

Management's Report and

Audited Consolidated Financial Statements of

NAV CANADA

Year ended August 31, 2014

MANAGEMENT'S REPORT TO THE MEMBERS OF NAV CANADA

These consolidated financial statements are the responsibility of management and have been approved by the Board of Directors of NAV CANADA ("the Company"). These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles, Part V – Pre-changeover accounting standards ("Canadian GAAP") and include amounts that are based on estimates of the expected effects of current events and transactions with appropriate consideration to materiality, judgments and financial information determined by specialists. In addition, in preparing the financial information we must interpret the requirements described above, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information.

Management has also prepared a Management's Discussion and Analysis ("MD&A"), which is based on the Company's financial results prepared in accordance with Canadian GAAP. It provides information regarding the Company's financial condition and results of operations, and should be read in conjunction with these consolidated financial statements and accompanying notes. The MD&A also includes information regarding the impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from our present assessment of this information because events and circumstances in the future may not occur as expected.

Management has developed and maintains a system of internal control over financial reporting and disclosure controls, including a program of internal audits. Management believes that these controls provide reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements, and we have signed certificates as required by National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* in this regard. The internal accounting control process includes management's communication to employees of policies that govern ethical business conduct.

The Board of Directors has appointed an Audit & Finance Committee that is composed of directors who are independent of the Company and to which the Board of Directors has delegated responsibility for oversight of the financial reporting process. The Audit & Finance Committee meets at least four times during the year with management and independently with each of the internal and external auditors and as a group to review any significant accounting, internal control and auditing matters. The Audit & Finance Committee reviews the consolidated financial statements, MD&A and Annual Information Form before these are submitted to the Board of Directors for approval. The internal and external auditors have free access to the Audit & Finance Committee.

With respect to the external auditors, the Audit & Finance Committee approves the terms of engagement and reviews the annual audit plan, the Independent Auditors' Report and the results of the audit. It also recommends to the Board of Directors the firm of external auditors to be appointed by the Members of the Company.

The independent external auditors, KPMG LLP, have been appointed by the Members to express an opinion as to whether the consolidated financial statements present fairly, in all material respects, the Company's financial position, results of operations and cash flows in accordance with Canadian GAAP. The report of KPMG LLP outlines the scope of their examination and their opinion on the consolidated financial statements.

(Signed) "John W. Crichton"

John W. Crichton
President and Chief Executive Officer

October 23, 2014

(Signed) "Brian K. Aitken"

Brian K. Aitken
Executive Vice President, Finance
and Chief Financial Officer

October 23, 2014

INDEPENDENT AUDITORS' REPORT

To the Members of NAV CANADA

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of NAV CANADA, which comprise the consolidated balance sheets as at August 31, 2014 and 2013 and the consolidated statements of operations, retained earnings, and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, Part V – Pre-changeover accounting standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of NAV CANADA as at August 31, 2014 and 2013, and its consolidated results of operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles, Part V – Pre-changeover accounting standards.

(Signed) KPMG LLP
Chartered Professional Accountants, Licensed Public Accountants
Ottawa, Canada
October 23, 2014

NAV CANADA
Consolidated Balance Sheets
As at August 31
(in millions of dollars)

	2014	2013
Assets		
Current assets		
Cash and cash equivalents	\$ 193	\$ 171
Accounts receivable and other (note 3)	116	99
Current portion of capital lease obligations reserve fund (notes 10 and 17)	56	13
Other	12	13
	<u>377</u>	<u>296</u>
Regulatory assets (notes 9 and 17)	36	-
Reserve funds		
Debt service (notes 4 and 17)	112	111
Capital lease obligations (notes 10 and 17)	190	225
	<u>302</u>	<u>336</u>
Investments and other		
Investments (note 17)	252	227
Investment in preferred interests (notes 5 and 17)	96	59
Embedded derivatives on investment in preferred interests (notes 5 and 17)	87	-
Long-term dividend receivable (notes 5 and 17)	7	1
Long-term derivative assets (note 17)	8	29
	<u>450</u>	<u>316</u>
Accrued pension and other benefits (notes 9 and 14)	276	365
Capital assets		
Property, plant and equipment (note 6)	651	666
Intangible assets (note 7)	1,006	1,042
	<u>1,657</u>	<u>1,708</u>
	<u>\$ 3,098</u>	<u>\$ 3,021</u>
Liabilities		
Current liabilities		
Accounts payable, accrued liabilities and other	\$ 190	\$ 193
Current portion of long-term debt (note 8)	25	25
Current portion of capital lease obligations (note 10)	56	13
	<u>271</u>	<u>231</u>
Rate stabilization account (note 9)	76	53
Long-term liabilities		
Long-term debt (notes 8 and 9)	1,950	1,974
Capital lease obligations (note 10)	161	200
Regulatory liabilities (note 9)	336	303
Future income tax liability (note 5)	35	-
Other (note 11)	241	232
	<u>2,723</u>	<u>2,709</u>
	<u>3,070</u>	<u>2,993</u>
Retained earnings (note 18)	28	28
	<u>\$ 3,098</u>	<u>\$ 3,021</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:
(Signed) "Marc Courtois"
Marc Courtois, Director

(Signed) "Paul Brotto"
Paul Brotto, Director

NAV CANADA**Consolidated Statements of Operations and Retained Earnings**

Years ended August 31

(in millions of dollars)

	2014	2013
Revenue		
Customer service charges (note 12)	\$ 1,226	\$ 1,181
Other (note 12)	46	50
	<u>1,272</u>	<u>1,231</u>
Rate stabilization (note 9)	(35)	16
	<u>1,237</u>	<u>1,247</u>
Operating expenses		
Salaries and benefits (note 13)	817	772
Technical services	108	114
Facilities and maintenance	65	61
Other	53	50
	<u>1,043</u>	<u>997</u>
Rate stabilization (note 9)	(33)	14
	<u>1,010</u>	<u>1,011</u>
Other expenses		
Interest	104	104
Depreciation and amortization	137	137
	<u>241</u>	<u>241</u>
Rate stabilization (note 9)	-	-
	<u>241</u>	<u>241</u>
Other loss (income)		
Fair value adjustments and other (note 17)	(35)	(29)
Rate stabilization (note 9)	21	24
	<u>(14)</u>	<u>(5)</u>
	<u>1,237</u>	<u>1,247</u>
Excess of expenses over revenue and other loss (income) (note 1)	\$ -	\$ -
Retained earnings, beginning of year	<u>28</u>	<u>28</u>
Retained earnings, end of year	<u>\$ 28</u>	<u>\$ 28</u>

See accompanying notes to consolidated financial statements.

NAV CANADA
Consolidated Statements of Cash Flows
Years ended August 31
(in millions of dollars)

	2014	2013
Cash and cash equivalents provided by (used for):		
Operations		
Receipts from customer service charges	\$ 1,218	\$ 1,187
Other receipts	38	41
Payments to employees and suppliers	(875)	(857)
Pension contributions - current service (note 14)	(79)	(79)
Pension contributions - special payments (note 14)	(14)	-
Other post-employment contributions (note 14)	(15)	(14)
Long-term disability plan surplus refund (deficit payment) (note 14)	1	(2)
Interest payments	(105)	(103)
Interest receipts	6	5
	<u>175</u>	<u>178</u>
Investing		
Capital expenditures	(93)	(128)
Investment in preferred interests (notes 5 and 17)	(35)	(58)
Recoverable input tax payments on termination of capital lease transaction	-	21
Capital lease obligation reserve fund	-	(1)
Settlement of derivative assets	1	-
	<u>(127)</u>	<u>(166)</u>
Financing		
Issuance of medium term notes (note 8)	-	348
Repayment of medium term notes and revenue bonds (note 8)	(25)	(275)
Settlement of bond forward (note 9)	-	(2)
Debt service reserve fund	(1)	(1)
	<u>(26)</u>	<u>70</u>
Increase in cash and cash equivalents	22	82
Cash and cash equivalents, beginning of year	171	89
Cash and cash equivalents, end of year	<u>\$ 193</u>	<u>\$ 171</u>

Cash and cash equivalents are comprised of interest bearing bank balances, net of outstanding cheques, of \$95 (August 31, 2013 – \$101) and short-term investments with original terms to maturity of three months or less of \$98 (August 31, 2013 – \$70).

See accompanying notes to consolidated financial statements.

NAV CANADA
Notes to Consolidated Financial Statements
Years ended August 31, 2014 and 2013
(in millions of dollars)

1. Nature of operations:

NAV CANADA was incorporated as a non-share capital corporation pursuant to Part II of the *Canada Corporations Act* to acquire, own, manage, operate, maintain and develop the Canadian civil air navigation system (the “ANS”), as defined in the *Civil Air Navigation Services Commercialization Act* (the “ANS Act”). NAV CANADA has been continued under the *Canada Not-for-profit Corporations Act*. The fundamental principles governing the mandate conferred on NAV CANADA by the ANS Act include the right to provide civil air navigation services and the exclusive ability to set and collect customer service charges for such services. The core business of NAV CANADA and its subsidiaries (collectively, the “Company”) is to provide air navigation services, for which it collects customer service charges. The core business is the Company’s only reportable segment. The Company’s air navigation services are provided primarily within Canada.

The charges for civil air navigation services provided by the Company are subject to the economic regulatory framework set out in the ANS Act, which provides that the Company may establish new charges and amend existing charges for its services. In establishing new charges or revising existing charges, the Company must follow the charging principles set out in the ANS Act. These principles prescribe that, among other things, charges must not be set at levels which, based on reasonable and prudent projections, would generate revenue exceeding the Company’s current and future financial requirements in relation to the provision of civil air navigation services. Pursuant to these principles, the board of directors of the Company (the “Board of Directors”), acting as rate regulator, approves the amount and timing of changes to customer service charges. The impacts of rate regulation on the Company’s financial statements are described in note 9.

The Company plans its operations to essentially result in an annual financial breakeven position after recording adjustments to the rate stabilization account (note 9).

The ANS Act requires that the Company communicate proposed new or revised charges to customers in advance of their introduction and to consult thereon. Customers may make representations to the Company as well as appeal revised charges to the Canadian Transportation Agency on the grounds that the Company either breached the charging principles in the ANS Act or failed to provide statutory notice.

NAV CANADA is exempt from income taxes as it meets the definition of a not-for-profit organization under the *Income Tax Act* (Canada); however, its subsidiaries operating in Canada and other jurisdictions are subject to Canadian and foreign taxes.

2. Significant accounting policies:

(a) Financial statement presentation:

These consolidated financial statements include the accounts of the Company’s subsidiaries. All significant intercompany balances and transactions have been eliminated in these consolidated financial statements.

These financial statements are in accordance with Canadian generally accepted accounting principles, Part V – Pre-changeover accounting standards (“Canadian GAAP”).

Certain comparative figures have been reclassified to conform to the current year’s financial statement presentation.

2. Significant accounting policies (continued):

(b) Rate regulation:

The timing of recognition of certain revenue and expenses differs from what would otherwise be expected for companies that are not subject to regulatory statutes governing the level of their charges, the effect of which is described in note 9.

(c) Changes in accounting policies:

There were no changes to accounting policies in the fiscal year ended August 31, 2014 ("fiscal 2014").

(d) Use of estimates:

In preparing the financial statements, management must make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from such estimates. Significant management estimates include assumptions used in estimating the current year's pension and other post-employment benefits costs, the useful lives of capital assets, asset retirement obligations, fair value of investments as well as estimates related to collective agreements.

(e) Cash and cash equivalents:

Cash and cash equivalents are defined as cash and short-term investments with original terms to maturity of three months or less. Such short-term investments are recorded at fair value.

(f) Investments:

All investments are designated as financial assets held-for-trading and are recorded at fair value with the exception of the Company's investment in preferred interests of Aireon LLC ("Aireon") which is designated as loans and receivables and is measured at amortized cost. Financial instruments not traded in an active market are valued using indicative market prices (if available) or a discounted cash flow approach. Fair value adjustments (including interest income and realized and unrealized gains and losses) are recognized in the statement of operations except for fair value adjustments of embedded derivatives related to the Company's investment in Aireon, which are deferred using regulatory accounting.

(g) Capital assets:

Capital assets consist of property, plant and equipment and intangible assets. The majority of the Company's capital assets are located in Canada.

Capital assets are carried at cost less accumulated depreciation and amortization. Capital assets are depreciated or amortized from the time an asset is substantially completed and ready for productive use. Capital assets are not depreciated or amortized while under development.

The cost of capital assets under development includes materials, labour and other costs that are directly attributable to the development of a capital asset. Interest costs are not capitalized.

Amounts received from third parties related to the installation, development or construction of capital assets are deducted from the carrying amount of the capital asset.

Capital assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in the normal course of business.

2. Significant accounting policies (continued):

(g) Capital assets (continued):

Depreciation and amortization of capital assets are calculated on a straight-line basis using the following estimated useful lives:

Capital assets	Estimated useful life (years)
Property, plant and equipment	
Buildings	15 to 40
Systems and equipment	3 to 25
Intangible assets	
Air navigation right	46
Purchased software	5 to 20
Internally generated software	5 to 20

(h) Revenue recognition:

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding sales taxes.

(i) Customer service charges:

Revenue is recognized as services are rendered. Rates for customer service charges are those approved by the Board of Directors, acting as rate regulator.

(ii) Other services:

Revenue is recognized as services are rendered. Revenue from a contract to provide services is recognized by reference to the stage of completion of the contract. When the outcome of a transaction involving the rendering of services cannot be estimated reliably, revenue is recognized to the extent of recognized expenses that are considered recoverable.

