Quarterly Financial Reports for Crown Corporations* requires that interim financial statements issued after April 1, 2011 be prepared based on the recognition and measurement standards used in the preparation of the organization's annual audited financial statements. Accordingly, the condensed interim financial statements have been prepared in accordance with the measurement and recognition principles of IFRS currently issued and expected to be effective at the end of CATSA's first annual IFRS reporting period, March 31, 2012. The comparative information presented in this Narrative Discussion and the condensed interim financial statements for the three and nine months ended December 31, 2011 have been restated to reflect the adoption of IFRS measurement and recognition standards.

QUARTERLY FINANCIAL INFORMATION

The following table provides key highlights of the Statement of Comprehensive Income for the three and nine months ended December 31, 2011 and December 31, 2010:

Key Financial Highlights - Statement of Comprehensive Income	Three Months Ended December 31				Nine Months Ended December 31			
	2011	2010			2011	2010		
(Millions of dollars)	(unaudited)	(unaudited)	$ Change	% Change	(unaudited)	(unaudited)	$ Change	% Change
Expenses:								
Payments to screening contractors	$ 89.4	$ 93.2	$ (3.8)	(4%)	$ 259.7	$ 271.3	$ (11.6)	(4%)
Depreciation and amortization	22.0	20.6	1.4	7%	64.9	59.3	5.6	9%
Direct administrative costs and corporate services	19.9	20.6	(0.7)	(3%)	58.9	59.4	(0.5)	(1%)
Equipment maintenance, spare parts and warehousing costs	10.4	9.0	1.4	16%	28.6	26.0	2.6	10%
Other operating costs	2.0	2.5	(0.5)	(20%)	6.3	7.8	(1.5)	(19%)
Total expenses	**$ 143.7**	**$ 145.9**	**$ (2.2)**	**(2%)**	**$ 418.4**	**$ 423.8**	**$ (5.4)**	**(1%)**
Total other income	**$ 0.1**	**$ 0.1**	**$ -**	**0%**	**$ 1.1**	**$ 0.6**	**$ 0.5**	**83%**
Financial performance for the period before government funding	**$ 143.6**	**$ 145.8**	**$ (2.2)**	**(2%)**	**$ 417.3**	**$ 423.2**	**$ (5.9)**	**(1%)**
Government funding:								
Parliamentary appropriations for operating expenses	$ 120.6	$ 126.2	$ (5.6)	(4%)	$ 349.3	$ 363.4	$ (14.1)	(4%)
Amortization of deferred funding contributions related to capital	22.1	20.9	1.2	6%	64.3	61.6	2.7	4%
Total government funding	**$ 142.7**	**$ 147.1**	**$ (4.4)**	**(3%)**	**$ 413.6**	**$ 425.0**	**$ (11.4)**	**(3%)**
Financial performance and total comprehensive income (loss) for the period	**$ (0.9)**	**$ 1.3**	**$ (2.2)**	**(169%)**	**$ (3.7)**	**$ 1.8**	**$ (5.5)**	**(306%)**

The following table provides key highlights of the Statement of Financial Position as at December 31, 2011 and March 31, 2011:

Key Financial Highlights - Statement of Financial Position	December 31, 2011	March 31, 2011		
(Millions of dollars)	(unaudited)	(unaudited)	$ Change	% Change
Total assets	**$ 481.7**	**$ 497.8**	**$ (16.1)**	**(3%)**
Total liabilities	**$ 459.7**	**$ 472.2**	**$ (12.5)**	**(3%)**

ANALYSIS OF FINANCIAL PERFORMANCE

The following section provides information on key account balances within the Statement of Comprehensive Income for the three and nine months ended December 31, 2011, compared to the same periods of the prior fiscal year.

RESULTS FOR THE THREE MONTHS ENDED DECEMBER 31, 2011

Payments to screening contractors

Payments to screening contractors decreased by $3.8 million (4%) for the three months ended December 31, 2011, compared to the same period in 2010. The decrease is primarily due to a reduction in screening hours purchased, primarily attributable to the implementation of operational efficiencies initiated as a result of the 2009 Strategic Review and CATSA Review 2010. These operational efficiencies, combined with more effective resource scheduling, allowed CATSA to decrease the number of screening hours purchased, and partially absorb the impact of passenger growth.

The decrease in payments to screening contractors was partially offset by an increase in the average billing rate resulting from wage rate increases required under the existing collective bargaining agreements between screening contractors and the unions representing the Screening Officers. The decrease was also partially offset by additional costs related to a tax liability resulting from a supplier incorrectly invoicing CATSA the applicable sales taxes.

Depreciation and amortization

Depreciation and amortization increased by $1.4 million (7%) for the three months ended December 31, 2011, compared to the same period in 2010. The increase is due to a higher number of new and replacement units of capital equipment subject to depreciation in the current quarter.

Direct administrative costs and corporate services

Direct administrative costs and corporate services decreased slightly for the three months ended December 31, 2011, compared to the same period in 2010. The decrease is due to a reduction in the average number of staffed indeterminate and fixed term positions, lower professional services, and decreased administrative costs, partially offset by annual salary increases and higher current service costs of CATSA's pension plan.

Equipment maintenance, spare parts and warehousing costs

Equipment maintenance, spare parts and warehousing costs increased by $1.4 million (16%) for the three months ended December 31, 2011, compared to the same period in 2010. The increase is primarily due to annual inflationary increases in existing equipment maintenance contracts, additional costs associated with expired equipment warranty coverage, and higher per unit support costs for equipment with more advanced technology deployed as part of CATSA's capital life-cycle management plan. The increase is also attributable to additional application support costs for the Boarding Pass Security System, which is installed at a higher number of airports as compared to the same quarter in the prior fiscal year.

Other operating costs

Other operating costs for the three months ended December 31, 2011 are comparable to the same period in 2010.

