



**Consolidated Financial Statements  
December 31, 2012 and 2011**



February 20, 2013

## **Independent Auditor's Report**

### **To the Shareholders of Chorus Aviation Inc.**

We have audited the accompanying consolidated financial statements of Chorus Aviation Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011 and the consolidated statements of changes in equity, income, comprehensive income and cash flows for the years then ended, and the related notes, which comprise 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 International Financial Reporting 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.

#### **Auditor's 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 the auditor's 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, the auditor considers 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 opinion.

#### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Chorus Aviation Inc. and its subsidiaries as at December 31, 2012 and December 31, 2011, and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

(signed) "PricewaterhouseCoopers LLP"

#### **Chartered Accountants**

---

*PricewaterhouseCoopers LLP*  
1601 Lower Water Street, Suite 400, Halifax, Nova Scotia, Canada B3J 3P6  
T: +1 902 491 7400, F: +1 902 422 1166



February 20, 2013

## Management's Report

The accompanying consolidated financial statements of **Chorus Aviation Inc.** are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles in Canada ("GAAP"). The consolidated financial statements include certain amounts and assumptions that are based on management's best estimates and have been derived with careful judgement.

In fulfilling its responsibilities, management has developed and maintains a system of internal accounting controls. These controls are designed to provide reasonable assurance that the financial records are reliable for preparation of the financial statements. The Audit, Finance and Risk Committee of the Board of Directors reviewed and approved the corporation's consolidated financial statements, and recommended their approval by the Board of Directors.

(signed) "Joseph D. Randell"  
President and Chief Executive Officer

(signed) "Richard Flynn"  
Chief Financial Officer

Consolidated Statements of Financial Position

(expressed in thousands of Canadian dollars)

	2012	2011
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents (note 4)	118,306	108,068
Restricted cash (note 4)	6,017	10,639
Accounts receivable – trade and other (note 5)	78,949	93,783
Spare parts, materials and supplies (note 6)	38,149	37,074
Prepaid expenses and deposits (note 7)	25,942	39,046
Assets held for sale (note 8)	—	12,956
<b>Total current assets</b>	<b>267,363</b>	<b>301,566</b>
<b>Property and equipment (note 9)</b>	<b>499,872</b>	<b>409,040</b>
<b>Goodwill (note 10)</b>	<b>6,693</b>	<b>6,693</b>
<b>Long-term investment (note 11)</b>	<b>—</b>	<b>16,351</b>
<b>Deferred income tax (note 12)</b>	<b>2,099</b>	<b>11,409</b>
<b>Other assets (note 13)</b>	<b>36,280</b>	<b>28,370</b>
	<b>812,307</b>	<b>773,429</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 14)	205,588	233,487
Dividends payable (note 21)	18,602	18,602
Current portion of obligations under finance leases (note 15)	2,875	2,691
Current portion of long-term debt (note 18)	20,281	11,853
Income tax payable	513	—
Promissory note payable (note 16)	—	23,002
Unearned revenue (note 17)	—	21,495
<b>Total current liabilities</b>	<b>247,859</b>	<b>311,130</b>
<b>Obligations under finance leases (note 15)</b>	<b>6,014</b>	<b>9,086</b>
<b>Long-term debt (note 18)</b>	<b>257,165</b>	<b>161,305</b>
<b>Convertible debentures (note 19)</b>	<b>76,769</b>	<b>75,108</b>
<b>Other long-term liabilities (note 20)</b>	<b>92,385</b>	<b>73,656</b>
	<b>680,192</b>	<b>630,285</b>
<b>Equity</b>	<b>132,115</b>	<b>143,144</b>
	<b>812,307</b>	<b>773,429</b>

**Economic dependence** (note 25)

**Commitments** (note 26)

**Contingencies** (note 31)

**Subsequent event** (note 32)

*The accompanying notes are an integral part of these consolidated financial statements.*

**Approved by the Board of Directors**

By: (signed) "Karen Cramm"  
Director

By: (signed) "Richard H. McCoy"  
Director

## Consolidated Statements of Changes in Equity

(expressed in thousands of Canadian dollars)

	Capital \$	Deficit \$	Contributed surplus \$	Equity component of convertible debentures \$	Total \$
<b>Balance - December 31, 2010</b>	—	(898,899)	1,050,269	9,497	160,867
Net income for the year	—	68,135	—	—	68,135
Other comprehensive loss for the year (net of tax)	—	(13,660)	—	—	(13,660)
Comprehensive income for the year	—	54,475	—	—	54,475
Dividends	—	(74,408)	—	—	(74,408)
Shares released from stock-based compensation plans	1,572	—	(1,568)	—	4
Expense related to the ongoing long-term incentive plan	—	—	2,206	—	2,206
<b>Balance - December 31, 2011</b>	1,572	(918,832)	1,050,907	9,497	143,144
Net income for the year	—	101,107	—	—	101,107
Other comprehensive loss for the year (net of tax)	—	(40,182)	—	—	(40,182)
Comprehensive income for the year	—	60,925	—	—	60,925
Dividends	—	(74,408)	—	—	(74,408)
Shares released from stock-based compensation plans	2,056	—	(2,056)	—	—
Expense related to the ongoing long-term incentive plan	—	—	2,454	—	2,454
<b>Balance - December 31, 2012</b>	3,628	(932,315)	1,051,305	9,497	132,115

*The accompanying notes are an integral part of these consolidated financial statements.*

Consolidated Statements of Income  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except earnings per share)

	2012 \$	2011 \$
<b>Operating revenue</b> (note 25)		
Passenger	1,702,585	1,657,091
Other	8,101	7,376
	1,710,686	1,664,467
<b>Operating expenses</b> (note 25)		
Salaries, wages and benefits	411,455	399,606
Aircraft fuel	396,413	410,735
Depreciation and amortization	56,745	44,139
Food, beverage and supplies	18,437	15,587
Aircraft maintenance materials, supplies and services	162,361	152,301
Airport and navigation fees	204,209	198,130
Aircraft rent	100,083	106,471
Terminal handling services	112,881	116,032
Other	119,508	119,519
	1,582,092	1,562,520
<b>Operating income</b>	128,594	101,947
<b>Non-operating income (expenses)</b>		
Interest revenue	1,337	1,090
Interest expense	(17,896)	(11,166)
Gain on disposal of property and equipment	1,232	682
Foreign exchange gain (loss)	5,909	(4,176)
Gain on Asset Backed Commercial Paper ("ABCP")	450	547
	(8,968)	(13,023)
<b>Income before deferred income taxes</b>	119,626	88,924
<b>Income tax expense</b> (note 12)		
Current income tax	(513)	—
Deferred income tax	(18,006)	(20,789)
	(18,519)	(20,789)
<b>Net income for the years</b>	101,107	68,135
<b>Earnings per share, basic</b> (note 22(b))	\$0.81	\$0.55
<b>Earnings per share, diluted</b> (note 22(b))	\$0.78	\$0.54

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



Consolidated Statements of Comprehensive Income  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars)

	2012 \$	2011 \$
<b>Net income for the years</b>	101,107	68,135
<b>Other comprehensive loss</b>		
<i>Items that will not be subsequently reclassified to the statement of income</i>		
Actuarial loss on employee benefit liabilities, net of tax recovery of \$8,696 (2011 - \$4,976)	(23,831)	(13,660)
Loss arising on revaluation of financial assets at fair value through other comprehensive loss (note 11)	(16,351)	—
<b>Comprehensive income</b>	60,925	54,475

*The accompanying notes are an integral part of these consolidated financial statements.*

Consolidated Statements of Cash Flows  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars)

	2012	2011
	\$	\$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income for the years	101,107	68,135
Charges (credits) to operations not involving cash		
Depreciation and amortization	56,745	44,139
Amortization of prepaid aircraft rent and related fees	2,280	1,975
Gain on disposal of property and equipment	(602)	(682)
Stock-based compensation	2,454	2,206
Unrealized foreign exchange (gain) loss on long-term debt and finance leases	(5,614)	3,517
Current income tax expense	513	—
Deferred income tax expense	18,006	20,789
Accretion of debt component of convertible debentures	1,661	1,567
Aircraft maintenance materials, supplies and services	2,090	—
Other	(1,606)	(2,379)
	177,034	139,267
Net changes in non-cash working capital balances related to operations (note 23)	(34,227)	13,702
	142,807	152,969
<b>Financing activities</b>		
Repayment of obligations under finance leases	(2,653)	(2,756)
Long-term borrowings	124,573	171,153
Repayment of long-term borrowings	(14,904)	(1,271)
Dividends	(74,408)	(55,806)
	32,608	111,320
<b>Investing activities</b>		
Additions to property and equipment	(170,120)	(208,016)
Assets held for sale	(281)	(12,956)
Proceeds on disposal of property and equipment	602	682
Decrease (increase) in restricted cash	4,622	(1,827)
	(165,177)	(222,117)
<b>Net change in cash and cash equivalents during the years</b>	<b>10,238</b>	<b>42,172</b>
<b>Cash and cash equivalents – Beginning of years</b>	<b>108,068</b>	<b>65,896</b>
<b>Cash and cash equivalents – End of years</b>	<b>118,306</b>	<b>108,068</b>
<b>Cash payments of interest</b>	<b>20,032</b>	<b>5,763</b>
<b>Cash receipts of interest</b>	<b>1,220</b>	<b>991</b>

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

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 1 General information

Chorus Aviation Inc. ("Chorus" or the "Company") was incorporated on September 27, 2010 under the laws of Canada. On November 18, 2010, Chorus incorporated Aviation General Partner Inc. to act as general partner for a newly formed partnership, Jazz Aviation LP (the "Partnership"). On January 5, 2011, substantially all of the assets of Jazz Air LP were transferred to the Partnership. The airline business previously carried on by Jazz Air LP is now carried on by the Partnership. On February 28, 2011, Chorus incorporated three wholly-owned subsidiaries under the Canada Business Corporations Act, as amended ("CBCA"); Chorus Leasing I Inc., Chorus Leasing II Inc., and Chorus Leasing III Inc. (collectively, the "Initial LeaseCos"). The Initial LeaseCos were established for the sole purpose of acquiring Q400 NextGen turboprop aircraft ("Q400 aircraft") and related equipment. On December 31, 2012, the Initial LeaseCos were reorganized (the "Reorganization") as follows: Chorus Leasing I Inc. and Chorus Leasing II Inc. amalgamated to form Chorus Leasing Amalco (2012) Inc. ("Amalco"), and Chorus Leasing III Inc. ("LeaseCo III") then acquired the assets and liabilities of Amalco in exchange for preferred shares.

The registered office of Chorus is located at 100 King Street West, 1 First Canadian Place, Suite 6100, P.O. Box 50, Toronto, Ontario, M5X 1B8 and its country of domicile is Canada. Chorus was established to acquire and hold, directly or indirectly, investments in the Partnership and its general partner Aviation General Partner Inc., 7503695 Canada Inc. ("7503695"), the Initial LeaseCos and other investments that it may acquire from time to time.

Reference to Chorus or the Company in the following notes to the consolidated financial statements refer to, as the context may require, Chorus, its subsidiaries (the Partnership, Aviation General Partner Inc., 7503695, Chorus Leasing I Inc., Chorus Leasing II Inc., Chorus Leasing III Inc. and Amalco) collectively, Chorus and one or more of its subsidiaries, one or more of Chorus' subsidiaries, or Chorus itself.