(i) Employee future benefits:

The Company has established and maintains defined benefit pension plans for its employees. The plans provide benefits based on age, length of service and best average earnings. Employee contribution rates vary by position and by plan. The majority of employees and retirees are members of a plan that provides benefits that are indexed for inflation. The Company also provides certain health care, life insurance and other post-employment benefits to eligible retirees and their dependents, and long-term disability benefits to eligible employees. The costs of providing these pension and other post-employment benefits are charged to operations as employees render service. The costs of these benefits are actuarially determined using the projected benefits method prorated on services and are based on assumptions that reflect management's best estimates of expected investment performance, compensation, retirement ages of employees, health-care costs and other factors. The discount rates used to determine the present value of accrued pension and other benefits are based on market interest rates for long-term high quality debt instruments. The expected return on pension plan assets is based on a market-related value of plan assets, which recognizes investment gains and losses over a five-year period. The costs of providing long-term disability benefits are charged to operations as they occur.

2. Significant accounting policies (continued):

(i) Employee future benefits (continued):

Adjustments to post-employment benefits arising from plan amendments are amortized on a straight-line basis over the expected average remaining period of service of the employees covered by the amendments. Adjustments to post-employment benefits arising from transitional balances upon adoption of the current accounting policy on September 1, 2000 are being amortized on a straight-line basis over the expected average remaining period of service of the employees covered by the post-employment benefits, ending on August 31, 2014. Adjustments to long-term disability benefits arising from plan amendments are recognized immediately in the period in which they arise.

Amortization of actuarial gains and losses for post-employment benefits is recognized as a cost for the year if the unamortized net actuarial gain or loss at the beginning of the year exceeds 10% of the greater of the value of the accrued benefit obligation or the market-related value of the plans' assets. The unamortized amount in excess of 10% of the greater of the value of the accrued benefit obligation and the market-related value of the plans' assets is amortized over the average remaining service life of active employees (approximately 13 years). Actuarial gains and losses for long-term disability benefits are recognized immediately in the period in which they arise.

A curtailment loss is recognized in the income of the plan when it is probable that the curtailment will occur and the net effects can be reasonably estimated. A curtailment gain is recognized in the income of the plan when an event giving rise to a curtailment has occurred. Gains and losses on settlements of post-employment benefit plans are recognized by the plan when settlement occurs. The settlement and curtailment gains and losses are recognized in the Company's statement of operations based on the plan year established by the measurement date of the plan. When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

The cumulative excess of pension contributions over pension expense and the cumulative excess of long-term disability contributions over long-term disability expense are included in accrued pension and other benefits on the balance sheet (note 14). The accrued post-employment benefit liability other than pensions and the accrued pension liability for supplemental pension benefits in excess of tax limits for federally registered pension plans are included in other long-term liabilities (notes 11 and 14).

The Company uses an annual measurement date of May 31 for estimating the accounting surplus or deficit of the pension, other post-employment and long-term disability plans and for establishing benefits costs for the ensuing fiscal year, all of which are dependent on the measurement factors at the measurement date.

The latest actuarial valuation for funding purposes of the Company's pension plans was performed as at January 1, 2014, and future actuarial valuations for funding purposes are expected to be performed annually thereafter.

(j) Foreign currency translation:

Monetary assets and liabilities denominated in foreign currencies are translated at the prevailing rates of exchange at the balance sheet date. Transactions denominated in foreign currencies are translated at the exchange rates prevailing on the transaction dates. Foreign exchange gains and losses are included in the statement of operations, with the exception of unrealized gains and losses associated with the capital lease transactions and the Company's investment in preferred interests of Aireon (note 17 (c)).

2. Significant accounting policies (continued):

(k) Asset retirement obligations:

An asset retirement obligation is recognized in the period in which the Company incurs a legal obligation to restore land, and/or remove buildings, systems or equipment, if reasonably estimable. The fair value of the liability is equal to the present value of the estimated future restoration or removal expenditures. When the liability is initially recorded, an equivalent amount is capitalized as an inherent cost of the associated buildings, systems or equipment. In each subsequent period, the carrying amount of the asset retirement obligation is adjusted to reflect the fair value of the obligation due to the passage of time and revisions to the timing or amount of cash flows. The capitalized cost is depreciated over the useful life of the capital asset.

Some of the Company's air navigation system assets, particularly those located on leased sites, may have asset retirement obligations. The majority of these leases are long-term in nature with continuous renewal rights. All other leased facilities are renewed continuously, as the Company is required by the ANS Act to provide air navigation services indefinitely. As a result, no retirement date can be determined and consequently a reasonable estimate of the fair value of any related asset retirement obligations for these facilities cannot be made at this time. If at some future date it becomes possible to estimate the fair value of these asset retirement obligations, the obligation will be recognized at that time.

(l) Future accounting pronouncements – International Financial Reporting Standards (“IFRS”):

In February 2013, the Canadian Accounting Standards Board (“AcSB”) issued an amendment dated March 2013 to the Introduction to Part 1 of the CPA Canada Handbook allowing qualifying entities with rate-regulated activities to adopt IFRS for the first time no later than interim and annual financial statements relating to annual periods beginning on or after January 1, 2015. The Company is a qualifying entity and decided to avail itself of the deferral. As this optional deferral is not reflected in National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*, the Company applied for and received from the Ontario Securities Commission (“OSC”), the Company's principal securities regulator, an exemption from, and deferral of, the mandatory changeover date to IFRS subject to certain conditions including, among others, the requirement to provide updated discussion in its annual and interim Management's Discussion and Analysis (“MD&A”) regarding its preparations for changeover to IFRS and, if possible, the expected effect of the changeover on its financial statements. In November 2013, the AcSB decided against permitting further deferrals of the mandatory implementation date for first-time adoption of IFRS by rate-regulated entities. Accordingly, the Company will adopt IFRS in the fiscal year ending August 31, 2016, resulting in an IFRS transition date of September 1, 2014 due to the requirement for one year of comparative figures.

In September 2012, the International Accounting Standards Board (“IASB”) decided to restart its comprehensive project on rate-regulated activities with a discussion paper (“DP”) rather than an exposure draft (“ED”). Restarting the comprehensive project with a DP will allow the IASB to conduct a full analysis of the accounting impacts of the various forms of rate regulation; however, it will increase the time required to complete the project. In September 2014, the IASB published the DP relating to a final standard; it is open for comment until January 2015. Given the time needed to develop a final standard, in December 2012 the IASB decided to develop an interim standard, to provide temporary guidance on accounting for rate-regulated activities for first-time adopters of IFRS. In January 2014, the IASB published the interim standard, Regulatory Deferral Accounts, which essentially allows the Company to continue to account for regulatory deferral account balances under IFRS in accordance with existing Canadian GAAP. The interim standard introduces limited changes to previous accounting practices, which are primarily related to presentation and disclosure. The Company will continue to monitor developments in this area.

2. Significant accounting policies (continued):

(l) Future accounting pronouncements – International Financial Reporting Standards (“IFRS”) (continued):

The transition from Canadian GAAP to IFRS is a significant undertaking that will materially affect the Company’s reported financial position and results of operations. As part of the transition to IFRS, the Company is actively monitoring ongoing IASB projects, giving consideration to any proposed changes by the IASB as the Company finalizes its policy determinations. The Company also actively monitors regulatory updates on IFRS adoption in Canada, as issued by the Canadian Securities Administrators and the OSC.

As the Company has been granted exemptive relief by the OSC and is permitted to avail itself of the optional deferral referred to above, the Company is required to quantify the estimated differences between IFRS and Canadian GAAP based on an IFRS transition date of September 1, 2014. The estimated differences between IFRS and Canadian GAAP currently expected to be material to the Company’s statement of financial position are in the areas of employee benefits and the capital lease transaction. Although these differences are expected to be material, the Company has the ability to use regulatory accounting to offset some of these differences under the interim IFRS standard Regulatory Deferral Accounts. This assessment is based on available information and the Company’s expectations as of the date of these financial statements and thus is subject to change based on new facts and circumstances.

Employee benefits, net of regulatory liabilities

a) Defined pension benefits

Policy determinations and preliminary impact analyses have been completed for the Company’s defined pension benefits.

Under Canadian GAAP, actuarial gains and losses are deferred off balance sheet and amortized to earnings before rate stabilization using a “corridor” approach. Under IFRS, the actuarial gains and losses will be recognized in other comprehensive income in the period they are incurred, with no subsequent reclassification to earnings. As a consequence, actuarial gains and losses that have been deferred off balance sheet under Canadian GAAP will be recognized on the balance sheet upon transition to IFRS. This change will not affect the determination of customer service charges, as the Company uses a rate-regulated approach in determining the recovery of pension costs (described in note 9).

The impact on transition to IFRS will be based on actual balances at the date of transition. Based on the pension accounting deficit at September 1, 2014 of \$1,174, the impact upon transition to IFRS on the accrued defined pension benefits is expected to result in the elimination of the accrued pension asset of \$268 recognized under Canadian GAAP, an increase in the accrued pension liability of \$1,118 and a corresponding decrease in retained earnings (increase in the deficit) of \$1,386. The Company expects to fully offset this impact by recording a corresponding regulatory debit with a corresponding decrease in the deficit of \$1,386.

2. Significant accounting policies (continued):

- (l) Future accounting pronouncements – International Financial Reporting Standards (“IFRS”) (continued):

Employee benefits, net of regulatory liabilities (continued)

- b) Other post-employment benefits

Policy determinations and preliminary impact analyses have been completed for the Company’s other post-employment benefits.

Under Canadian GAAP, actuarial gains and losses are deferred off balance sheet and amortized to earnings before rate stabilization using a “corridor” approach. Under IFRS, the actuarial gains and losses will be recognized in other comprehensive income in the period they are incurred, with no subsequent reclassification to earnings. As a consequence, actuarial gains and losses that have been deferred off balance sheet under Canadian GAAP will be recognized on the balance sheet upon transition to IFRS. The Company intends to use a rate-regulated approach in determining the recovery, through customer service charges, of the impact on transition and subsequent re-measurements of other post-employment benefit costs under IFRS.

The impact on transition to IFRS will be based on actual balances at the date of transition. Based on the actuarial valuations performed as at September 1, 2014 the impact upon transition to IFRS on other post-employment benefits is expected to result in an increase in the accrued other post-employment benefit liabilities of \$40 and a corresponding decrease in retained earnings (increase in the deficit) of \$40. The Company expects to fully offset this impact by recording a corresponding regulatory debit with a corresponding decrease in the deficit of \$40.

- c) Accumulating sick leave

Policy determinations and preliminary impact analyses have been completed for the Company’s accumulating sick leave benefits.

Under Canadian GAAP non-vesting accumulating sick leave is not recorded until the leave has been taken; only vested sick leave is recorded and actuarial gains and losses and past service costs are deferred off balance sheet and amortized to earnings using a “corridor” approach. Under IFRS a liability for non-vesting sick leave will be recorded and actuarial gains and losses on vested and non-vesting sick leave and vested past service costs are recognized in net income in the period they are incurred. The impact on transition to IFRS will be based on actual balances at the date of transition. Based on the actuarial valuation performed as at September 1, 2014 the impact on transition to IFRS is expected to result in an increase to vested and unvested sick leave liability of \$34 and a corresponding decrease in retained earnings (increase in the deficit) of \$34. The Company expects to fully offset this impact by recording a corresponding regulatory debit with a corresponding decrease in the deficit of \$34.

- d) Long-term disability benefits

Policy determinations and preliminary impact analyses have been completed for the Company’s long-term disability benefits.

Under Canadian GAAP long-term disability benefits are recognized as of the Company’s annual measurement date of May 31. Under IFRS, long-term disability benefits are measured as of the reporting date.

2. Significant accounting policies (continued):

(l) Future accounting pronouncements – International Financial Reporting Standards (“IFRS”) (continued):

Employee benefits, net of regulatory liabilities (continued)

d) Long-term disability benefits (continued)

The impact on transition to IFRS will be based on actual balances at the date of transition. Based on the actuarial valuation performed as at September 1, 2014 the impact upon transition to IFRS on the long-term disability benefit asset is expected to result in a decrease in the accrued long-term disability benefit asset of \$4 and a corresponding decrease in retained earnings (increase in the deficit) of \$4. The Company expects to fully offset this impact by recording a corresponding regulatory debit with a corresponding decrease in the deficit of \$4.

Capital lease transaction, net of regulatory liability

Policy determinations and preliminary impact analyses have been completed for the capital lease transaction.

Under Canadian GAAP, although the Company is considered to have a variable economic interest in NC ANS QTE 2003-1 Statutory Trust (the “Statutory Trust”), the special purpose entity that was created by a U.S. entity at the inception of the transaction, the Company is not considered to be the primary beneficiary of the Statutory Trust, and therefore is not required to consolidate this entity. Accordingly, capital lease obligations – payment undertaking agreements, reserve funds and capital lease obligations were recognized on the Company’s balance sheet upon entering into the transaction. Under IFRS, the Statutory Trust will be fully consolidated in the Company’s financial statements as the Company is exposed to and has the power to control the returns of the Statutory Trust. The capital lease obligation will be eliminated in the consolidated financial statements, and the Company will recognize the long-term debt owed by the Statutory Trust on the cross border transaction.

As a result of these adjustments upon transitioning to IFRS, the table below shows that there is no expected impact on retained earnings. The risks associated with these transactions will continue to be disclosed under IFRS reporting.

	<u>Transition adjustment debit (credit)</u>
De-recognition of:	
Property, plant and equipment	\$ (10)
Current portion of capital lease obligations	56
Capital lease obligations	161
Other regulatory liabilities	2
Recognition of:	
Current portion of long-term debt	(56)
Long-term debt	(153)
Net impact on retained earnings	<u>\$ -</u>

2. Significant accounting policies (continued):

(l) Future accounting pronouncements – International Financial Reporting Standards (“IFRS”) (continued):

Regulatory deferral accounts

As permitted under Canadian GAAP, the Company currently follows specific accounting policies unique to a rate-regulated business (see note 9). Under IFRS the use of regulatory accounting is permitted as discussed above and is expected to have limited impacts on transition to IFRS; these impacts will be primarily related to presentation and disclosure. On transition to IFRS the Company intends to offset the impacts to retained earnings with adjustments to regulatory deferral accounts, as these impacts will be considered for rate setting using the Company’s regulatory approach.