Parliamentary appropriations for operating expenses

Parliamentary appropriations for operating expenses decreased by $5.6 million (4%) for the three months ended December 31, 2011, compared to the same period in 2010. The decrease is partially due to the decrease in payments to screening contractors, as discussed above. The decrease is also due to a solvency deficit payment for CATSA's pension plan made during the third quarter of the prior fiscal year. CATSA has not made any similar payments in the current quarter.

Amortization of deferred funding contributions related to capital

Amortization of deferred funding contributions related to capital increased by $1.2 million (6%) for the three months ended December 31, 2011, compared to the same period in 2010. This is due to a higher number of new and replacement units of capital equipment subject to depreciation in the current quarter.

RESULTS FOR THE NINE MONTHS ENDED DECEMBER 31, 2011

Payments to screening contractors

Payments to screening contractors decreased by $11.6 million (4%) for the nine months ended December 31, 2011, compared to the same period in 2010. The decrease is primarily due to a reduction in screening hours purchased, partially offset by an increase in the average billing rate and additional costs relating to sales taxes, as discussed above. The decrease in the cost of screening hours purchased is also partially offset by an increase in account management and fixed fees required under the previous ASSAs, and an increase in screening hours purchased for the operation of Full-Body Scanners.

Depreciation and amortization

Depreciation and amortization increased by $5.6 million (9%) for the nine months ended December 31, 2011, compared to the same period in 2010. The increase is primarily due to a higher number of new and replacement units of capital equipment subject to depreciation in the current period, as discussed above. The increase is also attributable to a revision of the assumptions used in determining decommissioning liabilities which resulted in a one-time reduction to depreciation expense in the first quarter of the prior fiscal year.

Direct administrative costs and corporate services

Direct administrative costs and corporate services decreased slightly for the nine months ended December 31, 2011, compared to the same period in 2010. This is due to a reduction in the average number of staffed positions, lower professional services and decreased administrative costs, partially offset by annual salary increases and higher pension costs.

Equipment maintenance, spare parts and warehousing costs

Equipment maintenance, spare parts and warehousing costs increased by $2.6 million (10%) for the nine months ended December 31, 2011, compared to the same period in 2010. The increase is primarily due to annual maintenance contract rate increases, additional warranty costs, and higher support costs for equipment with more advanced technology, as discussed above. The increase is also attributable to the purchase of non-capitalized RAIC equipment and application support for the Boarding Pass Security System. This is partially offset by a stronger Canadian dollar during the current period.

Other operating costs

Other operating costs decreased by $1.5 million (19%) for the nine months ended December 31, 2011, compared to the same period in 2010. The decrease is partially due to lower uniform costs resulting from a reduction in the Screening Officer workforce, and a decrease in the consumption of trace and consumables. The decrease is also attributable to lower training costs for maintenance providers, resulting from a decrease in the deployment of new Explosives Detection System (EDS) equipment.

Parliamentary appropriations for operating expenses

Parliamentary appropriations for operating expenses decreased by $14.1 million (4%) for the nine months ended December 31, 2011, compared to the same period in 2010. The decrease is primarily a result of the decrease in payments to screening contractors, as discussed above. The decrease is also due to a pension contribution made by CATSA in the prior fiscal year, as discussed above.

Amortization of deferred funding contributions related to capital

Amortization of deferred funding contributions related to capital increased by $2.7 million (4%) for the nine months ended December 31, 2011, compared to the same period in 2010. The increase is due to a higher number of new and replacement units of capital equipment subject to depreciation in the current period. This is partially offset by proceeds on disposal of EDS equipment received in the form of credit notes from a supplier.

ANALYSIS OF FINANCIAL POSITION

The following section provides information on key account balances within the Statement of Financial Position as at December 31, 2011 compared to March 31, 2011.

TOTAL ASSETS

Total assets decreased by $16.1 million (3%) primarily due to the following:

- Cash increased by $70.3 million primarily due to the receipt of appropriations which were not payable to CATSA until January 2012 and the receipt of the April 2011 to September 2011 recoverable sales tax refund;
- Accounts receivable decreased by $31.4 million primarily due to the receipt of parliamentary appropriations relating to the prior fiscal year which had been accrued at March 31, 2011. The parliamentary appropriations balance at March 31, 2011 reflected traditionally high fourth quarter

spending. The decrease is also due to the receipt of recoverable sales tax refunds during the nine months ended December 31, 2011; and

- Property and equipment and intangible assets decreased by $53.2 million primarily due to depreciation and amortization for the period ($64.9 million), partially offset by the acquisition and installation of equipment ($13.3 million).

TOTAL LIABILITIES

Total liabilities decreased by $12.5 million (3%) primarily due to the following:

- Deferred funding contributions decreased by $10.9 million due to operating expenditures incurred ($349.3 million) and amortization of deferred funding related to capital ($64.3 million), partially offset by parliamentary appropriations invoiced ($367.7 million) and January 2012 appropriations received in advance ($35.0 million).

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 parliamentary appropriations used for operating expenditures and operating expenses reported under IFRS:

Parliamentary Appropriations Used - Operating	**Three Months Ended December 31**		**Nine Months Ended December 31**	
(Millions of dollars)	**2011** (unaudited)	**2010** (unaudited)	**2011** (unaudited)	**2010** (unaudited)
Total expenses (IFRS)	$ 143.7	$ 145.9	$ 418.4	$ 423.8
Non-operating expenses:				
Depreciation and amortization	(22.0)	(20.6)	(64.9)	(59.3)
Other sources of funding:				
Net change in prepaids and inventories	(0.7)	(1.0)	(3.1)	(2.2)
Interest income and net foreign exchange gain/loss	(0.1)	(0.2)	(0.3)	(0.1)
Non-cash accounting adjustments:				
Employee costs accruals	(0.5)	(0.6)	(1.0)	(0.8)
Employee benefits expense	0.2	2.9	0.2	2.6
Deferred lease inducement expense	-	(0.2)	-	(0.6)
Total parliamentary appropriations used - Operating	**$ 120.6**	**$ 126.2**	**$ 349.3**	**$ 363.4**