Chorus provides a significant part of Air Canada's domestic and transborder network. Chorus is economically and commercially dependent upon Air Canada and certain of its subsidiaries, as, in addition to being Chorus' primary source of revenue, these entities currently provide significant services to Chorus. Chorus and Air Canada are parties to an amended and restated capacity purchase agreement, effective January 1, 2006, as amended by a letter agreement (the "Rate Amending Agreement") dated July 28, 2009 and an amending agreement (the "CPA Amending Agreement") dated September 22, 2009 (as amended, the "CPA"), under which Air Canada currently purchases the greater part of Chorus' fleet capacity on aircraft operated by Chorus (the "Covered Aircraft") at predetermined rates (the "Rates"). On March 8, 2011, Chorus and Air Canada agreed to a second amendment to the CPA (the "Second Amending Agreement") to facilitate the acquisition and leasing of the Q400 aircraft. On June 29, 2012, Chorus and Air Canada agreed to amend the CPA to support the continued fleet renewal program in connection with the acquisition of the six additional Q400 aircraft and the removal of nine CRJ aircraft (starting in December 2012) from the Chorus fleet.

On April 13, 2012, Chorus announced that it had received notification from Thomas Cook of its intention to discontinue operating dedicated charter aircraft, branded as Thomas Cook Canada, due to market conditions. As a consequence, the remaining three years of the five-year Flight Services Agreement with Chorus were terminated, effective April 30, 2012. Chorus had, prior to such termination, operated Boeing 757-200 aircraft on behalf of Thomas Cook to various sun destinations from Canadian gateways. Chorus and Thomas Cook reached a commercial settlement in respect of the termination of the Flight Services Agreement, the economic terms of which reflect the original and intended expiration of the agreement, and address the recovery of certain initial start-up costs and foregone revenues. In the second quarter of 2012, approximately \$9,000 was recorded in the financial statements of Chorus as revenue in respect of this settlement.

Under the CPA, Chorus has historically experienced greater demand for its services in the second and third quarters of the calendar year and lower demand in the first and fourth quarters of the calendar year. Termination of the Thomas Cook flying program is expected to return seasonality to these previous patterns. Chorus has substantial fixed costs that do not meaningfully fluctuate with passenger demand in the short-term. Chorus' revenues do not fluctuate significantly with passenger load factors.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 2 Basis of presentation

Chorus prepares its consolidated financial statements in accordance with generally accepted accounting principles in Canada ("GAAP") as set out in the Handbook of the Canadian Institute of Chartered Accountants – Part 1 ("CICA Handbook") which incorporates International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements include all adjustments, composed of normal recurring adjustments, considered necessary by management to fairly state Chorus' annual results of operations, financial position and cash flows.

These consolidated financial statements have been authorized for issuance by the Board of Directors on February 20, 2013.

### 3 Significant accounting policies

#### a) Basis of measurement

These consolidated financial statements have been prepared under a historical cost basis, except for certain financial assets and financial liabilities, including the long-term investment that are measured at fair value.

#### b) Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Significant estimates made in the preparation of these financial statements include, but are not limited to, the following areas, with further information contained in the applicable accounting policy or note:

#### *Employee benefits*

The cost and related liabilities of Chorus' post-employment benefit programs are determined using actuarial valuations. The actuarial valuations involve assumptions including those in relation to discount rates, expected rates of return on assets, future salary increases, mortality rates and future benefit increases. Also, due to the long-term nature of these programs, such estimates are subject to significant uncertainty. See note 3(g) for further details.

#### *Depreciation of long-lived assets*

Management makes estimates and judgements about the expected useful life and the expected residual value of long-lived assets. Depreciation methods for long-lived assets are based on management's judgment of the most appropriate method to reflect the pattern of an asset's future economic benefit. Useful life and residual values are based on estimates of future fair values and can vary significantly from actual. Management revises depreciation estimates and patterns regularly and makes any changes on a prospective basis. A 25% reduction to the residual values of aircraft would result in an increase of \$5,197 to annual depreciation expense.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

---

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 3 Significant accounting policies (continued)

#### c) Principles of consolidation

These consolidated financial statements include the accounts of Chorus and its subsidiaries, the Partnership, 7503695, the Initial LeaseCos, Aviation General Partner Inc., and the special purpose entity ("SPE") which held the Jazz long-term incentive plan ("Jazz LTIP"). All inter-company and inter-entity balances and transactions are eliminated. Chorus has no non-controlling interests, therefore, all profits and comprehensive income are attributable to the shareholders of the Company.

#### d) Cash and cash equivalents

Cash and cash equivalents consist of current operating bank accounts, term deposits and fixed income securities with an original term to maturity of 90 days or less. Cash equivalents are readily convertible into a known amount of cash and are subject to an insignificant risk of changes in value.

#### e) Restricted cash

Chorus has recorded restricted cash under current assets relating to funds on deposit with a financial institution as collateral for letters of credit.

#### f) Operating revenue

Under the CPA, Chorus is paid to provide services to Air Canada, as explained in note 1. The related fees payable by Air Canada are recognized in revenue as the capacity is provided and incentive payments and margin adjustments are recognized, respectively, as increases in and reductions of, passenger revenue based on management estimates during the year when the amount of revenue can be measured reliably, and it is probable that the economic benefit will flow to Chorus. Revenue billings related to services performed over an extended period are billed based on the stage of completion of the transaction at the end of the reporting period, when the overall revenue and related costs can be reliably measured.

Revenue earned by Chorus under its flight services agreement with Thomas Cook and operation of charter flights is also included in passenger revenue and recognized when the service is provided. Maintenance, repair and overhaul ("MRO") operations and other sources of revenue such as third party ground handling services, are included in other revenue and are recognized when the service is provided. Revenue billings related to services performed over an extended period are billed based on the stage of completion of the transaction at the end of the reporting period, when the overall revenue and related costs can be reliably measured.

The CPA with Air Canada provides for a monthly payment for an amount per aircraft designed to reimburse Chorus for certain aircraft ownership costs. Chorus has concluded that a component of its revenue under the CPA is rental income since the CPA identifies the "right of use" of a specific type and number of aircraft over a stated period of time otherwise known as the Covered Aircraft. The amount deemed to be rental income is \$153,353 for the year ended December 31, 2012 (\$141,937 for the year ended December 31, 2011).

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 3 Significant accounting policies (continued)

#### g) Employee benefits

Chorus' significant policies related to defined benefit pension plan for its pilots, the supplemental executive retirement plan for Chorus executives, which is also a defined benefit pension plan (collectively referred to as "Pension Benefits"), and the Other Employee Benefits are as follows:

- The cost of pension benefits earned by employees is actuarially determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation and retirement ages of employees. Obligations are attributed to the period beginning on the date the employee joins the plan and ending on the earlier of the date of termination, death or retirement. Actuarial gains and losses on the pension benefits are recognized in full in the period in which they occur in other comprehensive income and retained earnings without recycling to the statement of income in subsequent periods. Current service cost, the recognized element of any past service cost, the expected return on plan assets and the interest arising on the pension liability are included in salaries, wages and benefits in the statement of income.
- Other employee benefits consist of two categories of benefits:
  - Medical and dental benefits provided to employees while on long-term disability, and Worker's Compensation and Workers Safety Insurance Board benefits in respect of Ontario employees, are collectively referred to as other long-term benefits. The actuarial gains and losses for this component of other employee benefits are charged to operating expense in the year they occur.
  - Sick leave benefits are paid to certain employees upon or just prior to retirement. The actuarial gains and losses on this component of other employee benefits are charged to other comprehensive income in the year they occur.
- The cost of the other employee benefits is actuarially determined using the projected benefit method prorated on service (where applicable), market interest rates, and management's best estimate of retirement ages of employees, health care cost inflation, salary escalation and general inflation, as applicable to each of the categories of benefits.
- The expected return on plan assets is based on the long-term expected rate of return on plan assets and the fair value of the plan assets. It is reasonably possible that management's estimate of the long-term rate of return may change as management continues to assess future investments and strategies and as a result of changes in financial markets.
- Past service costs arising from plan amendments of the defined benefit pension plan and the supplemental executive retirement plan are recognized immediately in income unless the changes to the plan are conditional on the employee remaining in service for a specified period of time (the vesting period). In this case, the past service costs are recognized over the vesting period.
- The registered pension plan is subject to certain minimum funding requirements. The liability in respect of the minimum funding requirement is determined using the projected minimum funding requirements based on actuarial forecasts. The liability in respect of the minimum funding requirement and any subsequent re-measurement of that liability is recognized in other comprehensive income without subsequent reclassification to income.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 3 Significant accounting policies (continued)

- The measurement date of each of the plans' assets and obligations is December 31. Pension obligations are attributed to the period beginning on the employee's date of joining the plan and ending on the earlier of the date of termination, death or retirement. The obligations relating to other employee benefits plans are attributed to the period beginning on the employee's date of joining the plan or disablement (whichever applicable) and ending on the earlier of retirement or end of disablement or age 65 (whichever applicable).
- Chorus also maintains several defined contribution pension plans. The cost of defined contribution pension plans is charged to expense as the contributions become payable.

#### h) Stock-based compensation

##### *Long-term incentive plan*

The Chorus Aviation Inc. long-term incentive plan (the "Chorus LTIP") is a "restricted share unit" plan under which participants receive an annual grant of restricted share units that vest at the end of a three year period, if certain performance goals established at the time of grant by the Board of Directors are achieved. A "Performance Cycle" commences January 1 of the year in respect of which the restricted share units are granted. Restricted share units entitle the participant to receive common shares of Chorus on a one-for-one basis. Additional restricted share units representing the value of quarterly dividends paid on corresponding common shares of Chorus accrue for the benefit of participants. Unvested restricted share units held by participants are forfeited if performance goals or service conditions are not met. On vesting, Chorus has the option to issue the shares from treasury or purchase them on the secondary market.

The Jazz LTIP was also a "restricted share unit" plan similar to the Chorus LTIP which applied to awards granted prior to the implementation of the Chorus LTIP on December 31, 2010. As detailed in note 22(c), the remaining awards granted in the Jazz LTIP vested during 2012. The Jazz LTIP held all of the same attributes as the Chorus LTIP except that the shares of the Jazz LTIP were purchased in the secondary market and held in a trust for the benefit of the participants until vesting occurred. Dividends paid by Chorus on common shares held by the trust were also used to invest in additional common shares and vested concurrently and proportionately with the restricted units. On forfeiture of any restricted units, the common shares and related dividends accrue to Chorus. The trust was a SPE which was consolidated by Chorus. The shares of Chorus held by the trust were presented as a reduction of equity.