Although the adoption of IFRS will materially affect the Company’s reported financial position, changing to IFRS will not significantly affect customer service charges. This is because the Company will continue to follow a rate regulated approach in determining the rates it charges to customers for air navigation services.

3. Accounts receivable and other:

Accounts receivable and other were comprised of the following:

	August 31 2014	August 31 2013
Trade receivables (note 17 (c))	\$ 89	\$ 78
Accrued receivables and unbilled work in progress	27	20
Input tax receivables	2	3
Allowance for doubtful accounts (note 17 (c))	(2)	(2)
	\$ 116	\$ 99

The Company’s exposure to credit and foreign exchange risks, and to impairment losses related to accounts receivable is described in note 17 (c).

4. Reserve funds:

Pursuant to the Master Trust Indenture (note 8), the Company is required to establish and maintain certain reserve funds, as follows:

Operations and maintenance reserve fund

The Company is required to maintain a reserve fund of at least 25% of its prior year’s annual operating and maintenance expenses, as defined in the Master Trust Indenture. At August 31, 2014, the Company met this requirement with an allocation of \$250 in undrawn availability under its committed credit facility (note 17 (c)). If at any fiscal year end the amount in the operations and maintenance reserve fund is less than 25% of the Company’s operating and maintenance expense for the year (before rate stabilization, depreciation, amortization, interest and extraordinary expenses), the Company must, at a minimum, increase the balance in the fund to the required level over the following four fiscal quarters through additional contributions or an allocation of its committed credit facility.

4. Reserve funds (continued):

Debt service reserve fund

At the end of each fiscal year, the amount in the debt service reserve fund must be equal to the annual projected debt service requirement (principal amortization, interest and fees) on outstanding Master Trust Indenture obligations determined in the manner required by the Master Trust Indenture. Any additional contributions required to be made to the debt service reserve fund must, at a minimum, be made in equal instalments over the following four fiscal quarters. Funds deposited into the debt service reserve fund are held by a Trustee and are released only to pay principal, interest and fees owing in respect of outstanding borrowings under the Master Trust Indenture except that, provided no event of default has occurred and is continuing, surplus funds may be released from time to time at the request of the Company. At August 31, 2014 the Company had a balance of \$112 (August 31, 2013 – \$111) of cash and investments in the debt service reserve fund.

The Company met all reserve fund requirements at August 31, 2014.

The above reserve funds are restricted for the purposes described above. The restricted use of the capital lease obligations reserve fund including the current portion is described in note 10.

Pursuant to the General Obligation Indenture (note 8), the Company is required to maintain certain liquidity levels similar to the reserve fund requirements of the Master Trust Indenture. Specifically, the Company must maintain a minimum liquidity level equal to twelve months net interest expense plus 25% of the annual operating and maintenance expenses. Liquidity is defined to include all cash and qualified investments, amounts held in the operations and maintenance and debt service reserve funds and any undrawn amounts available under a committed credit facility. In addition, the Company must maintain cash liquidity equal to twelve months net interest expense. Cash liquidity includes cash and qualified investments held in the reserve funds maintained under the Master Trust Indenture.

The Company met the liquidity covenants of the General Obligation Indenture for the year ended August 31, 2014.

5. Investment in preferred interests of Aireon LLC:

In November 2012, the Company entered into agreements (the “November 2012 agreements”) setting out the terms of its participation as an investor in Aireon. Aireon’s mandate is to provide global satellite-based surveillance capability for air navigation service providers (“ANSPs”) around the world through Automatic Dependent Surveillance-Broadcast (“ADS-B”) receivers built as an additional payload on the Iridium NEXT satellite constellation, which is expected to be launched by Iridium Communications Inc. (“Iridium”) within the 2015-2017 time period.

Under the terms of the November 2012 agreements, the Company’s overall investment in Aireon is expected to be implemented in stages for up to a total of \$150 U.S. (\$163 CDN) by calendar year 2017 (including \$55 U.S. (\$60 CDN) excluding transaction costs invested in the fiscal year ended August 31, 2013 (“fiscal 2013”) and \$33 U.S. (\$35 CDN) in fiscal 2014). If all investment stages are completed, the Company will have purchased preferred interests which, upon conversion to common equity interests, will represent 51% of the fully diluted common equity of Aireon. The preferred interests provide for a 5% dividend (except for the second stage investment described below that provides for a 10% dividend), calculated from the date of issuance, and will be redeemed for cash in three annual instalments beginning in November 2020 in the event the preferred interests have not been converted to common equity or redeemed by that time.

5. Investment in preferred interests of Aireon LLC (continued):

The Company's investment is expected to be made in five stages, each subject to the satisfaction of various operational, technical, commercial, regulatory and financial conditions. The stage investments are contingent upon the successful achievement by Aireon and Iridium of certain specific milestones with respect to, among other things, development of the ADS-B payload, deployment of the Iridium NEXT satellite constellation, marketing Aireon's ADS-B service to potential ANSP customers, and regulatory approvals of the technology's use.

The payment for the first stage investment of preferred interests amounting to \$15 U.S. (\$15 CDN) and representing, on a post conversion basis, 5.1% of the fully diluted common equity of Aireon was made in November 2012. In June 2013, the Company made the payment for its second stage investment in Aireon preferred interests in the amount of \$40 U.S. (\$42 CDN), representing, on a post conversion basis, an additional 13.6% of Aireon's fully diluted common equity, bringing its total interest on a post conversion basis to 18.7% of Aireon's fully diluted common equity. At that time the November 2012 agreements were modified as follows:

- (i) Certain conditions precedent to the Company's second and subsequent stage investments were either amended or deleted.
- (ii) The dividend rate on the second stage investment made in June 2013 was set at 10% rather than 5%, whereas the dividend rate on the Company's other preferred interests remained at 5%.
- (iii) The circumstances under which the Company could obtain the option to acquire additional preferred interests described under (b) below were amended.

In December 2013, the November 2012 agreements were modified again to provide for the making of an aggregate investment of \$120 U.S. (\$130 CDN) in Aireon by three additional major ANSPs, namely ENAV (Italy), the Irish Aviation Authority ("IAA"), and Naviair (Denmark) (the "Additional Investors"). The investment in Aireon by the Additional Investors is expected to be made in four stages between the 2014 and 2017 calendar years as key milestones are met, in exchange for preferred interests in Aireon. It has been agreed that a portion of Iridium's existing common equity interest in Aireon will be redeemed in the future for a payment from Aireon of \$120 U.S. (\$130 CDN) to finalize the ownership interests of all of Aireon's investors. Upon this redemption and the conversion of all preferred interests into common interests, NAV CANADA will hold 51% of the fully diluted common equity interests of Aireon, ENAV will hold 12.5%, and each of IAA and Naviair will hold 6%, with the remaining 24.5% being retained by Iridium. This redemption is expected to occur in calendar year 2018.

In February 2014, the Additional Investors made their first stage investments in Aireon. As a result, the Company's fully diluted common equity interest on a post conversion basis was reduced from 18.7% to 17.3%.

Given the timing of Aireon's planned cash disbursements, Aireon requested that the Company and the Additional Investors defer contributing half of their next stage investment amounts until early in calendar year 2015. The Company and the Additional Investors accepted Aireon's request. Given the foregoing, in June 2014 the Company made half of its third stage investment in Aireon preferred interests in the amount of \$33 U.S. (\$35 CDN), representing an additional 9.6% of Aireon's fully diluted common equity on a post conversion basis, bringing its total interest to 26.9%.

The Company's cumulative preferred interest investments of \$96 (including transaction costs) in Aireon as at August 31, 2014 have been classified as loans and receivables within financial assets and are measured at amortized cost. The following embedded derivatives have been identified:

- (a) The Company may at any time and from time to time elect to convert all or a portion of its preferred interests in Aireon into common equity interests. In addition, in June 2014 the Company agreed to defer contributing half of its third stage investment amount until early in calendar year 2015. This has resulted in a \$32 U.S. (\$35 CDN) commitment to acquire preferred interests that also include a conversion option.

5. Investment in preferred interests of Aireon LLC (continued):

- (b) Under certain circumstances, the Company may, in its sole discretion, exercise an option once certain preconditions are met to acquire additional preferred interests, in aggregate amount not to exceed 19% of the fully diluted common equity of Aireon, at a fixed rate per basis point. This option expires when the Additional Investors have made investments in Aireon totalling \$75 U.S. (\$82 CDN), which is expected to occur early in calendar year 2015.

Embedded derivatives are to be separated from the host contract and accounted for as stand-alone derivative instruments. Prior to the investment by the Additional Investors, the Company considered that amortized cost measurement represented the most reliable measure of the value of its investment in Aireon, as Aireon is a private company in start-up phase without any operations; accordingly, fair value could not be determined reliably for the embedded derivatives. The price paid by the Additional Investors in February 2014 is considered to be a reliable estimate of the fair value of Aireon, and the Company has used this valuation to measure the embedded derivatives described in (a) above as at August 31, 2014 (note 17).

The Company's future income tax assets and liabilities at August 31, 2014 relate to its investment in Aireon held in one of the Company's wholly-owned subsidiaries. They are comprised of future income tax liabilities amounting to \$39 U.S. (\$42 CDN) (August 31, 2013 – \$3 CDN) primarily due to the increase in the fair value of the embedded derivatives discussed above and tax assets amounting to \$7 U.S. (\$7 CDN) (August 31, 2013 – \$4 CDN) for operating losses and research and development expenses carried forward that have been allocated to the Company's subsidiary. The future income tax assets and liabilities are netted on the balance sheet and amount to a future income tax liability of \$32 U.S. (\$35 CDN). The operating losses carried forward will begin to expire in calendar year 2033.

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5. Investment in preferred interests of Aireon LLC (continued):

The table below shows the balance sheet impact of the Company's investment in preferred interests of Aireon and the impact of the use of regulatory accounting:

	August 31 2014	August 31 2013
Investments and other		
Investment in preferred interests	\$ 96	\$ 59
Embedded derivatives on investment in preferred interests	87	-
Long-term dividend receivable	7	1
Accounts payable, accrued liabilities and other		
Derivative liabilities	(1)	-
Future income tax liability	(35)	-
Balance sheet impact of the investment in preferred interests of Aireon, before regulatory accounting	<u>\$ 154</u>	<u>\$ 60</u>
Regulatory assets		
Derivative liabilities	\$ 1	\$ -
Future income tax liability	35	-
	<u>\$ 36</u>	<u>\$ -</u>
Regulatory liabilities		
Embedded derivatives on investment in preferred interests	\$ (87)	\$ -
Unrealized foreign exchange gain on the investment	(3)	(1)
Accrued dividend on preferred interests	(7)	(1)
	<u>\$ (97)</u>	<u>\$ (2)</u>
Net balance sheet impact of the investment in preferred interests of Aireon, after regulatory accounting	<u>\$ 93</u>	<u>\$ 58</u>

The net balance sheet impact of the Company's investment in preferred interests of Aireon above reflects the actual amounts paid for the Company's investment in Aireon (at the exchange rates prevailing on the dates of the transactions and including unamortized transaction costs). As at August 31, 2014 the net regulatory accounting balances of \$61 (August 31, 2013 – \$2) comprised of regulatory assets of \$36 (August 31, 2013 – \$nil) and regulatory liabilities of \$97 (August 31, 2013 – \$2) referred to above, defer the accounting recognition of transactions related to the Company's investment in Aireon on the Company's consolidated statements of operations. As a result, there is no impact on the Company's consolidated statements of operations for the year ended August 31, 2014 related to the Company's investment in Aireon. These amounts are not considered for rate setting purposes until realized in cash.

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6. Property, plant and equipment:

Property, plant and equipment were comprised of the following:

	August 31, 2014			August 31, 2013		
	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
Land and buildings	\$ 368	\$ (206)	\$ 162	\$ 360	\$ (192)	\$ 168
Systems and equipment	1,131	(706)	425	1,069	(651)	418
Property, plant and equipment under development	54	-	54	68	-	68
	1,553	(912)	641	1,497	(843)	654
Net increase from capital lease	30	(20)	10	30	(18)	12
	<u>\$ 1,583</u>	<u>\$ (932)</u>	<u>\$ 651</u>	<u>\$ 1,527</u>	<u>\$ (861)</u>	<u>\$ 666</u>

During the year ended August 31, 2014, the Company capitalized to property, plant and equipment \$21 of internal labour and travel costs (August 31, 2013 – \$26).

The net increase from the capital lease is being depreciated over the term of the lease (note 10).

As at August 31, 2014, the cost of assets under the capital lease was \$274 (August 31, 2013 – \$274), and accumulated depreciation and other credits amounted to \$246 (August 31, 2013 – \$241).

The Company recorded depreciation expense of \$81 during the year ended August 31, 2014 (August 31, 2013 – \$84).

7. Intangible assets:

Intangible assets were comprised of the following:

	August 31, 2014			August 31, 2013		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Air navigation right	\$ 1,367	\$ (665)	\$ 702	\$ 1,367	\$ (640)	\$ 727
Purchased software	285	(141)	144	276	(124)	152
Internally developed software	207	(68)	139	200	(55)	145
Intangible assets under development	17	-	17	15	-	15
Goodwill	4	-	4	3	-	3
	<u>\$ 1,880</u>	<u>\$ (874)</u>	<u>\$ 1,006</u>	<u>\$ 1,861</u>	<u>\$ (819)</u>	<u>\$ 1,042</u>

7. Intangible assets (continued):

During the year ended August 31, 2014, the Company capitalized to intangible assets \$10 of internal labour and travel costs (August 31, 2013 – \$12).