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

Parliamentary Appropriations Used - Capital	**Three Months Ended December 31**		**Nine Months Ended December 31**	
(Millions of dollars)	**2011** (unaudited)	**2010** (unaudited)	**2011** (unaudited)	**2010** (unaudited)
Total capital asset acquisitions (IFRS)	$ 5.4	$ 5.4	$ 13.3	$ 16.3
Proceeds on disposal of property and equipment	-	-	(2.5)	(1.0)
Total parliamentary appropriations used - Capital	**$ 5.4**	**$ 5.4**	**$ 10.8**	**$ 15.3**

PARLIAMENTARY APPROPRIATIONS USED COMPARED TO CORPORATE PLAN

The following table provides key highlights of parliamentary appropriations used for operating expenditures during the nine months ended December 31, 2011, compared to the approved 2011/12 Corporate Plan annual budget:

Parliamentary Appropriations Used Compared to Corporate Plan - Operating (Millions of dollars)	Nine Months Ended December 31, 2011 (unaudited)	Corporate Plan Budget 2011/12	% of Budget Used
Operating expenses (IFRS):			
Payments to screening contractors	$ 259.7	$ 344.7	75%
Direct administrative costs and corporate services	58.9	87.7	67%
Equipment maintenance, spare parts and warehousing costs	28.6	46.7	61%
Other operating costs	6.3	11.0	57%
Other sources of funding	(3.4)	(3.9)	87%
Non-cash accounting adjustments	(0.8)	-	100%
Total parliamentary appropriations used - Operating	**$ 349.3**	**$ 486.2**	**72%**

The following section provides information on CATSA's use of parliamentary appropriations for the nine months ended December 31, 2011, compared to the approved 2011/12 Corporate Plan annual budget.

PARLIAMENTARY APPROPRIATIONS USED - OPERATING

Parliamentary appropriations used for operating expenditures for the nine months ended December 31, 2011 represent 72% of the approved annual operating budget.

Payments to screening contractors

Payments to screening contractors were comparable to planned expenditures. This is primarily due to the realization of earlier than anticipated passenger throughput efficiencies identified in CATSA Review 2010, which allowed CATSA to partially absorb the increase in passenger growth. This is offset by unanticipated costs relating to the identification of a sales tax liability, as discussed above. Passenger growth was not accommodated in the 2011/12 Corporate Plan budget.

Direct administrative costs and corporate services

Direct administrative costs and corporate services were lower than planned primarily due to lower than anticipated employee costs resulting from a lower average number of staffed indeterminate and fixed term positions, and lower than anticipated professional services and other administrative costs.

Equipment maintenance, spare parts and warehousing costs

Equipment maintenance, spare parts and warehousing costs were lower than planned partially due to a stronger performance of the Canadian dollar than anticipated, resulting in lower equipment maintenance service costs with U.S. vendors. Costs were also lower than planned due to lower than anticipated corrective maintenance costs resulting from the resolution of certain EDS equipment performance issues, and lower than anticipated spare parts usage. Lastly, costs were lower than planned due to delays in the deployment of EDS equipment, as discussed below, as well as delays in a number of initiatives aimed at further enhancing equipment performance.

Other operating costs

Other operating costs were lower than planned partially due to lower than anticipated uniform costs for Screening Officers, and lower than anticipated consumption of trace and consumables.

PARLIAMENTARY APPROPRIATIONS USED – CAPITAL

The following table provides key highlights of parliamentary appropriations used for capital expenditures during the nine months ended December 31, 2011, compared to the 2011/12 Corporate Plan annual budget:

Parliamentary Appropriations Used Compared to Corporate Plan - Capital (Millions of dollars)	Nine Months Ended December 31, 2011 (unaudited)	Corporate Plan Budget 2011/12	% of Budget Used
EDS	$ 9.8	$ 26.1	38%
Non-EDS	3.5	6.9	51%
Total capital asset acquisitions (IFRS)	**$ 13.3**	**$ 33.0**	**40%**
Proceeds on disposal of property and equipment	(2.5)	-	100%
Total parliamentary appropriations used - Capital	**$ 10.8**	**$ 33.0**	**33%**

EDS

EDS capital expenditures included costs associated with the following projects:

- Completion of an HBS conveyor system upgrade at the Montreal Pierre Elliott Trudeau International Airport;
- Significant progress on a trans-border expansion project at the Edmonton International Airport, which is expected to be completed by fiscal year-end; and
- Deployment of split PBS lanes at select airports to facilitate improved passenger throughput at PBS checkpoints.

Non-EDS

Non-EDS capital expenditures included costs associated with the following projects:

- Installation of the Boarding Pass Security System at Winnipeg James Armstrong Richardson International Airport and Billy Bishop Toronto City Airport; and
- Implementation of the Integrated Time Tracking and Invoice Processing tool.

Parliamentary appropriations used for capital expenditures for the nine months ended December 31, 2011 represent 33% of the approved annual capital budget. A significant portion of CATSA's capital spending is planned to take place in the fourth quarter. Capital expenditures for the nine months ended December 31, 2011 were lower than planned due to:

- Delays in the purchase and deployment of certain EDS equipment as a result of an extended competitive bidding process, which is expected to generate cost savings;
- Favourable pricing for the purchase of new EDS equipment for the trans-border expansion project at the Edmonton International Airport; and
- Lower spending associated with certain non-EDS projects, including the Corporate Management Systems, due to a reassessment of project requirements.

Capital expenditures were partially offset by proceeds on disposal of EDS equipment of $2.5 million received in the form of credit notes from a supplier. These proceeds will be applied against planned EDS capital purchases, as approved in the 2011/12 Corporate Plan, resulting in a corresponding reduction in CATSA's capital appropriations for fiscal year 2011/12.