For the Chorus LTIP, the cost of the restricted share units is measured at the fair value of the common shares of Chorus at the grant date and the number of restricted share units expected to vest. The cost is recognized as compensation cost in the statement of income from the date of grant on a straight-line basis over the vesting period with a corresponding increase in equity. Chorus revises the estimate of the number of restricted stock units expected to vest when necessary, if subsequent information indicates that the number of restricted share units expected to vest differs from previous estimates.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 3 Significant accounting policies (continued)

#### *Deferred share units*

Non-executive directors receive a portion of their remuneration in deferred share units ("DSUs") under a DSU Plan designed to promote the alignment of interests between individual non-executive directors and the shareholders of Chorus. DSUs have a value equivalent to the value of the Chorus shares. DSUs vest immediately and may only be redeemed for cash and will be paid out only subsequent to the time the director ceases to be a director, or in the case of a U.S. taxpayer, subsequent to the date such person incurs a "separation from service" under applicable U.S. law. Participating directors will receive, in respect of their DSUs, an amount equivalent to the amount of any dividends paid on the shares in the form of additional DSUs. Under the DSU Plan, participants may receive an annual grant of DSUs. In addition, a participating director may elect to have his or her annual retainer and/or any additional retainer payable in the form of DSUs or a combination of DSUs and cash. DSUs are cash-settled share-based payments that are measured at fair value and recognized as a liability. The liability is remeasured at fair value each period and at the settlement date with changes in fair value recognized in the statement of income.

#### *Employee share ownership program*

Chorus' employee share ownership plan (the "ESOP") permits employees to buy common shares of Chorus through payroll deduction. Under this plan, contributions made by employees are matched to a specific percentage by Chorus. These contributions are expensed to salaries, wages and benefits expense over the one year vesting period. The amount expected to vest is reviewed at least annually, with any change in estimate recognized immediately in salaries, wages and benefits.

#### i) Financial instruments

Chorus has early adopted IFRS 9, *Financial Instruments*. The new standard requires financial assets to be classified into two measurement categories: amortized cost and fair value. Classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For investments in equity instruments which are not subject to control, joint control, or significant influence, on initial recognition IFRS allows an entity to irrevocably elect classification at "fair value through profit or loss" or "fair value through other comprehensive income". For financial liabilities, changes in fair value attributable to an entity's own credit risk are recorded through other comprehensive income rather than through net income.

Management has designated that equity investments not held for trading that were previously classified as available for sale, be classified as fair value through other comprehensive income.

The new accounting standard provides more relevant information for users to assess the amounts, timing and uncertainty of future cash flows. The new accounting standard was applied retrospectively and there were no resulting changes to opening retained earnings or the classification of comparable period fair value adjustments through the statement of income or statement of comprehensive income as a result of the adoption of IFRS 9.

Financial instruments are classified as follows:

- Asset backed commercial paper is classified as "Fair Value through Profit and Loss." These financial assets are measured at fair value, with changes in fair value recognized in the statement of income each reporting period.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 3 Significant accounting policies (continued)

- Cash and cash equivalents, restricted cash and accounts receivable are classified as "Financial Assets Measured at Amortized Cost". After their initial fair value measurement, they are measured at amortized cost using the effective interest method, less a provision for impairment, established on an account-by-account basis, based on, among other factors, prior experience and knowledge of the specific debtor and its assessment of the current economic environment.
- Chorus' investment in LARAH, has been classified as "Fair Value through Other Comprehensive Income". Fair Value through Other Comprehensive Income assets are non-derivative equity instruments that have been irrevocably elected to have changes in fair value recognized in other comprehensive income with no recycling through net income. Financial assets classified as Fair Value through Other Comprehensive Income are recognized initially at fair value plus transaction costs and are subsequently carried at fair value with the changes in fair value recorded in other comprehensive income.
- Accounts payable, dividends payable, promissory note payable, credit facilities, long-term debt and the debt component of convertible debentures are classified as "Other Financial Liabilities". Other Financial Liabilities are initially recognized at fair value less transaction costs, except for the debt component of the convertible debentures. Subsequent to initial recognition, Other Financial Liabilities are measured at amortized cost using the effective interest method.

#### *Impairment of financial assets*

At each reporting date, Chorus assesses whether there is objective evidence that a financial asset carried at amortized cost is impaired. If such evidence exists, Chorus recognizes an impairment loss, as the difference between the carrying value of the instrument and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate or a discount rate based on the risk associated with the financial asset being tested. The carrying amount of the asset is reduced by this amount through a charge to the statement of income.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

#### j) Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Property and equipment are depreciated to estimated residual values based on the straight-line method over their useful lives. Aircraft and flight equipment are depreciated over 20 to 30 years, with 5% - 25% estimated average residual values.

Major maintenance overhaul expenditures ("heavy checks"), including labour, are capitalized and depreciated over the expected life of the maintenance cycle. Any remaining carrying value is derecognized when the major maintenance overhaul commences. All other costs associated with maintenance of fleet assets (including engine maintenance provided under "power-by-the-hour" arrangements) are charged to the statement of income as incurred.

Buildings are depreciated over their useful lives not exceeding 40 years on a straight-line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**3 Significant accounting policies (continued)**

Depreciation on other property and equipment is provided on a straight-line basis from the date assets are placed in service, to their estimated residual values, over the following estimated useful lives:

Leaseholds	Over the term of the related lease
Ground and other equipment	5 years

Property under finance leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments. Property and equipment under finance leases are depreciated to estimated residual value over the useful life, unless there is no reasonable certainty that Chorus will obtain ownership at the end of the lease term, in which case the asset is depreciated over the shorter of the lease term and its useful life.

Depreciation methods, residual values and useful lives of the assets are reviewed at least annually and adjusted if appropriate.

k) Transaction costs

Transaction costs that are incremental and directly attributable to the acquisition or issue of a financial asset or financial liability are recorded as follows:

- Financial assets or financial liabilities at fair value through profit and loss - expensed to net income as incurred;
- Financial liabilities recorded at amortized cost - included in the carrying value of the financial asset or financial liability and amortized over the expected life of the financial instrument using the effective interest method; and
- Equity instruments recorded at fair value through other comprehensive income - included in the initial cost of the underlying asset.

Transaction costs for operating and finance leases are capitalized and amortized over the life of the lease on a straight-line basis.

l) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of Chorus' share of the net identifiable assets of the acquired business at the date of acquisition. Goodwill is tested annually for impairment, or at any time if an indication of impairment exists, and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. For the purpose of impairment testing, goodwill is tested for impairment at the cash-generating unit or ("CGU") level.

m) Impairment of non-financial assets

Property and equipment, prepaid aircraft rent and prepaid expenses and deposits are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets that are not amortized are subject to an annual impairment test. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units or CGUs). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

Chorus evaluates impairment losses for potential reversals when events or circumstances warrant such consideration.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

---

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 3 Significant accounting policies (continued)

#### n) Foreign currency translation

Items included in the financial statements of each of the consolidated entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The functional currency of Chorus and its subsidiaries is the Canadian dollar.

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the statement of financial position. Non-monetary assets, liabilities and other items recorded in income are translated at rates of exchange in effect at the date of the transaction.

Foreign currency transactions are translated into Canadian dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation of monetary assets and liabilities denominated in currencies other than the Canadian dollar are recognized in the statement of income.

#### o) Provisions

Provisions are recognized in other liabilities when Chorus has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material. Chorus performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

#### p) Aircraft lease payments

Total aircraft rentals under operating leases and the related lease inducements received and fees paid over the lease term are amortized to operating expense on a straight-line basis. Prepaid aircraft rentals and related fees are the difference between the straight-line aircraft rent and the payments stipulated under the lease agreements and legal and related transaction fees associated with the leases. Current and non-current unamortized lease inducements are included in accounts payable and accrued liabilities and other long-term liabilities, respectively.

#### q) Spare parts, materials and supplies

Spare parts, materials and supplies are valued at the lower of cost, determined on a first in, first out basis, and net realizable value.

#### r) Income taxes

Chorus uses the asset and liability method for accounting for income taxes.

Current tax assets and liabilities for the current and prior periods are measured at the amounts expected to be paid or recovered, using tax rates and tax laws that have been enacted or substantively enacted by the end of the period.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 3 Significant accounting policies (continued)

Deferred tax assets and liabilities are recognized for all future tax consequences attributable to the differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases, except for the initial recognition of goodwill and the initial recognition of an asset or liability, which at the time of the transaction, affects neither accounting profit nor taxable profit or loss. Deferred tax assets are also recognized for unused tax losses and unused tax credits. Deferred tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilized. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates and tax laws expected to apply when the carrying amount of the assets or liabilities are recovered or settled or the unused losses are expected to be utilized.

Current and deferred income tax expense is recognized in the statement of income for the period, except to the extent that the income taxes related to a transaction or event which is recognized, in the same or different period, either in other comprehensive income or directly in equity.

#### s) Earnings per share

Earnings per share are calculated on a weighted average number of shares outstanding basis. Shares formerly held in trust under the Jazz LTIP reduced the weighted average number of outstanding shares from the date they were contributed to the plan.

Diluted earnings per share are presented for the effects of all dilutive potential common shares by adjusting the net income attributable to Chorus shareholders and the weighted average number of shares outstanding, for convertible debentures, by adding back to net income the after-tax effect of any interest expense or other changes recognized in the statement of income, and by adding to the weighted average number of common shares outstanding, the weighted average number of common shares that would be issued on the conversion of the convertible debentures at the later of the beginning of the period, or the date the convertible debentures were issued.

#### t) Dividends

Dividends payable by Chorus to its shareholders, which are determined at the discretion of the Directors, are recorded when declared.

#### u) Assets held for sale

Long-term assets held for sale are classified as current assets if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when completion of the sale is highly probable within one year from the date of classification and the asset is available for immediate sale in its present condition.

#### v) Unearned revenue

Unearned revenue represents cash amounts received from customers for services that have not yet been provided. Revenue is recognized once the service has been performed.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

---

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 3 Significant accounting policies (continued)

#### Accounting standards issued but not yet applied

Chorus does not expect to early adopt the following revised standards and amendments. Accordingly, Chorus expects to adopt these standards on the effective dates listed below.

##### *IFRS 10, Consolidated Financial Statements*

The IASB issued IFRS 10, "Consolidated Financial Statements" ("IFRS 10"), effective for annual periods beginning on or after January 1, 2013. IFRS 10 replaces portions of IAS 27, "Consolidated and Separate Financial Statements" ("IAS 27") that addresses consolidation, and supersedes Standing Interpretations Committee ("SIC") SIC-12 in its entirety. The objective of IFRS 10 is to define the principles of control and establish the basis of determining when and how an entity should be included within a set of consolidated financial statements. IAS 27 has been amended to reflect the issuance of IFRS 10 and retains guidance only for separate financial statements. Chorus continues to assess the impact of IFRS 10 on its consolidated financial statements.

##### *IFRS 11, Joint Ventures*

The IASB issued IFRS 11, "Joint Ventures" ("IFRS 11"), effective for annual periods beginning on or after January 1, 2013. IFRS 11 supersedes IAS 31, "Interest in Joint Ventures" and SIC-13, "Jointly Controlled Entities - Non Monetary Contributions by Venturers". Through an assessment of the rights and obligations in an arrangement, IFRS 11 establishes principles to determine the type of joint arrangement and guidance for financial reporting activities required by the entities that have an interest in arrangements which are controlled jointly. As a result of the issuance of IFRS 10 and IFRS 11, IAS 28, "Investments in Associates and Joint Ventures" ("IAS 28") was amended to reflect the guidance provided in IFRS 10 and IFRS 11. Currently, this standard has no impact on the consolidated financial statements of Chorus.