The Company recorded amortization expense of \$56 during the year ended August 31, 2014 (August 31, 2013 – \$53).

8. Long-term debt:

Because NAV CANADA is a non-share capital corporation, the Company's initial acquisition of the ANS and its ongoing requirements are financed with debt. Until February 21, 2006, all indebtedness was incurred and secured under a Master Trust Indenture that provided the Company with a maximum borrowing capacity, which declines each year. On February 21, 2006, the Company entered into a new indenture (the "General Obligation Indenture") that established an unsecured borrowing program that qualifies as subordinated debt under the Master Trust Indenture. The borrowing capacity under the General Obligation Indenture does not decline each year. In addition, there is no limit on the issuance of notes under the General Obligation Indenture so long as the Company is able to meet an additional indebtedness test.

(a) Security:

The Master Trust Indenture established a borrowing platform secured by an assignment of revenue and the debt service reserve fund. The General Obligation Indenture is unsecured, but provides a set of positive and negative covenants similar to those of the Master Trust Indenture. In addition, under the terms of the General Obligation Indenture, no further indebtedness may be incurred under the Master Trust Indenture; furthermore, the amount of the Company's \$675 syndicated bank credit facility (see note 17 (c)) that is secured under the Master Trust Indenture is limited to the declining amount of outstanding bonds issued under the Master Trust Indenture. At August 31, 2014, this amount is \$575 and will decline by \$25 on March 1 of every year in conjunction with the annual principal repayment of the series 97-2 amortizing bonds. The remaining \$100 of the \$675 credit facility ranks *pari passu* to the borrowings under the General Obligation Indenture. The \$575 portion of the credit facility along with the \$250 series 96-3 bonds and \$325 series 97-2 bonds gives a total of \$1,150 of indebtedness secured under the Master Trust Indenture and ranking ahead of General Obligation Indenture debt.

As bonds mature or are redeemed under the Master Trust Indenture, they may be replaced with notes issued under the General Obligation Indenture. Borrowings under the General Obligation Indenture are unsecured and repayment is subordinated and postponed to prior payment of Master Trust Indenture obligations unless the Company can meet an additional indebtedness test.

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8. Long-term debt (continued):

(b) Borrowings:

Long-term debt outstanding was comprised of the following:

	August 31 2014	August 31 2013
Bonds and notes payable		
Issued under the Master Trust Indenture:		
7.40% revenue bonds, series 96-3, maturing June 1, 2027	\$ 250	\$ 250
7.56% amortizing revenue bonds, series 97-2, maturing March 1, 2027	325	350
	575	600
Issued under the General Obligation Indenture:		
4.397% general obligation notes, series MTN 2011-1, maturing February 18, 2021	250	250
5.304% general obligation notes, series MTN 2009-1, maturing April 17, 2019	350	350
1.949% general obligation notes, series MTN 2013-1, maturing April 19, 2018	350	350
4.713% general obligation notes, series MTN 2006-1, maturing February 24, 2016	450	450
	1,400	1,400
Total bonds and notes payable	1,975	2,000
Adjusted for deferred financing costs and discounts	(7)	(8)
Adjusted for regulatory realized hedging transaction asset (note 9 (h))	(1)	(2)
Adjusted for regulatory realized hedging transaction liability (note 9 (i))	8	9
Carrying value of total bonds and notes payable	1,975	1,999
Less: current portion	(25)	(25)
Total long-term debt outstanding	\$ 1,950	\$ 1,974

The Company is in compliance with all covenants of the Master Trust Indenture and General Obligation Indenture as at August 31, 2014.

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8. Long-term debt (continued):

(b) Borrowings (continued):

The series 96-3 and 97-2 bonds and the series MTN 2009-1, MTN 2006-1, MTN 2011-1 and MTN 2013-1 notes are redeemable in whole or in part at the option of the Company at any time at the higher of par and the Canada yield price plus a redemption premium. The series 97-2 bonds are amortizing bonds repayable in 20 consecutive equal annual instalments of principal payable on March 1 of each year. The instalment payments commenced on March 1, 2008 and will be made until maturity on March 1, 2027. The instalment of principal due within the next twelve months relating to these amortizing bonds is classified in the current portion of long-term debt.

9. Financial statement impact of rate regulation:

In accordance with disclosures required for entities subject to rate regulation, the Company's regulatory balances are as follows:

	August 31 2014	August 31 2013
Regulatory assets		
Regulatory unrealized hedging transaction assets (a)	\$ 1	\$ -
Regulatory future income tax (b)	35	-
	<u>\$ 36</u>	<u>\$ -</u>
Rate stabilization account liability		
Operating deferrals (c)	\$ 82	\$ 85
Gains on capital lease transaction (d)	9	11
Fair value adjustments (e)	(15)	(43)
	<u>\$ 76</u>	<u>\$ 53</u>
Regulatory liabilities		
Regulatory pension and long-term disability liabilities (f)	\$ 229	\$ 269
Regulatory unrealized hedging transactions liabilities (a)	8	29
Other regulatory liabilities (g)	99	5
	<u>\$ 336</u>	<u>\$ 303</u>
Long-term debt		
Regulatory realized hedging transaction asset (h)	\$ (1)	\$ (2)
Regulatory realized hedging transaction liability (i)	8	9
	<u>\$ 7</u>	<u>\$ 7</u>

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9. Financial statement impact of rate regulation (continued):

In order to mitigate the effect on its operations of unpredictable and uncontrollable factors, principally unanticipated fluctuations in air traffic levels, the Company maintains a rate stabilization mechanism. Amounts are added to or deducted from the rate stabilization account based upon variations from amounts used when establishing customer service charges.

When establishing customer service charges, the Board of Directors considers the balance in the rate stabilization account, adjusted notionally for the non-credit related portion of the fair value variance from face value on investments. The Board of Directors also considers the balance of the accrued pension benefit asset (net of its regulatory liability) when determining the level of customer service charges, as discussed in note 9 (f) below.

The long-term target liability balance of the rate stabilization account is 7.5% of total planned annual expenses net of other loss (income), excluding non-recurring items, on an ongoing basis. For fiscal 2014, the target balance was \$93 (fiscal 2013 – \$93). As at August 31, 2014, the balance in the rate stabilization account adjusted notionally for the \$17 net non-credit related fair value variance from face value on investments (see note 17 (b)) and after recording additional pension expense as described in note 9 (f) below, was a liability of \$93 (August 31, 2013 – \$93).

The table below shows the impact of rate stabilization adjustments on the excess of expenses over revenue and other loss (income) as reported in the statements of operations:

	August 31 2014	August 31 2013
Before rate stabilization:		
Revenue	\$ 1,272	\$ 1,231
Expenses	1,284	1,238
Other income	(35)	(29)
	23	22
Rate stabilization adjustments:		
Favourable variances from planned results	(56)	(51)
Initial approved drawdown (adjustment)*	(11)	16
Additional drawdown related to pension**	44	13
	(23)	(22)
Excess of expenses over revenue and other loss (income), after rate stabilization	\$ -	\$ -

* The initial approved drawdown (adjustment) is combined with the revenue variances from planned results on the statements of operations.

** The additional drawdown related to pension is combined with the operating expenses variances from planned results on the statements of operations.

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9. Financial statement impact of rate regulation (continued):

The following are the changes in the rate stabilization account for the years ended:

	August 31 2014	August 31 2013
Rate stabilization account		
Liability balance, beginning of year	\$ 53	\$ 31
Variances from planned results:		
Revenue higher (lower) than planned, before approved adjustment (drawdown)	24	-
Operating expenses lower than planned, before drawdown related to pension	11	27
Other income higher than planned	21	56
	<u>109</u>	<u>82</u>
Initial approved adjustment (drawdown) (j)	11	(16)
Additional drawdown related to pension	(44)	(13)
Liability balance, end of year	<u>\$ 76</u>	<u>\$ 53</u>

(a) Regulatory unrealized hedging transactions assets and (liabilities):

Regulatory unrealized hedging transactions assets and (liabilities) as at August 31, 2014 and August 31, 2013 are as follows:

	August 31 2014	August 31 2013
Unrealized fair value losses on foreign exchange forward contracts ⁽ⁱ⁾	\$ 1	\$ -
Unrealized fair value gains on forward dated interest rate swap agreements ⁽ⁱⁱ⁾	(8)	(29)
Regulatory unrealized hedging transaction liabilities	<u>\$ (7)</u>	<u>\$ (29)</u>

⁽ⁱ⁾ The Company has entered into foreign exchange forward contracts to hedge its anticipated investments in preferred interests in Aireon in fiscal 2015.

⁽ⁱⁱ⁾ The Company intends to cash settle these forward dated interest rate swap agreements in February 2016 when the anticipated refinancing is expected to occur. When the anticipated transaction occurs, the realized gains or losses will be reclassified to a regulatory realized hedging transaction asset or liability (see notes 9 (h) and 9 (i)).

(b) Regulatory future income tax:

As at August 31, 2014, the Company had a future income tax liability of \$35 (August 31, 2013 – \$nil) within one of its wholly-owned subsidiaries due to temporary differences (note 5). Income taxes are not considered for rate setting purposes until the temporary differences are realized. The recognition of income taxes on the Company's consolidated statements of operations has been fully offset by the application of regulatory accounting (note 5).

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9. Financial statement impact of rate regulation (continued):

(c) Operating deferrals:

Should actual revenue exceed the Company's actual expenses, such excess is reflected as a liability (or as a reduction of an asset) in the rate stabilization account. Conversely, should actual revenue be less than actual expenses, such shortfall is reflected as an asset (or as a reduction of a liability) in the rate stabilization account. An asset balance in the rate stabilization account represents amounts recoverable through future customer service charges, while a liability balance represents amounts returnable through future customer service charges.

(d) Gains on capital lease transaction:

Included in the rate stabilization account at August 31, 2014 is an amount of \$9 (August 31, 2013 – \$11), representing the portion of the gain on the remaining capital lease transaction that would not have been recorded as of August 31, 2014 under Canadian GAAP applicable to companies not subject to regulatory statutes governing the level of their charges.

(e) Fair value adjustments:

As at August 31, 2014, the total of fair value variances from face value on investments recorded on the Company's balance sheet was \$18, of which \$15 is from fair value adjustment losses recorded on investments currently held by the Company. During the year ended August 31, 2014 this amount decreased, primarily due to positive fair value adjustments of \$23 on its investments based on lower discount factors in keeping with market conditions and a decrease in the credit loss provision of \$5.

(f) Regulatory pension and long-term disability liabilities:

Included in regulatory liabilities at August 31, 2014 is \$221 (August 31, 2013 – \$263) relating to the recovery through customer service charges of special pension contributions and \$8 (August 31, 2013 – \$6) of long-term disability ("LTD") contributions (note 14). Accrued pension and other benefit assets, net of their regulatory liabilities as at August 31, 2014 and August 31, 2013 are as follows:

	August 31, 2014			August 31, 2013
	Pension	LTD	Total	Total
Accrued pension and other benefit assets (note 14)	\$ 268	\$ 8	\$ 276	\$ 365
Regulatory liabilities				
Balance, September 1, prior calendar year	(263)	(6)	(269)	(316)
Regulatory decrease	86	(2)	84	60
Additional rate stabilization drawdown related to pension	(44)	-	(44)	(13)
Balance, end of period	(221)	(8)	(229)	(269)
Accrued pension and other benefit assets, net of their regulatory liabilities	\$ 47	\$ -	\$ 47	\$ 96

9. Financial statement impact of rate regulation (continued):

(f) Regulatory pension and long-term disability liabilities (continued):

The accrued pension and other benefit assets, net of their related regulatory liabilities, represent the cumulative amounts by which Company contributions to the pension and LTD benefit plans have exceeded the amounts expensed. The Company intends to recover the accrued pension benefit asset, net of its regulatory liability balance, through customer service charges over time.

The Company uses a regulatory approach to determine its expense for pension and LTD, which is charged to the statement of operations. The objective of this approach is to establish benefit expense to reflect the cash cost of the plans. The difference between the pension and LTD expense for regulatory purposes and pension benefit and LTD costs as determined by CPA Canada Handbook Section 3461, Employee Future Benefits, is included in pension and LTD expense in salary and benefits expense on the statement of operations and in the pension and LTD regulatory liability on the balance sheet.

For several years prior to fiscal 2008, pension expense was lower than the Company's actual contributions to the pension plan. In 2008, the Board of Directors approved a policy by which the fiscal 2008 cumulative balance of contributions made in excess of pension expense would be expensed over a period no longer than 15 years. Accordingly for fiscal 2014, the regulatory approach for determining annual pension expense for the Company's registered pension plans includes an amount equal to the Company's originally planned annual pension contributions (\$83), plus an amount (\$19) to reduce the net cumulative balance of recoverable pension contributions made in the past in excess of pension expense plus an amount related to supplemental pension benefits in excess of tax limits for federally registered pension plans (\$3).

To further accelerate the reduction of the balance in the accrued pension benefit asset (net of its regulatory liability), the Board of Directors approved, effective September 1, 2010, that if at the end of a quarterly reporting period the "notional" balance (described above) in the rate stabilization account is greater than the target balance, the excess over the target will be recorded as additional pension expense in the reporting period. For the year ended August 31, 2014 this amounted to an additional \$44 (year ended August 31, 2013 – \$13) of pension expense. During the year ended August 31, 2014, the accrued pension benefit asset, net of its related regulatory liability, decreased by \$52 from \$99 as at August 31, 2013 to \$47 at August 31, 2014.