REPORT ON USE OF GOVERNMENT APPROPRIATIONS

The following table provides a summary of appropriations that remain unused as at December 31, 2011 and December 31, 2010:

Unused Parliamentary Appropriations	Nine Months Ended December 31	
(Millions of dollars)	2011 (unaudited)	2010 (unaudited)
Parliamentary appropriations authorized by the Government of Canada[1]	$ 519.2	$ 577.6
Less:		
Parliamentary appropriations used for operating expenditures	349.3	363.4
Parliamentary appropriations used for capital expenditures	10.8	15.3
Unused parliamentary appropriations	**$ 159.1**	**$ 198.9**

1. Parliamentary appropriations authorized by the Government of Canada for the nine months ended December 31, 2010 represent the budget approved in the 2010/11 Corporate Plan less the authorized funding re-profile of $17.4 for operating ($8.1) and capital ($9.3) expenditures to future years.

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 the Authority, as at the date of and for the periods presented in the condensed interim financial statements.

Angus Watt	Mario Malouin, CA
President and Chief Executive Officer	Vice-President and Chief Financial Officer
Ottawa, Canada	Ottawa, Canada
February 27, 2012	February 27, 2012

Condensed Interim Financial Statements of

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Three and nine months ended December 31, 2011 and 2010

(Unaudited)

CANADIAN AIR TRANSPORT SECURITY AUTHORITY

Condensed Interim Statement of Financial Position
(Unaudited)

(In thousands of Canadian dollars)

	December 31, 2011	March 31, 2011
Assets		
Current assets:		
Cash	$ 77,628	$ 7,335
Accounts receivable (note 5)	39,303	70,725
Inventories (note 6)	20,414	21,785
Prepaid expenses	1,672	3,355
	139,017	103,200
Non-current assets:		
Employee benefits (note 11)	13,076	11,804
Property and equipment (note 7)	317,048	369,989
Intangible assets (note 8)	12,572	12,849
	342,696	394,642
	$ 481,713	$ 497,842
Liabilities and Equity		
Current liabilities:		
Trade and other payables	$ 75,441	$ 78,106
Provisions (note 9)	18	18
Deferred funding contributions (note 10)	38,762	-
	114,221	78,124
Non-current liabilities:		
Provisions (note 9)	2,158	2,174
Deferred lease inducement	1,526	1,497
Deferred funding contributions (note 10)	333,253	382,911
Employee benefits (note 11)	8,586	7,483
	345,523	394,065
Equity:		
Retained earnings	21,969	25,653
	21,969	25,653
	$ 481,713	$ 497,842

Commitments (note 14) and contingent liabilities (note 17)

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 December 31		Nine months ended December 31	
	2011	2010	2011	2010
Expenses:				
Pre-Board Screening and Hold Baggage Screening	$ 124,314	$ 125,497	$ 366,479	$ 370,333
Corporate services	14,238	14,802	36,716	38,646
Non-Passenger Screening	3,920	4,684	11,458	12,176
Restricted Area Identity Card Program	1,205	914	3,725	2,662
Total expenses (note 12)	143,677	145,897	418,378	423,817
Other income (expenses):				
Gain (loss) on disposal of property and equipment	46	(79)	1,500	342
Finance income	165	120	406	277
Gain on settlement of decommissioning liabilities	2	-	23	325
Write-down of intangible assets	-	-	(631)	-
Foreign exchange gain (loss)	(115)	63	(118)	(253)
Finance cost	(17)	(11)	(44)	(58)
	81	93	1,136	633
Financial performance for the period before government funding	143,596	145,804	417,242	423,184
Government funding:				
Parliamentary appropriations for operating expenses (note 13)	120,581	126,266	349,241	363,426
Amortization of deferred funding contributions related to capital (note 10)	22,101	20,875	64,317	61,578
	142,682	147,141	413,558	425,004
Financial performance and total comprehensive income (loss) for the period	$ (914)	$ 1,337	$ (3,684)	$ 1,820

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 December 31:

		Retained earnings
Balance, October 1, 2010	$	18,769
Financial performance for the period		1,337
Balance, December 31, 2010	$	20,106
Balance, October 1, 2011	$	22,883
Financial performance for the period		(914)
Balance, December 31, 2011	$	21,969

For the nine months ended December 31:

		Retained earnings
Balance, April 1, 2010	$	18,286
Financial performance for the period		1,820
Balance, December 31, 2010	$	20,106
Balance, April 1, 2011	$	25,653
Financial performance for the period		(3,684)
Balance, December 31, 2011	$	21,969

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 December 31		Nine months ended December 31	
	2011	2010	2011	2010
Cash flows provided by (used in):				
Operating activities:				
Financial performance for the period	$ (914)	$ 1,337	$ (3,684)	$ 1,820
Items not involving cash:				
Depreciation of property and equipment (note 12)	20,777	19,560	61,381	56,736
Amortization of intangible assets (note 12)	1,262	1,017	3,502	2,612
Write-down of intangible assets	-	-	631	-
Unwinding of discount on decommissioning liabilities	12	11	37	58
Increase (decrease) in deferred lease inducement	(40)	192	29	576
Amortization of deferred funding contributions related to capital	(22,101)	(20,875)	(64,317)	(61,578)
Loss (gain) on disposal of property and equipment	(46)	79	(1,500)	(342)
Increase in employee benefits	(232)	(2,930)	(169)	(2,810)
Gain on settlement of decommissioning liabilities	(2)	-	(23)	(325)
Net change in non-cash working capital balances (note 16)	12,196	(457)	70,454	59,061
	10,912	(2,066)	66,341	55,808
Financing activities:				
Parliamentary appropriations received for capital funding	4,500	12,000	27,327	64,145
	4,500	12,000	27,327	64,145
Investing activities:				
Purchase of property and equipment	(684)	(4,911)	(20,828)	(62,523)
Purchase of intangible assets	(685)	(830)	(2,547)	(2,372)
Proceeds on disposal of property and equipment	-	-	-	2
	(1,369)	(5,741)	(23,375)	(64,893)
Increase in cash	14,043	4,193	70,293	55,060
Cash, beginning of period	63,585	54,379	7,335	3,512
Cash, end of period	$ 77,628	$ 58,572	$ 77,628	$ 58,572

Supplementary cash flow information (note 16)

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* (Canada) 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, pursuant to direction from the Minister of Transport, Infrastructure and Communities; 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 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.