##### *IFRS 12, Disclosure of Interests in Other Entities*

The IASB issued IFRS 12, "Disclosure of Interests in Other Entities" ("IFRS 12") effective for annual periods beginning on or after January 1, 2013. IFRS 12 requires extensive disclosures relating to a company's interests in subsidiaries, joint arrangements, associates, and unconsolidated structured entities. IFRS 12 enables users of the financial statements to evaluate the nature and risks associated with its interests in other entities and the effects of those interests on its financial position and performance. As this standard relates to disclosure, there will be no changes to the statements of income and financial position upon adoption of the new standard. Chorus continues to evaluate additional disclosures required.

##### *IFRS 13, Fair Value measurement*

The IASB issued IFRS 13, "Fair Value Measurement" ("IFRS 13") effective for annual periods beginning on or after January 1, 2013. IFRS 13 defines fair value, provides guidance in a single framework for measuring fair value and identifies the required disclosures pertaining to fair value measurement. Chorus does not anticipate any material changes to the statements of income and financial position upon adoption of the new standard.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**3 Significant accounting policies (continued)**

*Amendments to standards*

IAS 19, *Employee Benefits*, has been amended effective for annual periods beginning on or after January 1, 2013. The revised standard requires immediate recognition of actuarial gains and losses in other comprehensive income, eliminating the previous options that were available. A number of other amendments have been made to recognition, measurement and classification. Chorus' current accounting policy for recognition of actuarial gains and losses through other comprehensive income is consistent with the revisions contained in the standard. Chorus has analyzed the impacts of the revisions to IAS 19 and expects that in 2012, upon retrospective application, restated net income will be lower than originally reported under the current standard. The decrease is expected to arise due to the projected rate of return on plan assets being higher than the discount rate, and will result in the statement of income receiving an additional pre-tax charge of \$1,206 with an offsetting pre-tax reduction to the statement of comprehensive income. Chorus does not anticipate the revised standard will impact the balances of employee benefits in the statement of financial position.

IAS 1, *Presentation of Financial Statements*, has been amended to require entities to separate items presented in OCI into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately. The amendment is effective for annual periods beginning on or after July 1, 2012 with earlier application permitted. Chorus is already in compliance with the revisions to the standard.

**4 Cash and cash equivalents**

	As at December 31,	
	2012	2011
	\$	\$
Cash <sup>(1)</sup>	83,338	48,116
Term deposits and fixed income securities	34,968	59,952
<b>Cash and cash equivalents</b>	<b>118,306</b>	<b>108,068</b>

(1) Cash encumbered in support of issued letters of credit has been classified as restricted cash and shown separately in the consolidated statement of financial position (2012 - \$6,017; 2011 - \$10,639)

The weighted average interest rate on investments as at December 31, 2012 is 1.09% (2011 - 1.04%).

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**5 Accounts receivable - trade and other**

	<b>As at December 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Trade receivables	3,388	9,909
Allowance for doubtful accounts	—	(21)
Commodity taxes	3,553	11,808
Other receivables (note 8)	13,513	8,865
	<b>20,454</b>	<b>30,561</b>
Trade amounts due from Air Canada and its subsidiary (see note 25 - Economic Dependence)	58,495	63,222
	<b>78,949</b>	<b>93,783</b>

**6 Spare parts, materials and supplies**

	<b>As at December 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Spare parts	30,091	29,076
Materials and supplies	2,784	2,784
Fuel and glycol inventory	5,274	5,214
	<b>38,149</b>	<b>37,074</b>

For the year ended December 31, 2012, the cost of inventories recognized as expense was \$32,245 (2011 - \$32,479). For the year ended December 31, 2012 inventory writedowns to net realizable value of \$1,752 were recognized as an expense (2011 - \$1,165).

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**7 Prepaid expenses and deposits**

	<b>As at December 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Airport and navigation fees	11,557	13,355
Fuel	8,972	8,233
Aircraft rent and other	2,066	14,288
Other	3,347	3,170
	<b>25,942</b>	<b>39,046</b>

**8 Assets held for sale**

During 2012, Chorus completed a sale of Q400 spare parts to a third party for non-cash proceeds of \$13,237. These parts had previously been recorded as assets held for sale. The proceeds were received in the form of a credit note to be drawn down monthly against expenses with the same third party. The credit note has been classified into its current and long-term receivable portions and is expected to be fully realized by 2015. As at December 31, 2012 this non-cash transaction has been excluded from the statement of cash flows.

**9 Property and equipment**

	<b>Year ended December 31, 2011</b>				<b>Year ended December 31, 2012</b>				
	Opening net book value \$	Additions <sup>(1)</sup> \$	Disposals/ deposits applied \$	Depreciation for the period \$	Closing / opening net book value \$	Additions \$	Disposals/ deposits applied \$	Depreciation for the period \$	Closing net book value \$
Flight equipment	132,712	225,161	—	(19,904)	337,969	123,777	—	(32,799)	428,947
Major maintenance overhauls	11,531	16,233	—	(13,219)	14,545	11,267	—	(13,229)	12,583
Facilities	12,306	—	—	(630)	11,676	6,270	—	(683)	17,263
Equipment	12,537	3,358	—	(5,676)	10,219	4,181	—	(5,442)	8,958
Leaseholds	13,811	297	—	(1,897)	12,211	322	—	(1,795)	10,738
Flight equipment under finance leases	13,656	—	(58)	(2,813)	10,785	—	—	(2,797)	7,988
Deposits on aircraft/ engines	26,067	7,695	(22,127)	—	11,635	13,634	(11,874)	—	13,395
<b>Total</b>	<b>222,620</b>	<b>252,744</b>	<b>(22,185)</b>	<b>(44,139)</b>	<b>409,040</b>	<b>159,451</b>	<b>(11,874)</b>	<b>(56,745)</b>	<b>499,872</b>

(1) The purchase of the tenth Q400 aircraft represented a non-cash transaction, and as such, it was excluded from the statement of cash flows as at December 31, 2011.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**9 Property and equipment (continued)**

	<u>At December 31, 2011</u>			<u>At December 31, 2012</u>		
	Cost \$	Accumulated depreciation \$	Net book value \$	Cost \$	Accumulated depreciation \$	Net book value \$
Flight equipment	421,383	(83,414)	337,969	537,041	(108,094)	428,947
Major maintenance overhauls	28,847	(14,302)	14,545	29,261	(16,678)	12,583
Facilities	16,108	(4,432)	11,676	22,378	(5,115)	17,263
Equipment	41,929	(31,710)	10,219	46,110	(37,152)	8,958
Leaseholds	26,525	(14,314)	12,211	26,847	(16,109)	10,738
Flight equipment under finance leases	22,951	(12,166)	10,785	22,951	(14,963)	7,988
Deposits on aircraft/engines	11,635	—	11,635	13,395	—	13,395
<b>Total</b>	<b>569,378</b>	<b>(160,338)</b>	<b>409,040</b>	<b>697,983</b>	<b>(198,111)</b>	<b>499,872</b>

Depreciation expense related to property and equipment of \$56,745 was recorded for the year ended December 31, 2012 (2011 - \$44,139).

**10 Goodwill**

Goodwill, representing less than one percent of Chorus' total assets, is allocated to the Jazz CGU. The recoverable amount of the Jazz CGU was determined using fair value less costs to sell. No impairment of goodwill was recognized during 2012 or 2011.

**11 Long-term investment**

On April 30, 2010, Chorus purchased a 33% non-voting equity interest in Latin American Regional Aviation Holding Corporation ("LARAH"). LARAH held an indirect 75% equity interest in Pluna Líneas Aéreas Uruguayas S.A. ("Pluna"). The remaining 25% equity interest in Pluna was held, indirectly, by the Government of Uruguay. In the second quarter of 2012 it was announced that Pluna was in financial difficulty and that the Uruguayan government had taken control of the airline and ceased its operations. All of the shares in Pluna held indirectly by LARAH, including the portion indirectly owned by Chorus, were transferred to the Government of Uruguay. As a result, in the second quarter of 2012 Chorus recorded a write-down of \$16,351 to the fair value of the investment through other comprehensive loss.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**12 Income taxes**

The effective rate on the Company's earnings before income tax differs from the expected amount that would arise using the combined Canadian Federal and Provincial statutory income tax rates. A reconciliation of the difference is as follows:

	Year ended December 31,			
	2012 %	2012 \$	2011 %	2011 \$
Income tax expense at the Canadian statutory tax rate	27.3	32,674	28.3	25,167
Recognition of previously unrecognized cumulative eligible capital related to:				
- current period	(9.2)	(11,026)	(7.5)	(6,679)
- prior period	(5.4)	(6,404)	—	—
Net impact of capital items	(1.2)	(1,515)	0.5	403
Non-deductible expenses	2.0	2,376	3.1	2,748
Impact of tax rate changes and tax rate differential <sup>(1)</sup>	2.0	2,414	(1.0)	(850)
Income tax expense	15.5	18,519	23.4	20,789

(1) In 2012, as a result of the Reorganization, a deferred tax expense of \$2,333 has been recorded due to the tax rate differential upon movement of the non-capital loss carryforwards from Amalco to Chorus.

The Canadian statutory tax rate has decreased by approximately 1% over the prior year. The decrease is a result of a 1.5% previously enacted Federal income tax rate reduction offset with a change in the mix of inter-provincial flying and the physical location of property and equipment.

**Deferred tax**

Components of the net deferred income tax asset are as follows:

	December 31, 2011 \$	Recognized in Net Income \$	Recognized in OCI \$	Charged Directly to Equity \$	December 31, 2012 \$
Deferred income tax liability					
- Deferred Partnership income	(14,542)	(1,998)	—	—	(16,540)
- Convertible debentures	(820)	243	—	—	(577)
- Property and equipment	(4,115)	(22,286)	—	—	(26,401)
Deferred income tax asset					
- Loss carryforwards	10,319	11,523	—	—	21,842
- Deferred lease inducement	10,605	(1,653)	—	—	8,952
- Pension and other future employee benefits	8,987	(3,899)	8,696	—	13,784
- Other long-term liabilities	975	64	—	—	1,039
Net deferred income tax	11,409	(18,006)	8,696	—	2,099

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**12 Income taxes (continued)**

In addition to the tax deductible amounts recognized as deferred tax assets in the financial statements, Chorus has other tax deductible amounts of approximately \$547,543, as at December 31, 2012, related to cumulative eligible capital. In accordance with the initial recognition exemption, as outlined in IAS 12, the benefit of these deductible expenditures cannot be recognized in the financial statements until such time that those benefits can be applied to reduce current tax expense. During the years ended December 31, 2012 and December 31, 2011, Chorus utilized a total of \$63,841 (\$17,430 tax effected) and \$27,211 (\$6,679 tax effected), respectively, of these previously unrecognized tax deductions to reduce its taxable income. The benefit of the 2011 cumulative eligible capital deductions of \$23,793 (\$6,404 tax effected) that were previously restricted under the initial recognition exemption as well as the 2012 cumulative eligible capital deductions of \$40,048 (\$11,026 tax effected) were recognized as a reduction to the 2012 current tax expense.