(g) Other regulatory liabilities:

Other regulatory liabilities as at August 31, 2014 and August 31, 2013 are as follows:

	August 31 2014	August 31 2013
Regulatory liabilities on investment in preferred interests ⁽¹⁾		
Embedded derivatives on investment in preferred interests	\$ 87	\$ -
Unrealized foreign currency translation gains on investment in preferred interests	3	1
Accrued dividends on investment in preferred interests	7	1
Unrealized foreign currency translation gains on net capital lease obligations	2	3
	\$ 99	\$ 5

9. Financial statement impact of rate regulation (continued):

(g) Other regulatory liabilities (continued):

⁽¹⁾ The fair value adjustment on the embedded derivatives, the unrealized foreign currency translation gains, and the accrued dividends on preferred interests are not considered for rate setting purposes until realized in cash. The recognition of these items on the Company's consolidated statements of operations has been fully offset by the application of regulatory accounting (note 5).

(h) Regulatory realized hedging transaction asset:

The regulatory realized hedging transaction asset at August 31, 2014 consists of the remaining \$1 (August 31, 2013 – \$2) deferred loss on the bond forward that was settled April 16, 2013, which has been applied to the series MTN 2013-1 obligation.

(i) Regulatory realized hedging transaction liability:

The regulatory realized hedging transaction liability at August 31, 2014 consists of the remaining \$8 (August 31, 2013 – \$9) deferred gain on the bond forward settled February 18, 2011 which has been applied to the series MTN 2011-1 obligation.

(j) Initial approved adjustment (drawdown):

The Board of Directors approved an \$11 transfer to the rate stabilization account to be recorded in fiscal 2014, in order to achieve planned breakeven results of operations. The adjustment was transferred from revenue evenly throughout the year.

With respect to fiscal 2013, the Board of Directors approved a \$16 drawdown of the rate stabilization account to be recorded in fiscal 2013, in order to achieve planned breakeven results of operations. The drawdown was transferred to revenue evenly throughout the year. Accordingly, as at August 31, 2013, \$16 was transferred to revenue from the rate stabilization account.

10. Capital lease transaction:

During fiscal 2004, the Company entered into two long-term lease transactions with U.S. entities. These transactions involved the lease/leaseback of certain of the Company's air navigation equipment and software for periods of 24 years, with purchase options after 20 years. As a result of the leaseback transactions, the Company had long-term capital lease obligations that were reflected on the balance sheet. These were collateralized through payment undertaking agreements using the proceeds that were received on the head lease transactions (included in the capital lease obligations reserve fund). On June 7, 2012, the Company terminated one of the two capital lease transactions by negotiating an acceleration of the purchase option. This termination resulted in a gain of \$2 after legal and professional fees.

There is no foreign exchange risk that arises from the remaining lease transaction, since the U.S. dollar cash flows from the payment undertaking agreements were structured to fully meet the U.S. dollar capital lease obligations. The amounts at which the capital lease obligations and the payment undertaking agreements are reflected in the financial statements vary with the prevailing exchange rate at the balance sheet dates. Unrealized gains and losses from translating these financial instruments to Canadian dollars at the balance sheet dates are deferred.

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10. Capital lease transaction (continued):

The capital lease transaction is included on the consolidated balance sheets as follows:

	August 31 2014	August 31 2013
Current portion of capital lease obligations reserve fund	\$ 56	\$ 13
Capital lease payment undertaking agreements reserve fund	153	191
Property, plant and equipment	10	12
Current portion of capital lease obligations	(56)	(13)
Capital lease obligations	(161)	(200)
Other regulatory liabilities	(2)	(3)
	<u>\$ -</u>	<u>\$ -</u>

Remaining capital lease payments are due as follows:

Years ending August 31:	
2015	\$ 56
2016	18
2017	17
2018	17
2019	17
2020 through 2028	<u>151</u>
Net minimum lease payments	276
Less: amount representing interest (at approximately 5%)	<u>(59)</u>
Present value of net minimum capital lease payments	217
Less: current portion	<u>(56)</u>
Total long-term capital lease obligations	<u>\$ 161</u>

Interest expense during the year ended August 31, 2014 of \$11 (year ended August 31, 2013 – \$10) relating to the capital lease obligations, and the amortization of the net increase from the capital lease (note 6) are fully offset by and are recorded net of interest income of \$12 (year ended August 31, 2013 – \$12) from the payment undertaking agreements included in the capital lease obligations reserve fund.

At the inception of the remaining lease transaction, the U.S. entity created a special purpose entity, the activities of which are limited to receiving lease payments and making payments to third parties and the U.S. entity. While the Company is considered to have a variable economic interest in the special purpose entity, it is not considered to be the primary beneficiary of the special purpose entity and therefore is not required to consolidate the entity.

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11. Other long-term liabilities:

Other long-term liabilities were comprised of the following:

	August 31 2014	August 31 2013
Accrued post-employment benefit liabilities other than pensions (note 14)	\$ 183	\$ 176
Accrued pension benefit liability – supplemental pension benefits (note 14)	56	54
Non-derivative financial liability (note 17 (a))	2	2
	<u>\$ 241</u>	<u>\$ 232</u>

12. Revenue:

Customer service charges by type of service provided during the years ended August 31 were as follows:

	August 31 2014	August 31 2013
Enroute	\$ 641	\$ 613
Terminal	464	455
Daily / annual / quarterly	75	67
North Atlantic and international communication	46	46
	<u>\$ 1,226</u>	<u>\$ 1,181</u>

Customer service charges include:

- i) Enroute charges related to air navigation services provided or made available to aircraft during the enroute phase of the flight, whether they overfly Canadian-controlled airspace or take-off or land in Canada;
- ii) Terminal charges related to air navigation services provided or made available to aircraft at or in the vicinity of an airport;
- iii) Daily / annual / quarterly charges related to enroute and terminal air navigation services. These charges generally apply to propeller aircraft; and
- iv) North Atlantic and international communication charges related to certain air navigation and communication services provided or made available to aircraft while in airspace over the North Atlantic ocean, which is outside of Canadian sovereign airspace but for which Canada has air traffic control responsibility pursuant to international agreements. The international communication charges also include services provided or made available while in Canadian airspace in the north.

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12. Revenue (continued):

Other revenue for the years ended August 31 was as follows:

	August 31 2014	August 31 2013
Service and development contracts	\$ 26	\$ 34
Conference centre services	12	8
Aeronautical publications	4	4
Other	4	4
	<u>\$ 46</u>	<u>\$ 50</u>

The Company has two customers each of which represents more than 10% of total revenue before rate stabilization. For the year ended August 31, 2014, revenue from the largest customer was \$223 (year ended August 31, 2013 – \$221) and revenue from the second largest customer was \$146 (year ended August 31, 2013 – \$140), together representing 29% (year ended August 31, 2013 – 29%) of the total revenue of the Company before rate stabilization. The revenue from these two major customers arose from air navigation services.

13. Salaries and benefits:

Salaries and benefits expenses for the years ended August 31 were comprised of the following:

	August 31 2014	August 31 2013
Salaries and other	\$ 523	\$ 511
Overtime	86	81
Fringe benefits (note 14)	62	68
Pensions (notes 9 (f) and 14)	146	112
	<u>\$ 817</u>	<u>\$ 772</u>

14. Employee future benefits:

The Company maintains defined benefit plans that provide pension, other post-employment and LTD benefits to employees. The Company uses an annual measurement date of May 31 when estimating the accounting surplus or deficit of its plans and establishing benefit costs for the coming fiscal year, both of which are dependent on the measurement factors at that time.

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14. Employee future benefits (continued):

Information about the Company's pension benefits and LTD plans, using the measurement date of May 31, is as follows:

	Pension benefits		LTD		Total	
	2014	2013	2014	2013	2014	2013
Change in benefit obligations						
Benefit obligations at June 1, prior year	\$ 4,863	\$ 4,656	\$ 34	\$ 33	\$ 4,897	\$ 4,689
Current service cost	158	154	-	-	158	154
Interest cost on benefit obligations	204	196	-	-	204	196
Benefits paid	(169)	(156)	(6)	(7)	(175)	(163)
Past service costs	-	16	-	-	-	16
Actuarial losses (gains)	281	(3)	2	8	283	5
Benefit obligations at May 31	<u>5,337</u>	<u>4,863</u>	<u>30</u>	<u>34</u>	<u>5,367</u>	<u>4,897</u>
Change in plan assets						
Fair value of plan assets at June 1, prior year	3,974	3,650	35	33	4,009	3,683
Actual gains on plan assets	420	363	-	-	420	363
Employer contributions	82	86	10	9	92	95
Plan participants' contributions	33	31	-	-	33	31
Benefits paid	(169)	(156)	(6)	(7)	(175)	(163)
Fair value of plan assets at May 31	<u>4,340</u>	<u>3,974</u>	<u>39</u>	<u>35</u>	<u>4,379</u>	<u>4,009</u>
Funded status at May 31 surplus (deficit)	(997)	(889)	9	1	(988)	(888)
Unamortized net losses not yet recognized	1,158	1,159	-	-	1,158	1,159
Unamortized past service cost	15	16	-	-	15	16
Employer contributions (refunds) after May 31	36	22	(1)	2	35	24
	<u>212</u>	<u>308</u>	<u>8</u>	<u>3</u>	<u>220</u>	<u>311</u>
Reclassification to accrued pension benefit liability - supplemental pension benefits	<u>56</u>	<u>54</u>	<u>-</u>	<u>-</u>	<u>56</u>	<u>54</u>
Accrued pension and other benefits asset at August 31	<u>\$ 268</u>	<u>\$ 362</u>	<u>\$ 8</u>	<u>\$ 3</u>	<u>\$ 276</u>	<u>\$ 365</u>

The Company intends to recover the balance of the accrued pension benefit asset (net of its related regulatory liability) through customer service charges over time (see note 9 (f)).

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14. Employee future benefits (continued):

Information about the Company's other post-employment benefit plans, using the measurement date of May 31, is as follows:

	Other benefits	
	2014	2013
Change in benefit obligations		
Benefit obligations at June 1, prior year	\$ 201	\$ 204
Current service cost	7	7
Interest cost on benefit obligations	8	8
Benefits paid	(8)	(10)
Actuarial gains (losses)	14	(8)
Benefit obligations at May 31	222	201
Change in plan assets		
Employer contributions	8	10
Benefits paid	(8)	(10)
Funded status at May 31 (deficit)	(222)	(201)
Unamortized net losses not yet recognized	28	13
Unamortized past service cost	9	10
Employer contributions after May 31	2	2
Accrued benefit liability at August 31	\$ (183)	\$ (176)

Weighted-average assumptions at the measurement date of May 31 were as follows:

	Pension benefits		LTD		Other benefits	
	2014	2013	2014	2013	2014	2013
Benefit obligations at end of year						
Discount rate	4.30%	4.20%	2.72%	2.78%	4.09%	4.06%
Rate of inflation	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Benefit costs during the year						
Discount rate	4.20%	4.20%	2.72%	2.78%	4.06%	4.02%
Rate of inflation	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Expected long-term rate of return on plan assets	5.90%	6.00%	-	-	-	-

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14. Employee future benefits (continued):

The pension plans had an accounting deficit of \$997 as at the annual measurement date of May 31, 2014. The deficit at May 31, 2014 increased from a deficit of \$889 at May 31, 2013, primarily due to actuarial losses resulting from adopting updated mortality assumptions (see below), partially offset by positive investment experience on plan assets and a 10 basis point increase in the discount rate used to measure plan obligations.

The market-based discount rate is based on the yield on long-term high quality corporate bonds, with maturities matching the estimated cash flows of the plan. A 0.25% decrease in the discount rate would increase the accounting deficit by approximately \$252. Conversely, a 0.25% increase in the discount rate would decrease the accounting deficit by approximately \$235.

Between May 31, 2014 and August 31, 2014, the pension plans' accounting deficit increased to approximately \$1,174, primarily due to a 30 basis point decrease in the market-based discount rate used to determine pension obligations, partially offset by strong asset returns.

The average rate of compensation increase is expected to be equal to the rate of inflation with an adjustment for merit and productivity gains. An increase of 5.0% in drug and other health benefit costs was assumed for 2014 and an increase of 5.0% in drug and other health benefit cost was assumed for 2015. The impact of a one percent change in the assumed drug and other health benefit cost trend rate would have the following effects:

	1% increase	1% decrease
Effect on current service cost and interest cost on accrued benefit obligation	\$ 1	\$ (1)
Effect on benefit obligation	\$ 24	\$ (19)

Pension plan assets at the measurement date (May 31):

	2014	2013
Equities	53%	52%
Public debt	25%	27%
Private debt	1%	-%
Canadian real return bonds	14%	14%
Real estate	7%	7%

Pension plan assets are subject to investment risks. These risks are managed through diversification among different asset classes, risk factors and geographies and adherence to established investment guidelines. In addition, investment risk relative to plan liabilities is managed via implementation of liability driven investment strategies, including a 20% Canadian real return bond overlay.

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14. Employee future benefits (continued):

The Company's benefit costs, which are included in salaries and benefits on the statements of operations and in capital expenditures for the years ended August 31 were as follows:

	Pension benefits		LTD		Other benefits	
	2014	2013	2014	2013	2014	2013
Benefit costs arising from events in the year:						
Current service cost, net of plan participants' contributions	\$ 125	\$ 123	\$ -	\$ -	\$ 7	\$ 7
Past service cost	-	16	-	-	-	-
Curtailment loss	-	-	-	-	8	8
Interest cost on accrued benefit obligation	204	196	-	-	-	-
Actual returns on plan assets	(420)	(363)	-	-	-	-
Actuarial (gains) losses arising during the year on accrued benefit obligation	281	(3)	2	8	14	(8)
Elements of benefit costs before recognizing long term nature	190	(31)	2	8	29	7
Deferrals of amounts arising during the year:						
Excess of actual return over expected return	206	153	-	-	-	-
Actuarial gains (losses) on benefit obligation	(281)	3	-	-	(14)	8
Past service cost	-	(16)	-	-	-	-
Amortization of previously determined amounts:						
Net actuarial losses on benefit obligation	76	76	-	-	-	-
Past service cost	1	1	-	-	1	1
Transitional asset	-	(21)	-	-	-	-
Benefit costs	\$ 192	\$ 165	\$ 2	\$ 8	\$ 16	\$ 16

Pension expense for fiscal 2014 was \$146 (fiscal 2013 – \$112) consisting of pension benefit costs of \$192, partially offset by \$42 relating to regulatory pension adjustments and \$4 included in the cost of capital assets.