2. Basis of preparation (continued):

The TBS Standard requires interim financial statements be prepared based on the recognition and measurement standards used in the preparation of the annual audited financial statements. Accordingly, the interim financial statements have been prepared based on recognition and measurement standards applicable under International Financial Reporting Standards (IFRS). The comparative figures for the three and nine months ended December 31, 2010 and the year ended March 31, 2011 have also been restated to reflect the adoption of IFRS recognition and measurement standards. 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 annual audited financial statements and the narrative discussion included within the quarterly financial report for the three and nine months ended December 31, 2011.

The interim financial statements have been prepared in accordance with the accounting policies that CATSA expects to adopt in its March 31, 2012 annual financial statements. Those accounting policies are based on IFRS, including International Financial Reporting Interpretations Committee (IFRIC) interpretations that CATSA expects to be applicable at that time. The IFRS that will be applicable March 31, 2012 are not known with certainty at the time of preparing these interim financial statements. The policies set out below have been consistently applied to all the periods presented.

These interim financial statements were prepared under the historical cost convention except for the following material items in the statement of financial position:

- financial instruments categorized as fair value through profit or loss are measured at fair value; and
- defined benefit pension plan assets are recognized as the net total of the fair value of the plan assets and the present value of the defined benefit obligation.

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

- note 3(b) – Property and equipment
- note 9(a) – Decommissioning liabilities
- note 11 – Employee benefits

2. Basis of preparation (continued):

Estimates and underlying assumptions 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 discussed in the following notes:

- note 3(c) – Intangible assets
- note 9(b) – Legal claims
- note 17 – Contingent liabilities

3. Significant accounting policies:

(a) 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 and net realizable value is defined as replacement cost.

(b) 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 at the airports to ensure the assets are in a condition necessary for their intended use.

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

3. Significant accounting policies (continued):

(b) Property and equipment (continued):

(i) Recognition and measurement (continued):

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

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.

(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, as shown below:

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 capitalized and depreciated on a straight-line basis over the shorter of the related lease term or estimated useful life.

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

(c) Intangible assets:

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

3. Significant accounting policies (continued):

(c) 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 and to use the software product 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 3-5 years.

(d) Impairment:

Assets subject to depreciation and amortization are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is subsequently estimated.

The recoverable amount of an asset or cash-generating unit is the greater of an asset's value in use and fair value less costs to sell. In assessing value in use, the estimated future cash flows 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 assets. For the purposes of impairment testing, assets are grouped together into the smallest group of assets that generate cash flows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (Cash-Generating Unit).

3. Significant accounting policies (continued):

(d) Impairment (continued):

CATSA's corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the Cash-Generating Unit to which the corporate asset belongs.

An impairment loss is recognized if the carrying amount of an asset or its Cash-Generating Unit exceeds its estimated recoverable amount. Impairment losses are recognized in financial performance for the period.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation and amortization, if no impairment loss had been recognized. Reversals of impairment losses are recognized in financial performance for the period.

(e) 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 for the period on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(f) Financial instruments:

(i) Non-derivative financial assets:

Non-derivative financial assets are comprised of cash. Accounts receivable 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. Non-derivative financial assets are recognized initially on the trade date at which CATSA becomes a party to the contractual provisions of the instrument.

CATSA derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of the ownership of the financial asset are transferred.

3. Significant accounting policies (continued):

(f) Financial instruments (continued):

(i) Non-derivative financial assets (continued):

Financial assets and liabilities are offset and the net amount is presented in the statement of financial position when, and only when, CATSA has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

CATSA classifies its non-derivative financial assets into the category of financial assets at fair value through profit or loss. An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such on initial recognition. Financial instruments at fair value through profit or loss are initially measured at fair value, and subsequent changes therein are recognized in financial performance for the period. Upon initial recognition, attributable transaction costs are recognized in financial performance for the period when incurred.

(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 other financial liabilities. 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.

(g) Employee benefits:

(i) Post-retirement defined benefit plans:

CATSA maintains two defined benefit pension plans to provide retirement benefits to its employees (Defined Benefit Pension Plans). The Defined Benefit Pension Plans include a registered pension plan and a supplementary retirement plan. CATSA also sponsors other unfunded post-retirement benefits which include life insurance and eligible health and dental benefits (Other Benefits Plan). 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 plan, with CATSA providing the balance of funding as required based on actuarial valuations, with payments to the fund made monthly.

3. Significant accounting policies (continued):

(g) Employee benefits (continued):

(i) Post-retirement defined benefit plans (continued):

CATSA's net asset or liability 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 periods. 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 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 any minimum funding requirements that apply to any plan in CATSA. An economic benefit is available to CATSA if it is realizable during the life of the plan, or on settlement of the plan's 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.

When past service costs arise from plan improvements, the portion of the increased benefit relating to past service is recognized in financial performance for the period 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.

3. Significant accounting policies (continued):

(g) Employee benefits (continued):

(i) Post-retirement defined benefit plans (continued):

CATSA recognizes all actuarial gains and losses from post-retirement defined benefit plans in other comprehensive income. Expenses related to post-retirement defined benefit 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 post-retirement 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 are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus plans if CATSA has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

(h) 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.