As at December 31, 2012, Chorus had \$9,594 (December 31, 2011 - \$1,423) of allowable capital losses that have not been recognized as a deferred tax asset, as Chorus has no current plan in place to utilize these losses.

The estimated recovery periods for the deferred tax balances are as follows:

	December 31,	
	2012	2011
	\$	\$
Deferred tax assets		
- Deferred tax assets to be recovered within 12 months	16,360	6,759
- Deferred tax assets to be recovered after more than 12 months	29,259	24,127
Deferred tax liabilities		
- Deferred tax assets to be recovered within 12 months	(7,801)	(14,770)
- Deferred tax assets to be recovered after more than 12 months	(35,719)	(4,707)
	2,099	11,409

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**13 Other assets**

	As at December 31,	
	2012	2011
	\$	\$
Prepaid aircraft rent and related fees, net of accumulated amortization	24,089	25,006
Accrued pension benefit asset (SERP) (note 28)	7,509	2,624
Other long-term receivables (note 8)	3,679	—
Asset backed commercial paper (note 29)	1,003	740
	36,280	28,370

**14 Accounts payable and accrued liabilities**

	As at December 31,	
	2012	2011
	\$	\$
Trade payables and accrued liabilities	114,427	136,387
Commodity taxes	14,690	13,640
Current portion of deferred lease inducements	3,319	3,240
Debenture interest payable	—	3,810
	132,436	157,077
Trade payables and accrued liabilities due to Air Canada and its subsidiary (see note 25 - Economic Dependence)	73,152	76,410
	205,588	233,487

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**15 Obligations under finance leases**

Chorus has entered into finance leases related to aircraft. The obligations are as follows:

	2012 \$	2011 \$
No later than one year	3,546	3,625
Later than one year and no later than five years	6,541	10,311
Total minimum lease payments	10,087	13,936
Less: Amount representing interest (at rates ranging from 8.755% to 9.450%)	1,198	2,159
Present value of net minimum finance lease payments	8,889	11,777
Less: Current portion	2,875	2,691
Obligations under finance leases	6,014	9,086

The present value of net minimum finance lease payments is as follows:

	2012 \$	2011 \$
No later than one year	2,875	2,691
Later than one year and no later than five years	6,014	9,086
	8,889	11,777

A significant portion of the minimum lease payments for aircraft are payable in US dollars and have been converted to Canadian currency at \$0.9949, which was the exchange rate in effect at the end of day closing on December 31, 2012 (2011 - \$1.017). Interest of \$907 (2011 - \$1,130) relating to finance lease obligations has been included in aircraft rent. The majority of these lease agreements are renewable at the end of the lease period, at market rates.

**16 Promissory note payable**

As at December 31, 2011, Chorus had issued, to a third party, a 48 day, non-interest bearing promissory note to finance the bridge period between the purchase of the tenth Q400 aircraft on December 16, 2011 and the draw under the EDC long-term financing on February 2, 2012. The promissory note, with a principal amount of \$23,002 was secured by a first priority interest in the tenth Q400 aircraft.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 17 Unearned revenue

Chorus recorded unearned revenue in 2011 related to its Flight Services Agreement with Thomas Cook. As this agreement was terminated in April 2012, Chorus has not recorded any unearned revenue at December 31, 2012. At December 31, 2011 Chorus had recorded \$21,495 in unearned revenue which represented a prepayment for services occurring prior to April 2012. This revenue was recognized as services were rendered over the contract period.

### 18 Long-term debt

Long-term debt consists of the following:

	As at December 31, 2012	2011
	\$	\$
Term loans - purchased aircraft <sup>(1)</sup>	267,339	173,158
Term loans - purchased engines <sup>(2)</sup>	3,807	—
Term loan - Halifax facility <sup>(3)</sup>	6,300	—
	277,446	173,158
Less: Current portion	20,281	11,853
	257,165	161,305

- (1) 15 individual term loans, repayable in semi-annual instalments, ranging from \$826 to \$1,010, bearing fixed interest at a weighted average rate of 3.447%, maturing between May 2023 and June 2024, each secured by one Q400 aircraft and two PW150A engines. At December 31, 2012, the total Q400 aircraft financing payable in US dollars was US\$268,710 (December 31, 2011 - US\$170,264), and the net book value of property and equipment pledged as collateral under Q400 aircraft financing was \$308,953 (December 31, 2011 - \$189,940).
- (2) Two individual term loans, repayable in quarterly instalments of \$52, including fixed interest at a rate of 4.591%, maturing December 2024, each secured by one PW150A engine. At December 31, 2012, the total Q400 engine financing payable in US dollars was US\$3,853 (December 31, 2011 - \$nil) and the net book value of property and equipment pledged as collateral under Q400 engine financing was \$5,338 (December 31, 2011 - \$nil).
- (3) Nova Scotia Jobs Fund loan, with a maximum contribution of \$12,000, bearing interest at a fixed rate of 3.33% annually. Principal repayments of \$1,000 are payable annually commencing on August 31, 2016. Maturing on August 31, 2027, the loan may be repaid in full or in part at any time without bonus or penalty and is secured by a first security interest in the land and office building located at 3 Spectacle Lake Drive, Dartmouth, Nova Scotia and the assignment of the building tenant leases. As of December 31, 2012, the amount drawn on the loan was \$6,300 (December 31, 2011 - \$nil). The provincial financial assistance will also consist of an additional \$2,500 forgivable loan (which will be forgiven if certain employment targets are achieved) and a \$2,000 employee grant to recruit, train and develop new employees or to upgrade current employees' skills.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**18 Long-term debt (continued)**

The following future repayments of long-term debt are payable in US dollars and have been converted to Canadian currency at \$0.9949, which was the exchange rate in effect at the end of day closing December 31, 2012.

	\$
No later than one year	20,281
Later than one year and no later than five years	90,452
Later than five years	166,713
	<u>277,446</u>

Under its financing agreement with EDC (for both aircraft and engines), the “Jazz Group” (currently comprised of Jazz and LeaseCo III) is required to maintain a maximum adjusted leverage ratio of 2.25:1 and a minimum adjusted interest coverage ratio of 1.66:1. As at December 31, 2012, the Jazz Group was in compliance with these covenants. Failure by the Jazz Group to satisfy either such ratio at an applicable time would constitute an event of default under the financing agreement, which could have a material adverse effect on Chorus.

The financing agreement with EDC also contains several covenants which are specific to Jazz as the lessee of the Q400 aircraft and engines including:

- a tangible asset disposal covenant, and;
- a continuation of business under the CPA covenant.

As at December 31, 2012, Jazz was in compliance with both of these continuous covenants.

As additional security under the financing agreements, the aircraft and engine leases between Jazz and LeaseCo III have been assigned to EDC. Also, Chorus Aviation Inc. has provided a limited recourse guarantee to EDC and pledged the issued shares of LeaseCo III to EDC as security for such guarantee.

**19 Convertible debentures**

In November of 2009, Chorus entered into an agreement to sell to a group of underwriters \$86,250 principal amount of 9.50% convertible unsecured subordinated debentures (the “Debentures”). The net proceeds received by Chorus from the sale of Debentures were \$82,265 after deduction of the underwriters' fee and the expenses of the offering.

The Debentures bear interest at a rate of 9.50% per annum, payable semi-annually in arrears on June 30 and December 31 in each year commencing on June 30, 2010, and will mature on December 31, 2014 (the “Maturity Date”). The Debentures are convertible at the holder's option into shares of Chorus at any time prior to 5:00 pm (EST), on the earlier of the Maturity Date and the date fixed for redemption at a conversion price of \$5.25 per unit (the “Conversion Price”). The Debentures are not redeemable on or before December 31, 2012, except on a change of control of Chorus or default under the terms of the Debentures. After December 31, 2012 and prior to December 31, 2013, the Debentures may be redeemed in whole or in part from time to time at Chorus' option at a price equal to their principal amount plus accrued interest, provided that the volume weighted average trading price for the shares is not less than 125% of the Conversion Price. On and after December 31, 2013 and prior to the Maturity Date, the Debentures may be redeemed in whole or in part from time to time at Chorus' option at a price equal to their principal amount plus accrued interest. Subject to regulatory approval, Chorus may satisfy its obligation to repay the principal amount of the Debentures on redemption or at maturity, in whole or in part, by delivering that number of shares equal to the amount due divided by 95% of the market price for the shares at that time, plus accrued interest in cash. Upon issuance, the Debentures were separated into liability and conversion components for accounting purposes.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**19 Convertible debentures (continued)**

The following table allocates the Debentures between debt and equity:

	Cost of borrowing %	Debt \$	Equity \$	Total \$
<b>As at December 31, 2010</b>	9.5	73,541	9,497	83,038
Accretion expense		1,567	—	1,567
<b>As at December 31, 2011</b>		75,108	9,497	84,605
Accretion expense		1,661	—	1,661
<b>As at December 31, 2012</b>		76,769	9,497	86,266

Transaction costs are capitalized and offset with the debt and equity portions of the debentures and amortized over the life of the debentures using the effective interest rate.

For the year ended December 31, 2012, the total interest expense on the convertible debentures was \$9,281 (2011 - \$9,187) which included interest accretion of \$1,661 (2011 - \$1,567).

**20 Other long-term liabilities**

	As at December 31,	
	2012 \$	2011 \$
Accrued pension benefit liability ("RPP") (note 28)	42,632	20,737
Accrued other future employee benefits liability (note 28)	16,398	15,454
Deferred operating lease inducements, non-current portion	32,319	36,481
Other	1,036	984
	92,385	73,656

**21 Dividends**

Since January 1, 2011, Chorus has declared a \$0.15 quarterly dividend to shareholders of record on the last trading day of each quarter. Chorus declared \$74,408 in dividends during the year ended December 31, 2012 (2011- \$74,408). Cash dividends paid during the year ended December 31, 2012, were \$74,408 (2011-\$55,806 ).

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**22 Capital stock**

a) Capital stock

Authorized:

An unlimited number of Class A Variable Voting Shares, no par value; and  
An unlimited number of Class B Voting Shares, no par value

Issued and outstanding:

	Number of Shares	\$
Shares issued and outstanding December 31, 2010	124,015,471	—
Shares held in trust for the stock-based compensation plan December 31, 2010	(688,744)	—
Shares reported in equity December 31, 2010	123,326,727	—
Shares released from the stock-based compensation plan <sup>(1)</sup>	213,828	1,572
Shares reported in equity December 31, 2011	123,540,555	1,572
Shares released from the stock-based compensation plan <sup>(1)</sup>	474,916	2,056
Shares issued and outstanding December 31, 2012	124,015,471	3,628

1) As Shares from the stock-based compensation plan vested, they were released from the trust into capital at the weighted average cost on date of grant.