The Company's contributions to its benefit plans for the years ended August 31 were as follows:

	2014	2013
Company contributions to funded pension plans	\$ 95	\$ 83
Benefits paid directly to beneficiaries for:		
Non-funded supplemental pension benefits	1	1
Other non-funded post-employment benefits	8	7
Company contributions to the funded LTD plan	8	7
LTD plan deficit payment (surplus refund)	(1)	2
	111	100
Less: amounts capitalized	(4)	(5)
	\$ 107	\$ 95

14. Employee future benefits (continued):

Pension (other than the supplemental pension plan) and LTD benefits are funded. Other post-employment benefits are not funded.

Actuarial valuations for pension funding purposes are performed annually as at January 1 and are required to be filed with the Office of the Superintendent of Financial Institutions Canada ("OSFI") by June of the same year. The regulations governing the funding of federally regulated pension plans require actuarial valuations to be performed on both a going concern and a solvency basis. The actuarial valuations performed as at January 1, 2014 reported a going concern deficit of \$242 and a statutory solvency deficiency (see below) of \$606.

In February 2014, the Canadian Institute of Actuaries ("CIA") released its final report summarizing the results of a Canadian pensioner mortality study, which indicated improvements in life expectancy for Canadians. The 2014 Public Sector Mortality Table included in the CIA's final report is consistent with the results of the Company's recent study of its own limited pensioner mortality experience. The impact of adopting these unadjusted base mortality rates and improvement scales contained in the 2014 Public Sector Mortality Table is an increase in the pension plans' going concern liabilities of \$272 and an increase in the pension plans' solvency liabilities of \$446. The January 1, 2014 actuarial reports of the Company's registered pension plans included these revised mortality assumptions. Going concern pension contributions for the fiscal year ended August 31, 2014 were \$95 (2013 – \$83) including \$14 (2013 – \$nil) of special payments.

In October 2009, the federal government released a plan for the reform of the legislative and regulatory framework governing federally regulated private pension plans. It was announced that the funding period for solvency deficiencies would remain at 5 years but past deficits would be consolidated on a permanent basis for establishing solvency special payments, resulting in a fresh start every year. Following a transition phase, funding of solvency deficits would be based on an average of solvency ratios over the three most recent consecutive years, based on the market value of assets ("statutory solvency deficiency"). The funding regulations relating to the determination of statutory solvency deficiencies were adopted by the Company as of January 1, 2012. Regulations came into effect on April 1, 2011 permitting solvency special payments to be replaced by letters of credit provided the total value of the letters of credit does not exceed 15% of the pension plan's assets.

The Company is currently meeting its pension solvency funding requirements with letters of credit. As of August 31, 2014, the Company has put in place letters of credit totalling \$325 (representing 7% of registered pension plan assets as at August 31, 2014) to meet its cumulative pension solvency funding requirements to the end of calendar year 2014. For the annual period beginning July 1, 2014, contributions and letters of credit are based on the January 1, 2014 actuarial valuations.

The amount of required Company contributions and additional letters of credit for future years will be dependent on the investment experience of plan assets, the discount rates and other assumptions that will be used in future actuarial valuations to determine plan liabilities, as well as any changes in pension plan design or funding requirements that may be enacted.

15. Transactions with the Government of Canada:

The Company has arrangements with a number of federal government departments and agencies for the provision of various services, such as enhanced security services, weather forecasting and observation, and facilities. These arrangements are based on commercially negotiated terms and conditions.

The Company also has an agreement with the Department of National Defence ("DND") relating to the exchange of a variety of services with DND such as airspace controls, facilities, information and protocols and systems, for mutual benefit without significant cost or expense to either party.

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15. Transactions with the Government of Canada (continued):

The Government of Canada has maintained an indemnification program at no cost to the Company, which protects the Company from a terrorist-related loss that may be in excess of the Company's insurance coverage. This program has been in place since December 2001 and the current undertaking runs until December 31, 2015. The Company is contractually obligated to indemnify the Government of Canada for any loss suffered by or claimed against it which is covered by the Company's aviation operations liability insurance.

16. Guarantees:

The Company has not provided any material guarantees other than indemnification commitments typically provided in the ordinary course of business as described below. These indemnification commitments require the Company to compensate the counterparties for costs and losses incurred as a result of various events and are similar to the type of indemnifications required by the Company from suppliers of services and products, or by other companies in the aviation industry.

The Company has provided the following significant indemnification commitments:

Capital lease transactions

As described in note 10, the Company entered into two lease transactions with respect to a portion of its air navigation equipment and software. On June 7, 2012, the Company terminated one of the two capital lease transactions by negotiating an acceleration of the purchase option. In connection with the remaining transaction, the Company has agreed to indemnify the other parties to the transaction for certain costs or liabilities, including with respect to certain taxes that may be imposed on such party with respect to the leased equipment, or as a result of such party's participation in the lease transaction. This indemnification commitment will survive the termination of the lease transaction, but only with respect to events that occur prior to the termination of the lease transactions. This indemnification commitment does not provide for any limit on the maximum amount of the potential indemnification.

The Company has collateralized its obligations to pay base rent under the lease transaction by entering into payment undertaking agreements with two financial institutions. In certain circumstances the Company may be required to replace such collateral with similar collateral. Furthermore, the Company is required to provide additional collateral for the Company's contingent obligations under the lease transaction if: (i) the long term senior unsecured debt obligations of the Company are not rated at least A+ by Standard & Poor's and A1 by Moody's Investors Service or (ii) the Company's rights and powers under the ANS Act are substantially reduced.

The replacement of existing collateral, or the provision of additional collateral, may result in the Company incurring significant costs.

The Company may be required to make early termination payments under the lease transaction in the event that any portion of the leased equipment is lost or destroyed, and such equipment is not replaced by the Company. Such termination payments may be in excess of the collateral provided for such purpose. The maximum amount by which such early termination payments would exceed the amounts payable under the payment undertaking agreements is estimated to be \$28. Accordingly, \$37 of the capital lease obligation reserve fund, relating to the reinvestment of net present value benefits from the lease transactions, is available to meet any such obligations. Furthermore, \$25 of the Company's credit facility has been restricted in relation to this contingent liability.

If a financial institution that has entered into a payment undertaking agreement with the Company should fail to meet its obligations under such payment undertaking agreement for any reason, the Company will still be obligated to make the payments that are required pursuant to the lease transaction.

16. Guarantees (continued):

Capital lease transactions (continued)

The Company considers it unlikely that any of the above noted events will occur and that the described payments will be required.

Provision of service and system sales

- (i) The Company has entered into five agreements for the sale and maintenance of technology that would indemnify the counterparties up to a maximum of \$1,000 for each occurrence and in the aggregate for losses sustained as a result of the negligence of the Company. In addition, the Company has entered into one agreement for the sale and maintenance of technology that would indemnify the counterparty up to a maximum of the Company's ANS liability insurance coverage of \$5,031 U.S. (\$5,470 CDN). The Company's ANS liability insurance provides coverage for these indemnification commitments. These indemnities survive termination of the agreements.
- (ii) The Company entered into an agreement, which has now ended, with Natural Resources Canada for the production of civil aeronautical information products, which would indemnify the counterparty up to a maximum of \$100 for each occurrence and in the aggregate, for losses sustained by the counterparty arising out of or in any way connected with the agreement. The Company's liability insurance provides coverage for this indemnification commitment. This indemnity survives termination of the agreement.
- (iii) The Company has entered into a sales agreement for the supply of an air traffic services data management system and provision of related services, which would indemnify the counterparty up to a maximum of \$35 U.S. for the cumulative liability of the Company in relation to any claim in any manner howsoever arising out of or in connection with the agreement. The Company's liability insurance provides coverage for this indemnification commitment. This indemnity survives termination of the agreement.

Banking and credit agreements

The Company has agreed to indemnify its banks against costs or losses resulting from changes in laws and regulations, which would increase the banks' costs and from any legal claims resulting from defaults, misrepresentations, negligence or wilful misconduct of the Company or from environmental liabilities. These indemnification commitments extend for an unlimited period of time and do not provide for any limit on the maximum potential amount.

Indemnity with respect to third party sponsored asset-backed commercial paper (ABCP)

In connection with the restructuring of third party sponsored ABCP (see note 17), the Company (as a member of the Pan-Canadian Investors Committee) agreed to indemnify the indenture trustees of the ABCP trusts should the trustees suffer certain losses only as a result of acting in accordance with extraordinary resolutions passed by the requisite number of noteholders of the trusts. As part of the indemnity agreement, the Company acknowledged that the trustees have the benefit of existing contractual indemnities under the trust indenture and agreed to subordinate its recoveries to any entitlement of the trustees. Further, all members of the Pan-Canadian Investors Committee committed to provide additional protection beyond the contractual indemnification afforded by the trust indentures. The protection provided by members of the Committee is on a several basis and pro rata among the Committee members based upon their respective and aggregate investments in third party sponsored ABCP. While the indemnity survives the closing of the ABCP restructuring, the terms of the court-sanctioned restructuring plan have effectively eliminated the Company's exposure.

16. Guarantees (continued):

Other agreements

In the ordinary course of business the Company provides indemnification commitments to counterparties in transactions such as service arrangements, provision of maintenance services, system sales, sales of assets, licensing agreements, lease and site usage transactions, contribution agreements, and director and officer indemnification commitments. These indemnification commitments require the Company to compensate the counterparties for costs and losses as a result of various events such as results of litigation claims, environmental contamination or statutory sanctions that may be suffered by a counterparty or third party as a consequence of the transaction or in limited cases, for liabilities arising from acts performed by or the negligence of the indemnified parties. The terms of these indemnification commitments vary based on the contract. Certain indemnification agreements extend for an unlimited period and generally do not provide for any limit on the maximum potential amount. The nature of these indemnification commitments does not permit a reasonable estimate of the aggregate potential amount that could be required to be paid. The Company has acquired liability insurance that provides coverage for most of the indemnification commitments described in this paragraph.

Historically, the Company has not made any significant payments under any indemnification commitments and no material amount has been accrued in the financial statements with respect to these indemnification commitments.

17. Financial instruments and financial risk management:

(a) Summary of financial instruments:

Fair value is defined as the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The best evidence of fair value is quoted bid or ask prices in an active market. Quoted prices are not always available for transactions in inactive or illiquid markets. In these instances, internal models, normally with observable market-based inputs, are used to estimate fair value. Where financial instruments trade in inactive markets, or when using models where observable parameters do not exist, as described in note 17 (b), greater management judgment is required for valuation purposes. Financial instruments traded in a less active market have been valued using indicative market prices, discounted cash flow models or other valuation techniques. Fair value estimates normally do not consider forced or liquidation sales. The calculation of estimated fair value is based on market conditions at a specific point in time and therefore may not be reflective of future fair values.

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17. Financial instruments and financial risk management (continued):

(a) Summary of financial instruments (continued):

At August 31, 2014, the classification of the Company's financial instruments, as well as their carrying amounts and fair values are as follows:

Financial assets and liabilities	Classification	Carrying amount	Fair Value
Cash and cash equivalents ⁽¹⁾	Held-for-trading ⁽⁹⁾	\$ 193	\$ 193
Accounts receivable ⁽¹⁾	Loans and receivables	116	116
Reserve funds			
Debt service ⁽¹⁾	Held-for-trading ⁽⁹⁾	112	112
Capital lease obligations ⁽²⁾	Held-for-trading ⁽⁹⁾	37	37
Capital lease obligations – payment undertaking agreement ⁽³⁾	Held-to-maturity	209	236
Investments and other			
MAV II and ABCP ⁽²⁾	Held-for-trading ⁽⁹⁾	252	252
Preferred interests in Aireon LLC ⁽⁴⁾	Loans and receivables	96	96
Embedded derivatives on investment in preferred interests ⁽⁵⁾	Derivative financial assets	87	87
Long-term dividend receivable ⁽⁴⁾	Loans and receivables	7	1
Long-term derivative assets ⁽⁶⁾	Derivative financial assets	8	8
Accounts payable, accrued liabilities and other			
Accounts payable and accrued liabilities ⁽¹⁾	Other financial liabilities	189	189
Derivative liabilities ⁽⁶⁾	Derivative financial liabilities	1	1
Long-term debt			
Bonds and notes payable ⁽⁷⁾	Other financial liabilities	1,975	2,287
Capital lease obligations ⁽³⁾	Other financial liabilities	217	236
Other long-term liabilities			
Non-derivative financial liability ⁽⁸⁾	Other financial liabilities	2	2

⁽¹⁾ Due to the short term maturity of these financial assets and liabilities, their respective carrying amounts approximate their fair values.

⁽²⁾ These financial assets are comprised of investments in Master Asset Vehicle II ("MAV II"), Ineligible Asset Tracking notes and asset-backed commercial paper that are discussed in note 17 (b).

⁽³⁾ The fair value is calculated as the present value of the expected future cash flows. Prevailing market interest rates for the corresponding term are used for discounting.