3. Significant accounting policies (continued):

(h) Provisions (continued):

(i) Decommissioning liabilities:

CATSA recognizes a provision for future decommissioning liabilities associated with a lease agreement and the cost of disposing certain screening equipment in an environmentally responsible manner. In the year of acquisition, the decommissioning liability is based on a discounted estimate of the future cash outflows. The decommissioning liability is capitalized as part of the carrying amount of the related asset and amortized 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 estimated useful 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 are recognized in the related decommissioning liability and carrying amount of the related asset.

(ii) Legal 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 legal 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 legal claim is expected to be settled 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.

(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.

3. Significant accounting policies (continued):

(i) Parliamentary appropriations:

CATSA's funding is represented by parliamentary appropriations received or receivable from the Government of Canada. Parliamentary appropriations used for operating expenditures are recorded in financial performance in the period in which the related expenses are incurred. Parliamentary appropriations for operating expenditures that were billed but remain unused at period-end are recorded as a deferred funding contribution.

Parliamentary appropriations used to acquire property and equipment and intangible assets are recorded as a deferred funding contribution and amortized on a straight-line basis over the estimated useful lives of the assets. The amortization of the deferred funding contributions relating to capital is recognized in financial performance for the period.

In the event CATSA disposes of funded depreciable assets, the related remaining deferred funding contributions are recognized in financial performance in the period of disposal.

Unused parliamentary appropriations at year-end are returned to the Government of Canada.

(j) Finance income:

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

(k) 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.

(l) 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 at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in financial performance for the period.

(m) Deferred lease inducement:

Deferred lease inducement represents a rent-free period of common area costs as well as a period of significantly reduced rent related to leased premises. The deferred lease inducement is recognized in financial performance on a straight-line basis over the term of the lease, which expires November 30, 2017.

3. Significant accounting policies (continued):

(n) New accounting standards:

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 financial statements, the following applicable standards and amendments were issued but are not yet effective:

- IAS 1, *Presentation of Financial Statements*, effective for annual periods beginning on or after July 1, 2012;
- IAS 19, *Employee Benefits*, effective for annual periods beginning on or after January 1, 2013;
- IFRS 7, *Financial Instruments: Disclosures*, effective for annual periods beginning on or after July 1, 2011;
- IFRS 9, *Financial Instruments*, effective for annual periods beginning on or after January 1, 2013; and
- IFRS 13, *Fair Value Measurement*, effective for annual periods beginning on or after January 1, 2013.

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

4. Financial risk management:

(a) Fair value:

Fair values have been measured and disclosed based on a hierarchy that reflects the significance of inputs used in making these estimates. The hierarchy of fair value includes the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value of cash is determined based on Level 1 of the fair value hierarchy. The fair value of trade and other payables approximates their carrying values due to their short-term nature and the time left to maturity.

All of the financial instruments arose in the normal course of operations.

(In thousands of Canadian dollars)

4. Financial risk management (continued):

(b) Financial instrument risk:

(i) Market risk:

Market risk is the risk that the fair market value or future cash flows of a financial instrument will fluctuate because of changes in market price. CATSA's key market risk relates to foreign exchange 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. Foreign exchange 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
December 31, 2011	$ 113	$ 115
March 31, 2011	5,121	5,061

(ii) 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
December 31, 2011	$ 74,072	$ 1,387	$ -	$ 75,459
March 31, 2011	77,031	-	1,093	78,124

(In thousands of Canadian dollars)

5. Accounts receivable:

Accounts receivable are comprised of:

	December 31, 2011	March 31, 2011
Parliamentary appropriations	$ 29,662	$ 52,183
GST and HST recoverable	7,886	17,044
PST recoverable	1,548	1,369
Other	207	129
	$ 39,303	$ 70,725

6. Inventories:

Inventories are comprised of:

	December 31, 2011	March 31, 2011
Spare parts	$ 19,735	$ 19,688
RAIC	536	1,107
Uniforms	143	990
	$ 20,414	$ 21,785

(In thousands of Canadian dollars)

7. Property and equipment:

	PBS equipment	HBS equipment	NPS equipment	RAIC equipment	Computers, integrated software and electronic equipment	Office furniture and equipment	Leasehold improve-ments	Work-in-progress	Total
Cost									
Balance, April 1, 2011	$ 133,113	$ 644,499	$ 9,608	$ 8,644	$ 25,894	$ 729	$ 12,246	$ 35,010	$ 869,743
Additions	1,253	983	-	-	24	-	99	7,675	10,034
Disposals	(7,390)	(4,905)	(372)	(992)	(483)	(2)	(255)	(825)	(15,224)
Reclassifications	8,107	14,427	109	137	2,205	-	700	(26,229)	(544)
Revisions to decommissioning liabilities estimates	(11)	(14)	(1)	-	-	-	(6)	-	(32)
Balance, December 31, 2011	$ 135,072	$ 654,990	$ 9,344	$ 7,789	$ 27,640	$ 727	$ 12,784	$ 15,631	$ 863,977
Accumulated depreciation									
Balance, April 1, 2011	$ 59,822	$ 412,761	$ 2,293	$ 4,551	$ 11,558	$ 511	$ 8,258	$ -	$ 499,754
Depreciation	10,239	42,398	871	1,242	5,296	97	1,238	-	61,381
Disposals	(7,221)	(4,879)	(373)	(991)	(483)	(2)	(255)	-	(14,204)
Revisions to decommissioning liabilities estimates	(2)	-	-	-	-	-	-	-	(2)
Balance, December 31, 2011	$ 62,838	$ 450,280	$ 2,791	$ 4,802	$ 16,371	$ 606	$ 9,241	$ -	$ 546,929
Carrying amounts									
At April 1, 2011	73,291	231,738	7,315	4,093	14,336	218	3,988	35,010	369,989
At December 31, 2011	72,234	204,710	6,553	2,987	11,269	121	3,543	15,631	317,048