	2012	2011
Total issued and outstanding common shares		
Class A Variable Voting	15,472,846	13,173,264
Class B Voting	108,542,625	110,842,207
	124,015,471	124,015,471
Class B shares held in trust	—	(474,916)
Shares reported in equity	124,015,471	123,540,555

The common shares issuable by Chorus consist of an unlimited number of Variable Voting Shares and an unlimited number of Voting Shares. The two classes of common shares have equivalent rights as common shareholders except for voting rights. Holders of Variable Voting Shares are entitled to one vote per share unless (i) the number of Variable Voting Shares outstanding, as a percentage of the total number of voting shares of Chorus exceeds 25% or, (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Variable Voting Share will decrease proportionately such that, (i) the Variable Voting Shares as a class do not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares of Chorus, and (ii) the total number of votes cast by or on behalf of holders of Variable Voting Shares at any meeting do not exceed 25% of the votes that may be cast at such meeting.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**22 Capital stock (continued)**

Variable Voting Shares are to be held, beneficially owned or controlled, directly or indirectly, by persons who are not Canadians within the meaning of the Canada Transportation Act. An issued and outstanding Variable Voting Share shall be converted into one Voting Share automatically and without any further act of Chorus or the holder, if such Variable Voting Share becomes held, beneficially owned and controlled, directly or indirectly, otherwise than by way of security only, by a Canadian, as defined in the Canada Transportation Act.

Voting Shares are to be held, beneficially owned and controlled, directly or indirectly, by Canadians. An issued and outstanding Voting Share shall be converted into one Variable Voting Share automatically and without any further act of Chorus or the holder, if such Voting Share becomes held, beneficially owned or controlled, directly or indirectly, otherwise than by way of security only, by a person who is not a Canadian.

b) Earnings per share

The following table provides a breakdown of the numerator and denominator used in the calculation of earnings per share and diluted earnings per share.

	2012	2011
	\$	\$
<b>Numerator</b>		
Income	101,107	68,135
Interest expense on convertible debentures, net of tax	7,193	7,137
Diluted income	108,300	75,272
<b>Denominator</b>		
Weighted average number of shares	123,946,699	123,513,092
Weighted average convertible debenture dilutive shares	15,278,095	15,278,096
Weighted average number of diluted shares	139,224,794	138,791,188

In 2011 and 2012, the Jazz LTIP shares held in trust were anti-dilutive and excluded from diluted earnings per share.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**22 Capital stock (continued)**

c) Stock-based compensation

The details of shares held in trust under stock-based compensation plans discussed in note 3 are as follows:

	December 31, 2012 Jazz LTIP	December 31, 2011 Jazz LTIP
Number of shares granted	995,892	995,892
Number of shares forfeited	(184,322)	(184,322)
	811,570	811,570
Number of shares vested	(811,570)	(336,654)
Number of shares outstanding, end of year	—	474,916
Weighted average remaining life (years)	—	0.08
Cost of shares purchased during the year <sup>(1)</sup>	\$nil	\$nil
Weighted average fair value per share on date of grant	\$nil	\$4.33

(1) Commencing with the 2010 grant, shares were granted notionally, rather than purchased on the open market at time of grant.

During the year ended 2012, Chorus notionally granted 667,703 shares under the Chorus LTIP (2011 - 498,962 shares were notionally granted under the Jazz LTIP).

Total compensation expense related to stock-based compensation during 2012 was \$2,454 (2011 - \$2,206).

**23 Statement of cash flows - supplementary information**

Net changes in non-cash working capital balances related to operations:

	2012 \$	2011 \$
Decrease (increase) in accounts receivable – trade and other	22,283	(6,752)
Increase in spare parts, materials and supplies	(1,075)	(3,230)
Decrease (increase) in prepaid expenses	13,104	(13,128)
Increase in other assets	(6,210)	(1,124)
(Decrease) increase in accounts payable and accrued liabilities	(28,358)	31,275
(Decrease) increase in unearned revenue	(21,495)	15,997
Decrease in other long-term liabilities	(12,476)	(9,336)
	(34,227)	13,702

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**24 Related parties**

**Compensation of key management**

Key management includes Chorus' Directors, President and Chief Executive Officer, Chief Operating Officer, Chief Financial Officer and Chief Administrative Officer. Compensation awarded to key management is summarized as follows:

	Year ended December 31,	
	2012	2011
	\$	\$
Salaries and other benefits	3,309	3,461
Other post-employment benefits	2,299	1,149
Stock-based compensation	1,449	1,658
	7,057	6,268

**25 Economic dependence**

The transactions between Air Canada and its subsidiary (Air Canada Capital Ltd.) and Chorus are summarized in the table below:

	Year ended December 31,	
	2012	2011
	\$	\$
<b>Operating revenue</b>		
Air Canada	1,646,402	1,575,394
<b>Operating expenses</b>		
Air Canada	79,617	87,662
Air Canada Capital Ltd.	78,094	77,469

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**25 Economic dependence (continued)**

The following balances with Air Canada and its subsidiary (Air Canada Capital Ltd.) are included in the financial statements:

	<b>December 31,</b>	
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
<b>Accounts receivable</b>		
Air Canada	58,495	63,222
<b>Accounts payable and accrued liabilities</b>		
Air Canada	65,816	68,915
Air Canada Capital Ltd.	7,336	7,495

**Capacity Purchase Agreement**

Chorus is party to the CPA with Air Canada, under which Air Canada purchases the capacity of certain specified aircraft operated by Chorus under the tradename of "Air Canada Express", formerly "Air Canada Jazz" on routes specified by Air Canada. Under this agreement, Chorus is required to provide Air Canada with the capacity of the specified aircraft, all crews and applicable personnel, aircraft maintenance, and airport operations for such flights. Air Canada determines routes and controls scheduling, sets ticket prices, determines seat inventories, and performs marketing and advertising for these flights. Air Canada retains all revenue derived from the sale of seats to passengers and cargo services and pays Chorus for the capacity provided.

Chorus is paid fees, on a monthly basis, for the capacity provided. These fees consist of a number of variable components based on certain different metrics, including block hours flown, flight hours, cycles (number of take-offs and landings), number of passengers and number of aircraft covered by the CPA. The Rates for these metrics are fixed for annual periods and vary by aircraft type with current Rates in effect until December 31, 2011. In addition, Air Canada is required to reimburse Chorus for certain pass-through costs, including fuel, de-icing, navigation, landing and terminal fees, station provisioning costs, station termination costs, passenger liability insurance and certain employee relocation costs. As these costs are required to operate the aircraft provided under the CPA, the reimbursement of these costs are included in revenue.

The fees which are related to controllable costs are paid on the first day of each month based on estimates for that month. Such estimates are reconciled at the end of the month for actual amounts and true-up payments are made no later than the 30<sup>th</sup> day of the following month. Pass-through costs are reimbursed by Air Canada 30 days following the month in which they were incurred.

Chorus also has the ability to earn certain performance incentive payments on a quarterly basis related to on-time performance, controllable flight completion, baggage handling performance and other customer satisfaction criteria. Rates negotiated under the CPA were initially established to provide a mark-up of 16.72% on Chorus' controllable costs.

**Amendments to the CPA**

On September 22, 2009, Chorus and Air Canada executed the CPA Amending Agreement to document certain amendments to the CPA, including those amendments described below.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 25 Economic dependence (continued)

The CPA Amending Agreement extends the initial term of the CPA from December 31, 2015 to December 31, 2020 and provides greater certainty regarding the number of annual Block Hours to be scheduled for flying by Chorus. Block Hours are calculated by adding the number of minutes elapsing from the time the chocks are removed from the wheels of an aircraft until the chocks are next again returned to the wheels of the aircraft, divided by 60 ("Block Hours"). Under the CPA Amending Agreement, Air Canada agreed to use reasonable commercial efforts to provide a minimum of 375,000 total annual Block Hours to Chorus, as measured by the sum of the twelve monthly schedules delivered by Air Canada to Chorus for a calendar year (the "Annual Delivered Block Hours"). In addition, Air Canada and Chorus agreed that the minimum average daily utilization per aircraft, measured in Block Hours, will not result in less than 339,000 annual Block Hours (the minimum average daily utilization guarantee or "MADUG"), notwithstanding the temporary reduction in the number of Covered Aircraft to 123 aircraft and the subsequent permanent reduction in the number of Covered Aircraft to 125, subject to Air Canada's one-time right to revise the MADUG in the circumstances described below.

In addition to establishing the annual minimum number of Block Hours on which the MADUG is based, the CPA Amending Agreement provides Air Canada with the right to revise the MADUG effective in January 2016 in the event Air Canada's domestic market share for the twelve month period from October 1, 2014 to September 30, 2015 has decreased by a fixed percentage compared to its domestic market share for the twelve month period from August 1, 2008 to July 31, 2009. In the event of such a decrease, the CPA Amending Agreement requires that Air Canada and Chorus agree to a revised MADUG by November 17, 2015, failing which Air Canada shall have the right to unilaterally set a revised MADUG by sending Chorus notice by November 20, 2015. The CPA Amending Agreement provides Chorus with the right to send Air Canada notice by December 18, 2015 of its intention to either accept the revised MADUG or exercise its right to terminate the CPA as of December 31, 2016.

The CPA Amending Agreement also amended the Rates established for the rate period commencing January 1, 2009 and ending on December 31, 2011 (the "2009-2011 Rate Period"). The Rates previously negotiated provided a mark-up of 16.72% on Chorus' Controllable Costs. Pursuant to the terms of the CPA Amending Agreement, Air Canada and Chorus agreed that the Controllable Mark-Up of 16.72% would only apply as of and from January 1, 2009 through to July 31, 2009. Effective August 1, 2009, an agreed set of revised Rates became effective, under which Chorus applies a Controllable Mark-Up of 12.50% on Chorus' Controllable Costs.

Following the expiration of the 2009-2011 Rate Period, the CPA Amending Agreement established the following three remaining rate periods during the initial term of the CPA: (i) January 1, 2012 to December 31, 2014; (ii) January 1, 2015 to December 31, 2017 and; (iii) January 1, 2018 to December 31, 2020. Prior to the commencement of each rate period Chorus and Air Canada shall determine the rates to be charged by Chorus during each period (applying a rate reset process set out in the CPA). The CPA provides that Air Canada and Chorus will review and agree in writing on the rates for the next rate period. The components of each rate to be considered in this process are set out in the schedules to the CPA and are based on costs forecasted by Chorus. If Chorus and Air Canada cannot agree on new rates, the matter is subject to the arbitration provisions in the CPA.

The CPA Amending Agreement also provides for adjustments to the Controllable Mark-Up in certain circumstances. Commencing January 1, 2010, if the Annual Delivered Block Hours are less than 375,000 Block Hours, the Controllable Mark-Up will be increased, to a maximum of 16.72%, to compensate Chorus for increased unit costs and margin lost due to the reduction in flying. If, on the other hand, the Annual Delivered Block Hours are greater than 375,000 Block Hours, then the Controllable Mark-Up of 12.50% will only apply to Chorus' fixed controllable charges and the Controllable Mark-Up of 12.50% shall be reduced to 5% on Chorus' variable controllable charges for Block Hours in excess of 375,000.

The CPA Amending Agreement provides for changes to the long range fleet plan, reflecting the agreement of Air Canada and Chorus to renew the fleet of Covered Aircraft. Air Canada and Chorus agreed that the fleet of Covered Aircraft shall be reduced from 133 aircraft to 125 aircraft (the "Guaranteed Minimum Number of Covered Aircraft"). The reduction in Covered Aircraft to the Guaranteed Minimum Number of Covered Aircraft was completed in April 2010.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 25 Economic dependence (continued)

The initial Q400 aircraft was delivered on May 26, 2011, and entered into service on June 7, 2011. Effective July 1, 2011, following the entry of the second Q400 aircraft into service, the number of aircraft comprising the Covered Aircraft returned to 125, being the Guaranteed Minimum Number of Covered Aircraft. Upon the delivery of each remaining Q400 aircraft, one CRJ will be removed from the fleet of Covered Aircraft, such that the number of aircraft shall remain at the Guaranteed Minimum Number of Covered Aircraft.