17. Financial instruments and financial risk management (continued):

(a) Summary of financial instruments (continued):

- (4) As discussed in note 5, preferred interests in Aireon provide for a dividend calculated from the date of issuance, and will be redeemed for cash in three annual instalments beginning in November 2020 (in the event the preferred interests have not been converted to common equity or redeemed by that time). These non-derivative financial assets with fixed payments are measured at amortized cost. Dividends are not considered for rate setting purposes until the cash is received. This is achieved by recording a regulatory liability (note 9 (g)).
- (5) The Company may at any time and from time to time elect to convert all or a portion of its preferred interests in Aireon into common interests. The Company has also agreed to defer contributing half of its third stage investment amount until early calendar year 2015. This has resulted in a future commitment to acquire preferred interests. These are embedded derivatives and as such are separated from the host contract and accounted for as stand-alone derivative instruments. These instruments are recorded at fair value (note 5).
- (6) Short-term and long-term derivative assets and liabilities are recorded at fair value determined using prevailing forward foreign exchange market rates and interest rates at the balance sheet date. The Company uses derivative financial instruments to manage risks from fluctuations in foreign exchange rates and interest rates. The Company's long-term derivative assets consist of forward dated interest rate swap agreements. Where permissible, the Company accounts for these financial instruments as cash flow hedges which ensures that counterbalancing gains and losses are recognized in income in the same period. With hedge accounting, changes in the fair value of derivative financial instruments designated as cash flow hedges are deferred and are included in regulatory assets or regulatory liabilities (note 9 (a)). When an anticipated transaction is subsequently recorded, the regulatory amounts deferred are reclassified to a regulatory liability or asset within the related asset or liability (notes 9 (h) and (i)). At the inception of entering into a hedging contract, the relationship between the hedged item and the hedging item is formally documented, in accordance with the Company's risk management objectives and strategies. The effectiveness of the hedging relationship, as discussed below, is assessed at inception of the contract related to the hedging item and then again at each balance sheet date to ensure the relationship is and will remain effective. Where hedge accounting is not permissible and derivatives are not designated in a hedging relationship, they are classified as held-for-trading and the changes in fair value are immediately recognized in the statement of operations.
- (7) Bonds and notes payable are initially recognized at fair value, net of financing fees, premiums, discounts and regulatory assets and liabilities due to cash settlements on hedging transactions that qualify as effective hedges for accounting purposes. They are subsequently measured at amortized cost. Any difference between the carrying amount and the maturity amount is recognized in the statement of operations over the life of the bond or note payable using the effective interest rate method. The fair value of the Company's bonds and notes payable is determined using quoted market prices for these issues.
- (8) The non-derivative financial liability consists of a put option liability that is recorded at fair value using a discounted cash flow approach. One of the Company's subsidiary's shareholder agreements contains a put option whereby the non-controlling shareholders may require that the Company purchase all of the non-controlling shareholders' shares of this subsidiary at any time between June 30, 2015 and September 30, 2015, at the fair value of the shares determined at that time.
- (9) These financial instruments were classified or designated as held-for-trading upon initial recognition by the Company either due to the presence of embedded derivatives or their original short term to maturity. Investments in MAV II, Ineligible Asset Tracking notes and ABCP are discussed in note 17 (b).

There has been no change in classification of financial instruments since August 31, 2013.

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17. Financial instruments and financial risk management (continued):

(b) Fair value hierarchy:

Financial instruments recorded at fair value on the balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

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

The method used to determine the fair value of financial instruments is described in note 17 (a).

The table below illustrates the classification of the Company's financial instruments valued and recognized at fair value:

	August 31, 2014			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Cash and cash equivalents	\$ 193	\$ -	\$ -	\$ 193
Debt service reserve fund	112	-	-	112
Capital lease obligations reserve fund	-	-	37	37
Investments – MAV II and ABCP	-	-	252	252
Long-term derivative assets	-	8	-	8
Embedded derivatives on investment in preferred interests	-	87	-	87
	<u>\$ 305</u>	<u>\$ 95</u>	<u>\$ 289</u>	<u>\$ 689</u>
Financial liabilities:				
Accounts payable, accrued liabilities and other				
Derivative liabilities	\$ -	\$ 1	\$ -	\$ 1
Other long-term liabilities				
Non-derivative financial liability	-	-	2	2
	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ 2</u>	<u>\$ 3</u>

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17. Financial instruments and financial risk management (continued):

(b) Fair value hierarchy (continued):

	August 31, 2013			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Cash and cash equivalents	\$ 171	\$ -	\$ -	\$ 171
Other current assets				
Derivative assets	-	2	-	2
Debt service reserve fund	111	-	-	111
Capital lease obligations reserve fund	-	-	34	34
Investments – MAV II and ABCP	-	-	227	227
Long-term derivative assets	-	29	-	29
	<u>\$ 282</u>	<u>\$ 31</u>	<u>\$ 261</u>	<u>\$ 574</u>
Financial liabilities:				
Other long-term liabilities				
Non-derivative financial liability	\$ -	\$ -	\$ 2	\$ 2
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2</u>	<u>\$ 2</u>

Level 3 financial instruments consist of the following investments in MAV II notes, Ineligible Asset Tracking notes and ABCP investments not subject to the restructuring by the Pan-Canadian Investors Committee as at August 31, 2014 and August 31, 2013:

	August 31, 2014			August 31, 2013		
	Face value	Fair value variances	Fair value	Face value	Fair value variances	Fair value
MAV II notes						
Class A-1	\$ 191	\$ (9)	\$ 182	\$ 191	\$ (22)	\$ 169
Class A-2	94	(7)	87	94	(13)	81
	<u>285</u>	<u>(16)</u>	<u>269</u>	<u>285</u>	<u>(35)</u>	<u>250</u>
Ineligible Asset						
Tracking notes	2	(1)	1	2	(2)	-
ABCP	20	(1)	19	20	(9)	11
	<u>\$ 307</u>	<u>\$ (18)</u>	<u>\$ 289</u>	<u>\$ 307</u>	<u>\$ (46)</u>	<u>\$ 261</u>

17. Financial instruments and financial risk management (continued):

(b) Fair value hierarchy (continued):

The MAV II notes received as a result of the restructuring of third party sponsored ABCP by the Pan-Canadian Investors Committee in January 2009 include a pooling of leveraged investments as well as traditional assets and cash. The leveraged investments are subject to a potential requirement to post additional collateral based on certain triggers being met (a margin call). Traditional assets are un-levered investments and include residential and commercial mortgage backed securities, corporate credit and cash equivalents. The Class A-1 and A-2 notes provide for the payment of interest on a quarterly basis provided that the three month Canadian Dealer Offered Rate ("CDOR"), renamed the Canadian Dollar Offered Rate subsequent to August 31, 2014, is above 50 basis points. The MAV II notes benefit from a margin funding facility to meet potential margin calls. This margin funding facility is being provided by certain international and Canadian banks.

The Ineligible Asset Tracking notes, also received as a result of the restructuring of third party sponsored ABCP, track the performance and repayment of the related underlying assets that have significant exposure to the U.S. residential mortgage market.

Within its Level 3 financial instruments, the Company holds the following ABCP investments:

- (i) \$10 of third party sponsored ABCP in a trust that was not covered by the January 2009 restructuring of third party sponsored ABCP. This trust was subject to a *Companies' Creditors Arrangement Act* ("CCAA") plan of arrangement that was sanctioned by the Ontario Superior Court in August 2014.
- (ii) \$10 of bank sponsored ABCP for which a restructuring has been completed. This trust is rated A(sf) by DBRS. It continues to pay interest on a monthly basis.

The Company is aware of a number of trades in the restructured notes that have occurred prior to August 31, 2014, but does not consider them to constitute an active market for purposes of a Level 1 valuation. As described below, the Company has used a discounted cash flow approach to determine the fair value of these investments, incorporating available information regarding market conditions as at the measurement date, August 31, 2014. The estimates arrived at by the Company are subject to measurement uncertainty and are dependent on market conditions as at the measurement date.

If an active market for the restructured notes were to develop in the future, the Company would change its valuation technique to determine the fair value of its notes using quoted market prices.

The Company's total provision for expected credit losses on Level 3 investments as at August 31, 2014 is \$1. This amount is included in the fair value variance from face value on investments of \$18. As a result of the CCAA restructuring referred to in (i) above, the Company reduced its credit loss provision by \$4 during the fourth quarter of fiscal 2014. Subsequent to August 31, 2014, the Company received proceeds of \$10 from the court appointed monitor for the trust that was subject to the CCAA arrangement. The estimate of expected credit losses with respect to Ineligible Asset Tracking notes was arrived at by estimating the expected realization of the underlying assets. As of August 31, 2014, the Class A-1 and A-2 notes were rated AA (low) (sf) and A (low) (sf) respectively by DBRS. As these are investment grade ratings, the Company has not provided for any credit losses with respect to the Class A-1 and A-2 notes.

The Company has used a discounted cash flow approach to determine the fair value of these investments, taking into account the expected risk and return profile of the notes in comparison to market returns. After deducting the estimated credit losses referred to above, the Company used a discount factor appropriate for a high yield instrument for the Ineligible Asset Tracking notes.

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17. Financial instruments and financial risk management (continued):

(b) Fair value hierarchy (continued):

The Company has used the following expected rates and discount factors at August 31, 2014:

Restructured notes	Return	Market discount factor
MAV II Class A-1	BAs minus 50 basis points	BAs plus 1.6%
MAV II Class A-2	BAs minus 50 basis points	BAs plus 2.9%
Ineligible Asset Tracking notes	BAs plus 30 basis points	BAs plus 27.1%
Other ABCP	BAs to BAs plus 33 basis points	BAs plus 2.3% and BAs plus 4.4%

The Company believes that the market discount factors shown above are reflective of functioning market returns for products with maturities and risk profiles similar to the respective notes.

The following table summarizes the changes in the fair value of financial instruments classified in Level 3 during the year ended August 31, 2014. The balance at August 31, 2013 is provided for comparative purposes.

	August 31, 2014			August 31, 2013
	MAV II and Ineligible Asset Tracking notes	Other ABCP	Total	Total
Fair value as at September 1	\$ 250	\$ 11	\$ 261	\$ 238
Net decrease in fair value provision	19	4	23	21
Net decrease in credit provision	1	4	5	2
Fair value as at August 31	<u>\$ 270</u>	<u>\$ 19</u>	<u>\$ 289</u>	<u>\$ 261</u>

During fiscal 2014, the Company decreased its fair value provision, which is determined using a discounted cash flow approach, by \$23 as a result of the use of lower discount factors in keeping with improvement in the market conditions for MAV II notes and the underlying assets within MAV II.

(c) Financial risk management:

The Company is exposed to several risks as a result of holding financial instruments. The following is a description of these risks and how they are managed.

(i) 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. Market risk comprises three types of risk: interest rate risk, foreign exchange risk and other price risk. The objective of market risk management is to contain market risk exposures within acceptable parameters, as set out in the Company's treasury policy that is approved by the Board of Directors. Interest rate risk, foreign exchange risk and other price risk are discussed below.

17. Financial instruments and financial risk management (continued):

- (c) Financial risk management (continued):
 (i) Market risk (continued):

The price risks associated with investments in MAV II and Ineligible Asset Tracking notes and other ABCP are discussed earlier in this note. The use of the discounted cash flow approach described in note 17 (b) resulted in a carrying value for these investments of \$289 on notes with a face value of \$307. The difference of \$18 is composed of fair value variances of \$17 due to the discounting of cash flows at market rates and an estimate of credit losses of \$1.

A change of 50 basis points in the market discount factors would impact the fair value variance by approximately \$3. There is no assurance that the fair value of the Company's investments in MAV II and Ineligible Asset Tracking notes and other ABCP will not decline, or that significant deterioration in financial markets will not cause margin calls in excess of MAV II's ability to meet them, resulting in a significant credit loss. The estimated fair value of the Company's investments, including the estimate of expected credit losses, may change in subsequent periods. Any such changes could be material and would be reflected in the statement of operations as they occur.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The following table summarizes financial assets and liabilities exposed to interest rate risk:

	August 31 2014	August 31 2013
Floating rate financial assets:		
Cash and cash equivalents	\$ 193	\$ 171
Debt service reserve fund investments	112	111
Investments in MAV II, Ineligible Asset Tracking notes and other ABCP	289	261
Total floating rate financial assets	<u>\$ 594</u>	<u>\$ 543</u>
Fixed rate financial liabilities:		
Bonds and notes payable	<u>\$ 1,975</u>	<u>\$ 2,000</u>

Investments included in the Company's cash and cash equivalents and debt service reserve fund earn interest at prevailing and fluctuating market rates. The investments in MAV II notes also earn interest at variable rates. If interest rates were to decline, earnings on these instruments would fall. A 100 basis point change in variable interest rates would result in an annual difference of approximately \$6 in the Company's earnings before rate stabilization.

17. Financial instruments and financial risk management (continued):

(c) Financial risk management (continued):

(i) Market risk (continued):

Interest rate risk (continued)

Interest rate risk related to the Company's fixed-interest long-term debt relates to the re-setting of interest rates upon maturity and refinancing of the debt. The Company mitigates this source of interest rate risk by spreading maturities of borrowings over periods currently up to and including 2027 so that only a portion of outstanding debt will mature in any given fiscal year. In addition, the Company has International Swaps and Derivatives Association ("ISDA") Agreements in place and, in November 2010, entered into a bond forward transaction in order to mitigate the impact of fluctuating interest rates on interest costs relating to the Company's MTN 2011-1 issue, which settled on February 18, 2011. A gain of \$11 on the bond forward was deferred and included in long-term debt.

This gain has been applied to the series MTN 2011-1 obligation and is being amortized to income using the effective interest rate method.