(In thousands of Canadian dollars)

8. Intangible assets:

	Externally acquired software	Internally developed software	Work-in-progress	Total
Cost				
Balance, April 1, 2011	$ 4,484	$ 17,309	$ 3,346	$ 25,139
Additions	104	2,668	540	3,312
Disposals	(6)	(130)	(631)	(767)
Reclassifications	615	1,909	(1,980)	544
Balance, December 31, 2011	$ 5,197	$ 21,756	$ 1,275	$ 28,228
Accumulated amortization				
Balance, April 1, 2011	$ 3,731	$ 8,559	$ -	$ 12,290
Amortization	552	2,950	-	3,502
Disposals	(6)	(130)	-	(136)
Balance, December 31, 2011	$ 4,277	$ 11,379	$ -	$ 15,656
Carrying amounts				
At April 1, 2011	753	8,750	3,346	12,849
At December 31, 2011	920	10,377	1,275	12,572

9. Provisions:

Provisions are comprised of:

	December 31, 2011	March 31, 2011
Decommissioning liabilities	$ 2,158	$ 2,174
Legal claims	18	18
	2,176	2,192
Less current portion	(18)	(18)
	$ 2,158	$ 2,174

(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 financial statements for the fiscal year ended March 31, 2011. The key assumptions include: credit-adjusted risk-free discount rates, inflation rates and the expected years to settlement.

(In thousands of Canadian dollars)

9. Provisions (continued):

(a) Decommissioning liabilities (continued):

A reconciliation of the provision for decommissioning liability is as follows:

	December 31, 2011	March 31, 2011
Balance, beginning of period	$ 2,174	$ 6,570
Revision in estimated cash flows including change in discount rate	(30)	(4,232)
Gain on settlement of liabilities	(23)	(449)
Unwinding of discount	37	69
Liabilities incurred during the period	-	216
Balance, end of period	$ 2,158	$ 2,174

The obligations relating to the decommissioning liabilities are expected to be settled between 2012 and 2018.

(b) Legal claims:

Management has accrued a provision for legal 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 legal claims cannot be reasonably determined.

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

	December 31, 2011	March 31, 2011
Balance, beginning of period	$ 18	$ 86
Additional provision made in the period	-	113
Proceeds paid out in settlement	-	(77)
Provision released in the period	-	(104)
Balance, end of period	$ 18	$ 18

(c) Onerous contracts:

No onerous contracts have been identified during the three and nine months ended December 31, 2011 and the year ended March 31, 2011.

(In thousands of Canadian dollars)

10. Deferred funding contributions:

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

	December 31, 2011	March 31, 2011
Balance, beginning of period	$ 382,911	$ 413,900
Parliamentary appropriations billed in relation to capital expenditures	12,659	54,934
Parliamentary appropriations billed in relation to operating expenditures	355,003	512,249
Parliamentary appropriations received in advance in relation to capital expenditures	2,000	-
Parliamentary appropriations received in advance in relation to operating expenditures	33,000	-
Parliamentary appropriations used during the period for operating expenditures	(349,241)	(512,249)
Amortization of deferred funding contributions related to capital	(64,317)	(85,923)
	372,015	382,911
Less current portion	(38,762)	-
Balance, end of year	$ 333,253	$ 382,911

11. Employee benefits:

The following table provides the expense and contributions relating to the Defined Benefit Pension Plans and Other Benefits Plan for the three and nine months ended December 31:

	Three months ended December 31		Nine months ended December 31	
	2011	2010	2011	2010
Expense:				
Defined Benefit Pension Plans	$ 1,041	$ 877	$ 3,124	$ 2,632
Other Benefits Plan	397	221	1,191	663
	$ 1,438	$ 1,098	$ 4,315	$ 3,295
Contributions:				
Defined Benefit Pension Plans	$ 1,641	$ 4,020	$ 4,395	$ 6,079
Other Benefits Plan	29	8	89	26
	$ 1,670	$ 4,028	$ 4,484	$ 6,105

(In thousands of Canadian dollars)

11. Employee benefits (continued):

The current service cost and the benefit obligation of the plans are actuarially determined on an annual basis using the projected unit credit method. The significant weighted-average assumptions used to determine CATSA's obligations as at December 31, 2011 and March 31, 2011 include the following:

	Defined Benefit Pension Plans	Other Benefits Plan
Expected rate of return on plan assets	6.83%	N/A
Discount rate for benefit cost	6.25%	6.25%
Discount rate for accrued benefit obligation	6.00%	6.00%
Inflation for benefit cost	2.25%	2.25%
Inflation for accrued benefit obligation	2.25%	2.25%
Long-term rate of compensation increase (including inflation and promotion)	4.25%	4.25%

The assumed health care cost trend rates used in determining the obligations as at December 31, 2011 and March 31, 2011 include the following:

Initial health care cost trend rate	7.90%
Ultimate health care cost trend rate	4.60%
Year ultimate rate reached	2021

(In thousands of Canadian dollars)

12. 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 and nine months ended December 31:

	Three months ended December 31		Nine months ended December 31	
	2011	2010	2011	2010
Payments to screening contractors	$ 89,422	$ 93,215	$ 259,740	$ 271,311
Depreciation of property and equipment	20,777	19,560	61,381	56,736
Employee costs	13,421	13,362	41,221	39,831
Equipment maintenance	10,387	9,108	28,604	26,393
Other administrative costs	4,399	5,234	12,121	13,868
Operating leases	1,460	1,650	4,673	4,974
Uniforms and other screening related costs	1,209	1,440	3,608	4,156
Amortization of intangible assets	1,262	1,017	3,502	2,612
Screening supplies and consumable goods	434	563	1,433	1,914
Communications and public awareness	488	307	804	734
Training and certification	233	377	695	1,188
RAIC	159	126	577	525
Equipment spare parts and warehousing costs	26	(62)	19	(425)
	$ 143,677	$ 145,897	$ 418,378	$ 423,817

Other administrative costs include travel expenses, office supplies, professional services, insurance, network and telephone costs.