On March 8, 2011, Chorus and Air Canada agreed to an amendment to the CPA (the "Second Amending Agreement") to facilitate acquisition and leasing of the Q400 aircraft. Under the Second Amending Agreement, Air Canada agreed that the Q400 aircraft may be acquired by one or more of Chorus' subsidiary leasing companies, which will then lease such aircraft to Jazz Aviation LP, as Covered Aircraft. The parties also agreed to the timing of scheduling of the Q400 aircraft into commercial service, based upon the anticipated delivery date of such aircraft.

On June 29, 2012, Chorus and Air Canada agreed to amend the CPA to support a continued fleet renewal program with the acquisition of the six additional Q400 aircraft and the removal of nine CRJ aircraft (starting in December 2012) from the Chorus fleet. Pursuant to this agreement, the number of Covered Aircraft will be reduced from 125 to 122. Effective February 2013, the annual minimum capacity guarantee of 339,000 Block Hours will be reduced to approximately 331,000 Block Hours to reflect the new number of Covered Aircraft. This agreement does not change the Controllable Mark-Up structure or rates, but establishes certain new metrics. The Compensating Mark-Up will now be applied based on the range between the new annual minimum targeted Block Hours of approximately 367,000 and the revised annual minimum capacity guarantee of approximately 331,000 Block Hours. The difference between the annual minimum capacity guarantee and the annual minimum targeted Block Hours remains at 36,000 Block Hours. This agreement also resolved one of the issues raised in the 2009 Benchmark Arbitration regarding the manner in which the Compensating Mark-Up formula would be applied.

On August 6, 2012, in accordance with the terms of the CPA, Chorus and Air Canada agreed on detailed Rates applicable to the period commencing on January 1, 2012 and ending on December 31, 2014. These new Rates were retroactive to January 1, 2012.

Pursuant to the terms of the CPA Amending Agreement, Air Canada and Chorus also agreed, effective as of August 1, 2009, to treat the rent charged to Chorus for five of the CRJ aircraft as a pass-through cost.

### 2009 Benchmark Process

The CPA provides that Controllable Mark-Up may be reduced as a result of benchmarking Chorus' Controllable Costs to those of a group of comparable operators (the "Comparable Operators") using publicly available information. Under the CPA, this benchmarking was to be effected in 2010 (based on information from Chorus' 2009 calendar year - the "2009 Benchmark") and again in 2016 (using information from Chorus' 2015 calendar year - the "2015 Benchmark"). If the 2009 Benchmark revealed that the percentage difference between Chorus' Unit Costs and the median controllable unit costs, stage length adjusted, of the Comparable Operators had increased compared to the percentage difference of these costs for the twelve-month period beginning July 1, 2006 and ending June 30, 2007, the Controllable Mark-up was to be reduced accordingly with effect as of January 1, 2010 until December 31, 2020 (unless as a result of the 2015 Benchmark it is further reduced) to the lower of 12.50% or the percentage that is equal to 16.72% minus the change in Controllable Mark-up resulting from the 2009 Benchmark. If the 2015 Benchmark indicates that percentage difference between Chorus' Unit Costs and the median controllable unit costs, stage length adjusted, of the Comparable Operators has increased compared to the percentage difference determined during the 2009 Benchmark, the Controllable Mark-Up then in effect shall be reduced based on the results of the 2015 Benchmark, with effect as of January 1, 2016 until December 31, 2020. The comparison of Chorus' Unit Costs to the median controllable unit costs of the Comparable Operators, stage length adjusted, shall be subject to adjustments required to reflect the differences between Chorus and each Comparable Operator for matters such as fleet type and size, aircraft utilization, currency, geographical deployment and growth relative to Chorus. These adjustments are necessary to facilitate a reasonable and fair comparison of unit costs.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 25 Economic dependence (continued)

Chorus and Air Canada were unable to reach an agreement in 2010 on the results of the 2009 Benchmark. On February 3, 2011, Chorus and Air Canada agreed to proceed to binding arbitration in respect of the 2009 Benchmark (the "Arbitration"). On October 3, 2011, Air Canada delivered its claim in the Arbitration (the "AC Claim"). In the AC Claim, Air Canada sought a declaration that the appropriate methodology for comparing Chorus' Unit Costs to the adjusted median controllable unit costs of the Comparable Operators is a "component unit cost driver methodology" or "CUCD". The AC Claim further sought a declaration that the proper application of the CUCD for the purpose of the 2009 Benchmark results in a reduction of the Controllable Mark-Up from 12.50% to 9.54%, effective from January 2010. Air Canada claimed that, if the Controllable Mark-Up was reduced from 12.50% to 9.54%, Chorus would be required to repay Air Canada the amount of \$26,000 in respect of payments made by Air Canada to Chorus in 2010.

At the commencement of the Arbitration hearings in June 2012, Air Canada amended its claim to seek a declaration that the Controllable Mark-Up be reduced to 9.48% rather than 9.54%, and that Chorus be required to repay Air Canada the amount of \$24,400 and \$24,700 in respect of payments made by Air Canada to Chorus in 2010 and 2011, respectively. In its amended Claim, Air Canada sought an order that Chorus be required to pay Air Canada those amounts, or such other amounts as the arbitration panel (the "Panel") may determine, as well as any other amount necessary to account for the adjustment of Controllable Mark-Up for payments made by Air Canada to Chorus in 2012 and on a going-forward basis. Such adjustment for 2012 is estimated to be approximately \$25,000. The AC Claim also alleged that the formula for calculating the Compensating Mark-Up ought to be adjusted to take into account any reduction in the Controllable Mark-Up (the "Compensating Mark-Up Claim").

On November 7, 2011, Chorus delivered its Defence and Counterclaim in the Arbitration (the "Chorus Claim"). In the Chorus Claim, Chorus asserted that the relevant provisions of the CPA provide that the preferred methodology to be applied for comparing Chorus' Unit Costs to the stage length adjusted median controllable unit costs of the Comparable Operators is on a "cost per available seat mile" or "CASM" basis. Chorus further asserted that, if a CASM methodology is applied with the appropriate normalizations and adjustments, no adjustment to the Controllable Mark-Up would be required as a result of the 2009 Benchmark. As a result, Chorus asserted that it was not required to repay Air Canada any amounts in respect of payments made in 2010 or 2011, and that its Controllable Mark-Up will remain at 12.50% going forward until at least the 2015 Benchmark. In the alternative, Chorus asserted that, even if the Panel were to accept that CASM was not an appropriate methodology, the CUCD methodology proposed by Air Canada in the AC Claim is not an "alternate market recognized benchmark" as contemplated by the CPA. In the further alternative, the Chorus Claim asserted that, even if CUCD were to be found to be an "alternate market recognized benchmark", a proper application of the CUCD methodology with the appropriate normalizations and adjustments would not result in the adjustment to the Controllable Mark-Up claimed by Air Canada. Finally, Chorus stated that the CPA does not provide for any adjustment to the Compensating Mark-Up formula resulting from an adjustment to the Controllable Mark-Up as a consequence of the 2009 Benchmark exercise.

During the Arbitration, Chorus and Air Canada resolved the Compensating Mark-Up Claim as part of the June 29, 2012 agreement to further amend the CPA to support a continued fleet renewal program with the acquisition of six additional Q400 aircraft and the removal of nine CRJ aircraft. The Compensating Mark-Up Claim was therefore removed as a dispute to be determined by the Panel.

The hearing of the arbitration occurred in June 2012. Subsequent to the hearing, the parties exchanged written submissions and then reply submissions. On October 2 and 3, 2012, the Panel released its award (the "Award").

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

---

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 25 Economic dependence (continued)

In the Award, two of the three member Panel concluded that the CUCD methodology put forward by Air Canada was the appropriate methodology to use in the 2009 Benchmark to compare Chorus' Unit Costs to the stage length adjusted median controllable unit costs of the Comparable Operators. However, the Panel also agreed with Chorus that a number of the additional adjustments proposed by Chorus were also required to be made (the "Adjustments") but did not provide guidance on the calculation of such Adjustments. The Panel also agreed with Chorus that fleet age impacts the rate at which maintenance costs increase. However, the Panel did not specify a methodology for the Fleet Age Adjustment and directed Air Canada and Chorus to negotiate a further adjustment that would account for the impact of fleet age on the rate at which maintenance costs increase (the "Fleet Age Adjustment") failing which the parties will submit new proposals and analysis to the Panel on that issue.

There remain substantive disputes between the parties with respect to the interpretation and application of the Award and its impact on the Controllable Mark-Up. The parties have been unable to reach agreement on either the calculation of certain of the Adjustments or the Fleet Age Adjustment.

Chorus' position is that, applying the CUCD methodology, along with the proper application of the Adjustments required by the Panel other than the Fleet Age Adjustment, the Controllable Mark-Up should remain at 12.50%.

Air Canada previously asserted to Chorus its view that the impact of the Adjustments required by the Panel would reduce the Controllable Mark-Up to 11.41%. However, this does not account for any impact that the Fleet Age Adjustment would have on the Controllable Mark-Up. Air Canada took the position at the hearing that there should be no such Fleet Age Adjustment.

Air Canada is now taking the position that a Fleet Age Adjustment ought to be made and that such adjustment should be in its favour. The effect of making the Fleet Age Adjustment, in the manner asserted by Air Canada, would be to materially reduce the Controllable Mark-Up below the 11.41% rate that Air Canada asserts should otherwise result from the application of the other Adjustments.

Chorus remains of the view that, given its older fleet relative to those of the relevant comparable operators, and consistent with the position it took at the initial hearing, any Fleet Age Adjustment would only be to the benefit of Chorus and therefore regardless of the decision on the other Adjustments, the Fleet Age Adjustment should result in the Controllable Mark-Up remaining at 12.50% going forward until at least the 2015 Benchmark and that it should not be required to repay Air Canada any amounts in respect of payments made since January 1, 2010.

Following the release of the Award, the parties had scheduled a further hearing with the Panel to occur in the last week of November 2012 to resolve the outstanding issues in dispute, including the impact of the Fleet Age Adjustment. That hearing was subsequently adjourned to the last week of January 2013 and then to the first week of April 2013 in order to provide the parties with additional time to put forward evidence on the issues which remain in dispute.

As a consequence of the issues remaining in dispute, the impact, if any, of the 2009 Benchmark and the Arbitration to the Controllable Mark-Up on Chorus' Controllable Costs cannot be stated at this time with reasonable certainty.