In June 2012, the Company entered into forward dated interest rate swap agreements totaling \$200 under which the Company will notionally pay a fixed rate of interest in exchange for receiving a floating rate of interest based on the three month CDOR rate with the purpose of mitigating the potential impact of rising interest rates on the cost of refinancing a portion of the Company's \$450 Series MTN 2006-1 notes that will mature on February 24, 2016. The Company intends to cash settle these agreements in February 2016 and offset any gain or loss at that time against a portion of the cost of refinancing the above mentioned notes.

In July 2012, the Company entered into a bond forward transaction in the amount of \$250 with the purpose of mitigating the potential impact of rising interest rates on the cost of refinancing the Company's \$250 Series MTN 2010-1 notes that matured on April 29, 2013. A loss of \$2 on the bond forward was deferred and included in long-term debt. The loss has been applied to the series MTN 2013-1 obligation and is being amortized to income using the effective interest rate method.

The Company has not entered into any other derivative contracts to manage interest rate risk.

Foreign exchange risk

The Company is exposed to foreign exchange risk on sales and purchases that are denominated in currencies other than the Canadian dollar, which is the functional currency of the Company. The Company invoices and receives the vast majority of its revenue in Canadian dollars and also incurs operating expenses and capital expenditures primarily in Canadian dollars. In some cases, the Company uses forward exchange contracts to purchase or sell foreign currencies to mitigate its foreign exchange risk on contractual agreements in foreign currencies. Accordingly, the Company does not have a significant exposure to losses arising from fluctuations in exchange rates, except for assets and liabilities relating to the capital lease transaction and the investments in and contractual obligations relating to the investment in preferred interests in Aireon mentioned below.

17. Financial instruments and financial risk management (continued):

(c) Financial risk management (continued):

(i) Market risk (continued):

Foreign exchange risk (continued)

As a result of entering into a capital lease transaction (note 10), the Company has a capital lease obligation and payment undertaking agreements (that are part of the capital lease obligations reserve funds) denominated in U.S. dollars. The U.S. dollar cash flows from the payment undertaking agreements, comprising funding commitments from two financial institutions, have been structured to fully meet the U.S. dollar capital lease obligations. As at August 31, 2014, the payment undertaking agreements were \$192 U.S. (\$209 CDN) and the capital lease obligation was \$200 U.S. (\$217 CDN). The Company has designated a portion of the capital lease obligation reserve fund as a cash flow hedge of the capital lease obligation. Unrealized gains and losses from translating these financial instruments to Canadian dollars at the balance sheet date are deferred and are included in other regulatory liabilities (note 9 (g)). The Company currently expects no further net effect on its cash flows or results of operations from these transactions.

Pursuant to the November 2012 agreements, the Company acquired preferred interests in Aireon and has agreed to acquire additional preferred interests pursuant to the terms and conditions of such agreements (note 5). These agreements were modified in December 2013 to allow the Additional Investors to invest in Aireon. The agreements are denominated in U.S. dollars. As at August 31, 2014, the Company's investment in preferred interests was \$88 U.S. (\$95 CDN) excluding transaction costs and the Company's outstanding commitment was \$62 U.S. (\$68 CDN) (see note 17 (c)). As at August 31, 2014, the Company had purchased \$47 U.S. (\$52 CDN) on a forward basis in order to hedge the Canadian dollar cost related to a portion of the outstanding commitment. The Company has applied hedge accounting to the forward purchases of U.S. dollars.

Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

In order to mitigate the risk of losses arising from investment activities, the Company only invests in highly-rated (see credit risk discussion below) and short-term instruments, excluding investments in MAV II, Ineligible Asset Tracking notes, other ABCP and Aireon. The price risks associated with investments in MAV II, Ineligible Asset Tracking notes and other ABCP are discussed earlier in this note. The price risk associated with the investment in preferred interests of Aireon has not been quantified as it is a start-up company and a sensitivity analysis would not be representative of the risks inherent in the investment. The estimated fair value of the Company's investments, including the estimate of expected credit losses, may change in subsequent periods. Any such changes could be material and would be reflected in the statement of operations as they occur.

(ii) Credit risk:

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The maximum credit risk to which the Company is exposed as at August 31, 2014 represents the carrying amount of cash equivalents, accounts receivable, reserve funds, investments, forward contracts to purchase or sell foreign currencies and forward dated interest rate swaps.

17. Financial instruments and financial risk management (continued):

(c) Financial risk management (continued):

(ii) Credit risk (continued):

Cash equivalents and the debt service reserve fund are invested in accordance with the Company's restrictive investment policy to manage credit risk. The Company invests only in short-term obligations – usually for periods of 90 days or less. Excluding investments in MAV II, Ineligible Asset Tracking notes and other ABCP, described in note 17 (b), the Company limits investments to obligations of the federal government, certain provincial governments, entities guaranteed by a federal or provincial government or other obligations of entities rated by at least two rating agencies in the top two categories for long-term debt or the highest category for short-term debt. The Company does not invest in instruments with exposure to underlying synthetic assets. The Company's portfolio is diversified, with dollar and percentage limits on investment counterparties. None of the Company's holdings in cash and cash equivalents or in current investments are past due or impaired, and all have long-term ratings of either AAA or AA or short-term ratings in the highest category (R1 (high)).

Credit risk with respect to investments in MAV II and Ineligible Asset Tracking notes and other ABCP is discussed earlier in this note.

The Company's additional planned investments in preferred interests of Aireon are subject to the satisfaction of certain conditions, increasing the likelihood of the successful achievement of Aireon's mandate and reducing the Company's overall risk of a financial loss on its investment in Aireon.

As a result of entering into a capital lease transaction, the Company has capital lease payment undertaking agreements (that are part of the capital lease obligations reserve funds). The U.S. dollar cash flows from the payment undertaking agreements, comprising funding commitments from financial institutions, have been structured to fully meet the U.S. dollar capital lease obligation. The capital lease payment undertaking agreements are provided by two financial institutions, rated at August 31, 2014 by Standard & Poor's as AA- stable and A stable and by Moody's as Aa3 stable and A2 negative.

Accounts receivable are primarily short-term receivables from customers that arise in the normal course of business. The Company provides air navigation services to various aircraft operators, including Canadian and foreign commercial air carriers as well as small general aviation aircraft. Credit limits and compliance with payment terms are monitored by the Company to manage its exposure to credit loss. The Company has established a maximum credit limit of \$4 for its largest air navigation services customers, and it has other credit control measures that reduce its credit exposure. The Company's general payment terms provide for payment periods of 30 days for air navigation services and payment periods of up to 45 days for some other types of services. Shorter payment terms are imposed where customer circumstances warrant. The Company's credit policies also require payments in advance or satisfactory security to be posted under certain circumstances.

The Company establishes an allowance for doubtful accounts that represents its estimate of incurred losses in respect to accounts receivable.

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17. Financial instruments and financial risk management (continued):

(c) Financial risk management (continued):

(ii) Credit risk (continued):

The aging of trade accounts receivable was as follows:

	August 31, 2014			August 31, 2013
	Gross balance	Allowance	Net balance	Net balance
0-30 days	\$ 86	\$ -	\$ 86	\$ 68
31-60 days	-	-	-	3
61-90 days	-	-	-	1
Over 91 days	3	(2)	1	4
Total	\$ 89	\$ (2)	\$ 87	\$ 76

As at August 31, 2014, \$2 of trade accounts receivable (August 31, 2013 – \$7) were past due. The balance of past due amounts not provided for in our allowance for doubtful accounts relates primarily to the Company's service and development contracts and are considered collectible.

There was no significant change to the Company's allowance for doubtful accounts during the year ended August 31, 2014.

(iii) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to evaluate current and expected liquidity requirements under both normal and stressed conditions to ensure that it maintains sufficient reserves of cash and cash equivalents or an available undrawn committed credit facility to meet its liquidity requirements in the short and longer term. Under the Company's Master Trust Indenture and General Obligation Indenture, the Company is required to maintain certain reserve funds and liquidity levels, as described in note 8.

The Company's credit facilities are utilized as follows:

	August 31 2014
Credit facilities	
Credit facility with a syndicate of Canadian financial institutions ⁽¹⁾	\$ 675
Letter of credit facilities for pension funding purposes ⁽²⁾	375
Total available credit facilities	1,050
Less: Outstanding letters of credit ⁽²⁾	339
Undrawn committed borrowing capacity	711
Less: Operations and maintenance reserve fund allocation ⁽³⁾	250
Less: Capital lease transaction restriction	25
Credit facilities available	\$ 436

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17. Financial instruments and financial risk management (continued):

(c) Financial risk management (continued):

(iii) Liquidity risk (continued):

- (1) The Company's credit facility with a syndicate of Canadian financial institutions in the amount of \$675 is comprised of two equal tranches maturing on September 12, 2017 and September 12, 2019. The credit facility agreement provides for loans at varying rates of interest based on certain benchmark interest rates, specifically the Canadian prime rate and the Canadian bankers' acceptance rate, and on the Company's credit rating at the time of drawdown. A utilization fee is also payable on borrowings in excess of 25% of the available facility. The Company is required to pay commitment fees, which are dependent on the Company's credit rating. The Company is in compliance with the credit facility covenants as at August 31, 2014.
- (2) The letter of credit facilities for pension funding purposes are comprised of three equal facilities that will expire on December 31, 2014 unless extended prior to that date. Of the \$339 in letters of credit shown above as outstanding at August 31, 2014, \$325 was drawn from the \$375 credit facilities for pension solvency funding purposes (see note 14). Based on the pension solvency funding requirements for calendar year 2014 that were established in the most recent actuarial valuation for funding purposes, the Company increased its outstanding letters of credit for pension solvency funding to \$325 during the fourth quarter of fiscal 2014.
- (3) The operations and maintenance reserve fund may be used to pay operating and maintenance expenses, if required.

The following table presents the contractual maturities of the Company's financial liabilities owed by the Company and its contractual commitments as at August 31, 2014:

	Remaining payments – for years ending August 31						
	Total	2015	2016	2017	2018	2019	Thereafter
Accounts payable, accrued liabilities and other	\$ 190	\$ 190	\$ -	\$ -	\$ -	\$ -	\$ -
Long-term debt (including current portion)	(1),(2) 1,975	25	475	25	375	375	700
Interest payments	(2) 637	101	89	76	74	65	232
Operating leases	58	8	7	8	7	6	22
Purchase obligations	24	17	5	1	1	-	-
Other long-term obligations	(3) 241	11	11	11	11	13	184
Investment in preferred interests of Aireon	(4) 68	52	-	-	16	-	-
Total contractual obligations	\$ 3,193	\$ 404	\$ 587	\$ 121	\$ 484	\$ 459	\$ 1,138

(1) Payments represent principal of \$1,975. The Company intends to refinance principal maturities and bank loans at their maturity dates. The Company may choose to repay a portion of these maturities with available cash or may increase the size of a re-financing to generate additional liquidity or for other purposes.

(2) Further details on interest rates and maturity dates on long-term debt are provided in note 8 to these financial statements.

17. Financial instruments and financial risk management (continued):

(c) Financial risk management (continued):

(iii) Liquidity risk (continued):

⁽³⁾ Includes long-term obligations for post-employment benefits, accrued pension benefit liability for the Company's supplemental pension plan and other.

⁽⁴⁾ Payments represent contractual obligations to invest in preferred interests of Aireon subject to conditions pursuant to the agreements described in note 5. Amounts are presented in \$CDN translated using the \$U.S. foreign exchange rate at the current balance sheet date.

The Company's contributions to its pension plans are discussed in note 14 to these financial statements.

18. Capital disclosures:

The Company is a non-share capital corporation and, as discussed in note 1, must not set customer service charges higher than what is needed to meet its current and future financial requirements for the provision of civil air navigation services. The Company views capital as the sum of its issued long-term debt, retained earnings, rate stabilization account and other regulatory liabilities, less the accrued pension and other benefits asset, as depicted in the following table. This definition of capital is used by management and may not be comparable to measures presented by other companies. The Company's capital is as follows:

	August 31 2014	August 31 2013
Carrying value of total bonds and notes payable (note 8)	\$ 1,975	\$ 1,999
Retained earnings	28	28
Regulatory assets (note 9)	(36)	-
Rate stabilization account liability (note 9)	76	53
Regulatory liabilities (note 9)	336	303
Accrued pension and other benefits asset (note 14)	(276)	(365)
Accumulated surplus	128	19
Total capital	\$ 2,103	\$ 2,018

In addition to tracking its capital as defined above for purposes of managing capital adequacy, the Company also takes into consideration known contingent exposures and off balance sheet obligations such as funding obligations of its defined benefit pension plans.

18. Capital disclosures (continued):

The Company's main objectives when managing capital are:

- (a) to safeguard the Company's ability to continue as a going concern;
- (b) to provide funds for the ongoing acquisition of systems and equipment necessary to implement and maintain a modern, cost-efficient ANS technology platform;
- (c) to ensure the funding of reserve funds as well as working capital and liquidity requirements;
- (d) to maintain the Company's credit ratings to facilitate access to capital markets at competitive interest rates; and
- (e) to minimize interest costs incurred by the Company subject to appropriate risk mitigation actions.

Given that the Company has no share capital, these objectives are achieved through a process that determines an appropriate period and level of cost recoveries through customer service charge rate setting, as well as the appropriate amount of debt and committed credit facilities. This process includes the Company's operational and capital budgeting process and considers the overall economic and capital market environment. The level of debt and committed credit facilities are approved by the Board of Directors. The Company is not subject to any externally imposed capital requirements.

There were no changes in the Company's approach to capital management during the year ended August 31, 2014.

19. Contingencies:

The Company is party to legal proceedings in the ordinary course of its business. Management does not expect the outcome of any of these proceedings to have a material adverse effect on the consolidated financial position or results of operations of the Company.