13. Parliamentary appropriations:

Parliamentary appropriations approved and amounts used by CATSA during the nine months ended December 31 are as follows:

	2011	2010
Parliamentary appropriations approved for the fiscal year	$ 519,224	$ 577,646
Parliamentary appropriations used for operating expenditures	(349,241)	(363,426)
Parliamentary appropriations used for capital expenditures	(10,843)	(15,325)
Unused parliamentary appropriations	$ 159,140	$ 198,895

(In thousands of Canadian dollars)

13. Parliamentary appropriations (continued):

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 nine months ended December 31:

	Three months ended December 31		Nine months ended December 31	
	2011	2010	2011	2010
Parliamentary appropriations received and receivable	$119,503	$157,403	$421,859	$ 480,478
Amounts received and receivable related to prior periods	(11,079)	(23,108)	(33,856)	(63,682)
Amounts to be billed (used) in future periods	12,157	(8,029)	(38,762)	(53,370)
Parliamentary appropriations used for operating expenses	$120,581	$126,266	$349,241	$ 363,426

Parliamentary appropriations related to future periods for operating expenses are a result of CATSA receiving funds in advance of billings and 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 and nine months ended December 31:

	Three months ended December 31		Nine months ended December 31	
	2011	2010	2011	2010
Parliamentary appropriations received and receivable	$ 10,159	$ 9,834	$ 32,986	$ 61,979
Amounts received and receivable related to prior periods	-	(4,174)	(18,327)	(39,538)
Amounts to be used in future periods	(4,748)	(222)	(3,816)	(7,116)
Parliamentary appropriations used for capital expenditures	$ 5,411	$ 5,438	$ 10,843	$ 15,325

Parliamentary appropriations related to future periods for capital expenditures are a result of CATSA receiving funds in advance of billings, 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)

14. 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:

	December 31, 2011	March 31, 2011
No later than 1 year	$ 13,391	$ 13,616
Later than 1 year and no later than 5 years	21,530	24,583
Later than 5 years	5,321	6,609

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 except that 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 as at the date of extension.

There are no restrictions imposed by these arrangements.

(b) Contractual obligations:

Contractual obligations include capital commitments and other contractual obligations associated with various contracts for 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:

	December 31, 2011	March 31, 2011
No later than 1 year	$ 639,549	$ 342,809
Later than 1 year and no later than 5 years	1,578,181	139,514
Later than 5 years	91,157	31

(In thousands of Canadian dollars)

15. Capital management:

As a federal Crown corporation, CATSA is subject to the *Financial Administration Act* (Canada) which, in general, restricts it from borrowing money. As a result, CATSA relies upon capital and operating appropriations from the Government of Canada 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:

	December 31, 2011	March 31, 2011
Cash	$ 77,628	$ 7,335
Accounts receivable	39,303	70,725
Trade and other payables	(75,441)	(78,106)
Current portion of provisions	(18)	(18)
Current portion of deferred funding contributions	(38,762)	-
	$ 2,710	$ (64)

CATSA's objectives, policies, and processes for managing capital have not changed since March 31, 2011. CATSA is not subject to externally imposed capital requirements.

(In thousands of Canadian dollars)

16. 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 nine months ended December 31:

	Three months ended December 31		Nine months ended December 31	
	2011	2010	2011	2010
Decrease (increase) in accounts receivable	$ (3,873)	$ (11,355)	$ 20,467	$ 27,678
Decrease in inventories	278	36	1,388	29
Decrease in prepaid expenses	430	973	1,683	2,184
Increase (decrease) in trade and other payables	27,518	1,898	8,154	(24,257)
Increase (decrease) in current portion of provisions	-	(39)	-	56
Increase (decrease) in current portion of deferred funding contributions	(12,157)	8,030	38,762	53,371
	$ 12,196	$ (457)	$ 70,454	$ 59,061

Interest income received and recognized during the three and nine months ended December 31, 2011 amounts to $165 (2010 – $120) and $406 (2010 - $277), respectively.

Interest expense paid and recognized during the three and nine months ended December 31, 2011 amounts to $5 (2010 – Nil) and $7 (2010 - Nil), respectively.

For the three and nine months ended December 31, 2011, the change in accounts receivable excludes amounts of $6,495 (2010 – $6,340) and $12,668 (2010 - $41,704), respectively, in relation to capital funding, as the amounts relate to financing activities. Furthermore, the change in accounts receivable excludes amounts of $36 (2010 – Nil) and $1,713 (2010 – Nil), respectively, in relation to capital credit notes, as the amounts relate to investing activities.

For the three and nine months ended December 31, 2011, the change in inventories excludes amounts of $17 (2010 – Nil) and $17 (2010 – Nil), respectively, in relation to a transfer of spare parts from capital assets to inventory, as the amounts relate to a non-cash transaction.

For the three and nine months ended December 31, 2011, the change in accounts payable and accrued liabilities excludes amounts of $4,078 (2010 – $303) and $10,819 (2010 - $49,570), respectively, in relation to the acquisition of property and equipment and intangible assets, as the amounts relate to investing activities.

Non-cash investing activities for the three and nine months ended December 31, 2011 include non-cash proceeds of $36 (2010 – Nil) and $2,503 (2010 - $984), respectively, relating to the disposal of property and equipment, in the form of credit notes from a supplier.

17. Contingent liabilities:

CATSA has been named as a defendant in a legal action claiming damages. Although no amount has been included within the Statement of Claim, legal counsel has advised management that the claim is for several million dollars. Management is of the opinion that there is a strong defense against the claim and it is not probable that the claim will result in an outflow of economic benefits. Accordingly, a provision has not been recognized in the current period.