No amounts have been recorded in the accounts of Chorus in 2010, 2011 or 2012 related to this claim as management has determined that it is not probable that the AC claim will be successful, and it is not practicable to determine an estimate of the possible financial effect, if any, with sufficient reliability.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**25 Economic dependence (continued)**

**Margin adjustment**

As a result of the CPA Amending Agreement, the controllable target margin has been reduced from 14.32% to 11.11% effective August 1, 2009. With respect to each calendar year after 2009, during the remaining term of the CPA, if the annual margin for flights provided under the CPA is greater than 11.11%, Chorus will pay Air Canada an amount equal to 50% of the dollar value of the margin exceeding 11.11%. Margin represents the total operating revenue from scheduled flights under the CPA less expenses incurred related to such flights, including employee profit sharing expenses; however, it excludes incentive and pass-through revenue. For the years ended December 31, 2012 and 2011, no margin adjustment was recorded.

**Master Services Agreement**

Under a master services agreement dated September 24, 2004, between Chorus and Air Canada, Air Canada provides certain services to Chorus for a fee. These services include information technology services, french language training, insurance claims services and environmental affairs services.

The master services agreement will continue in effect until the termination or expiration of the CPA, but individual services can be amended or terminated earlier in accordance with the terms of the master services agreement.

**Other**

Air Canada provides certain supplies from third parties, primarily fuel, to Chorus and subsequently collects payment from Chorus. As these transactions and balances merely represent a method of settlement for transactions in the normal course of business, they have not been separately disclosed. Air Canada ground handling services, a division of Air Canada, provides ground handling services.

Substantially all of the trade receivable from Air Canada relates to outstanding balances under the CPA.

The balances in accounts payable and accrued liabilities are payable on normal trade terms and have arisen from the services provided by the applicable party.

**26 Commitments**

Chorus is committed to the following future minimum lease payments under operating leases for flight equipment and base facilities that have initial non-cancellable terms in excess of one year. The majority of these lease agreements are renewable at the end of the lease period, at market rates.

	<b>December 31, 2012</b>	
	<b>Other third parties</b>	<b>Air Canada and its subsidiary</b>
	<b>\$</b>	<b>\$</b>
No later than one year	12,899	80,083
Later than one year and no later than five years	29,085	284,345
Later than five years	17,821	319,049

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

---

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 26 Commitments (continued)

A significant portion of the minimum lease payments for aircraft are payable in US dollars and have been converted to Canadian currency at \$0.9949, which was the exchange rate in effect at the end of day closing on December 31, 2012 (2011 - \$1.017).

Certain of the aircraft lease agreements have been entered into by Air Canada Capital Ltd. or Air Canada with head lessors and subleased to Chorus. Future minimum lease payments that will arise under these leases are listed in the above table under the heading "Air Canada and its subsidiary".

In 2007 and 2010, Chorus entered into common terms agreements ("CTAs") with aircraft lessors which govern three of Chorus' aircraft leases and which will also apply to any future aircraft leases with the same lessors. As at December 31, 2012, Chorus was in compliance with the tangible asset disposal covenants contained in these CTAs.

On June 29, 2012, pursuant to its Q400 aircraft purchase agreement with Bombardier Inc., as represented by Bombardier Aerospace Commercial Aircraft, Chorus exercised six of 15 options to acquire additional Q400 aircraft. The agreement was conditional on Chorus making a pre-delivery lump sum payment of \$13,395, securing financing from a third party lender and reaching an agreement with Air Canada to amend the terms of the CPA to reflect the additional six aircraft. Based on the list price for the Q400 aircraft, these options are valued at approximately US\$189,000. These conditions have been satisfied by Chorus, and the six Q400 aircraft are scheduled to be delivered at a rate of two aircraft per month in each of February, March and April 2013.

During 2012, Chorus also entered into a separate agreement with a third party to purchase 2 additional PW150A engines by the end of 2013 with a list price of US\$6,600.

Chorus has secured financing from EDC of US\$126,100 for the purchase of the six Q400 aircraft and the two PW150A engines. Chorus is obligated to pay EDC a non-refundable commitment fee of 0.2% per annum on the undisbursed portion of the commitment. The availability of any undrawn amount will expire on January 11, 2014. EDC financing will provide for the majority of the purchase price of the Q400 aircraft and the Q400 engines with a term to maturity of 12 years, payable in semi-annual installments and quarterly installments, respectively.

### 27 Post-employment expenses

Chorus has recorded pension and other post-employment future benefit expenses for the year ended December 31, 2012 of \$31,088 (2011 - \$27,695).

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

---

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 28 Pension and other future employee benefits

Chorus maintains several registered defined contribution pension plans for eligible employees and a registered defined benefit plan for Pilots. Chorus is the plan sponsor for these plans under the Pension Benefits Standard Act, 1985 (Canada). In addition, Chorus maintains an unregistered supplemental executive retirement plan which is partially funded for certain employees. Contributions to the supplementary pension plan started in December 2007. The registered and supplementary defined benefit pension plans provide benefits upon retirement, termination or death based on the member's years of service and the final average earnings for a specified period.

Chorus also maintains Other (non-pension) Employee Future Benefits. The Other Employee Future Benefits include medical and dental benefits provided to the employees on long-term disability and Workplace Safety Insurance Board ("WSIB"). These benefits cease to be provided when the employee reaches age 65. The sick leave gratuity benefits represent the payout of sick leave accruals upon or just prior to retirement for eligible employees. The self-insured WSIB benefits are in respect of self-insured benefits provided to Ontario employees.

The total expense for Chorus' defined contribution plans including two pension plans sponsored by an employee group and a union respectively, for which Chorus is obligated to make defined contributions only, for the year ended December 31, 2012 is \$9,117, and for the year ended December 31, 2011 is \$8,700.

During 2012, Chorus made \$36,907 in cash payments to registered pension plans (2011 - \$32,203), comprised of \$27,842 for the Registered Defined Benefit Plan (2011 - \$23,426) and \$9,065 for defined contribution pension plans (2011 - \$8,777). Total cash payments made in 2012 for the Other Employee Future Benefits were \$1,252 (2011 - \$1,418).

The most recent actuarial valuations of the defined pension benefit plans for funding purposes were as of January 1, 2012 and the next funding valuation will be as of January 1, 2013.

The discount rate used to determine pension obligations was determined by reference to the market interest rates on corporate bonds rated "AA", or higher, with cash flows that approximate the timing and amount of the expected benefit payments. An increase to the discount rate of 0.25% results in a decrease to the pension obligation of \$9,300 and a decrease of \$1,200 to the pension expense. A decrease to the discount rate of 0.25% results in an increase to the pension obligation of \$10,000 and an increase of \$1,200 to the pension expense.

Expected return of plan assets are determined based on the facts and circumstances that exist at the measurement date. A 0.25% increase to return on assets decreases pension expense by \$500. A 0.25% decrease to return on assets increases pension expense by \$500.

Expected contributions to the defined benefit pension plans for the year ending December 31, 2013 are \$26,500. Expected contributions to the defined contribution pension plans for the year ending December 31, 2013 are \$9,400.

Information about Chorus' defined benefit plans and other future employee benefits in aggregate, is as follows:

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**28 Pension and other future employee benefits (continued)**

	Pension Benefits		Other Future Employee Benefits	
	2012 \$	2011 \$	2012 \$	2011 \$
<b>Change in benefit obligation</b>				
Benefit obligation, beginning of year	213,489	171,388	15,454	13,230
Current service cost	17,445	16,109	2,232	2,070
Interest cost	12,847	10,884	704	682
Plan participants' contributions	8,150	7,961	—	—
Benefits paid	(5,253)	(1,707)	(1,252)	(1,418)
Actuarial loss (gain)	35,282	8,854	(740)	890
<b>Benefit obligation, end of year</b>	<b>281,960</b>	<b>213,489</b>	<b>16,398</b>	<b>15,454</b>
<b>Change in plan assets</b>				
<b>Fair market value of plan assets, beginning of year</b>	<b>194,670</b>	<b>163,723</b>	<b>—</b>	<b>—</b>
Expected return on plan assets	12,506	11,073	—	—
Employer contribution	34,542	24,906	1,252	1,418
Plan participants' contributions	8,150	7,961	—	—
Benefits paid	(5,253)	(1,707)	(1,252)	(1,418)
Actuarial gain (loss)	1,617	(11,286)	—	—
<b>Fair market value of plan assets, end of year</b>	<b>246,232</b>	<b>194,670</b>	<b>—</b>	<b>—</b>
<b>Funded status, end of year</b>	<b>(35,728)</b>	<b>(18,819)</b>	<b>(16,398)</b>	<b>(15,454)</b>
<b>Accrued contributions</b>	<b>605</b>	<b>706</b>	<b>—</b>	<b>—</b>
<b>Accrued benefit liability</b>	<b>(35,123)</b>	<b>(18,113)</b>	<b>(16,398)</b>	<b>(15,454)</b>

- 1) Includes a \$42,632 liability related to RPP and a \$7,509 asset related to SERP (2011 - \$20,737 for RPP and \$2,624 for SERP). The accrued benefit liability for RPP is included in other long-term liabilities and the accrued benefit asset for SERP is included in other assets.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**28 Pension and other future employee benefits (continued)**

The amounts recognized in the balance sheet for the defined benefit pension plans are determined as follows:

	December 31,	
	2012	2011
	\$	\$
Present value of defined benefit obligation	281,960	213,489
Fair value of plan assets	246,232	194,670
Deficit in the plan	(35,728)	(18,819)
Actuarial loss on plan liabilities	35,282	8,854
Actuarial gain (loss) on plan assets	1,617	(11,286)

Plan assets are comprised as follows:

	December 31,	
	2012	2011
Canadian equity	32%	37%
Debt securities	43%	31%
International equity	20%	26%
Short-term and other	4%	6%
Real Estate	1%	—%
	100%	100%

The plan's assets are invested in Canadian bonds, equities and real estate and foreign equities. The balanced fund was unwound during the year. These assets include no significant investment in Chorus at the measurement date.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**28 Pension and other future employee benefits (continued)**

Weighted average assumptions used to determine the accrued benefit liability:

	Pension		Other Future Employee Benefits	
	2012	2011	2012	2011
Discount rate to determine accrued benefit obligations	4.4%	5.4%	3.7%	4.3%
Discount rate to determine the pension and benefit cost	5.4%	5.7%	4.3%	4.9%
Rate of compensation increase	4.5%	4.8%	5.0%	5.0%
Expected return on plan assets	5.8%	6.2%	n/a	n/a
Health care inflation - Select to determine accrued benefit obligation	n/a	n/a	6.4%	6.1%
Health care inflation - Select to determine pension and benefit cost	n/a	n/a	6.1%	6.9%

The health care inflation assumption was graded down in and after 2030 to 4.5% per annum

The effect of a 1% movement in the assumed health care cost trend rate on other employee future benefits is as follows:

	Increase \$	Decrease \$
Effect on the aggregate of the current service cost and interest cost	85	(75)
Effect on the defined benefit obligation	588	(531)

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**28 Pension and other future employee benefits (continued)**

Chorus' net defined benefit pension plan and other future employee benefits expense recognized in the consolidated statement of income and consolidated statement of comprehensive income is as follows:

	Pension		Other Future Employee Benefits	
	2012 \$	2011 \$	2012 \$	2011 \$
Components of cost under IAS 19				
Amounts recognized in profit or loss:				
Current service cost	17,445	16,109	2,232	2,070
Interest cost	12,847	10,884	704	682
Expected return on plan assets	(12,506)	(11,073)	—	—
Costs arising in the period	17,786	15,920	2,936	2,752
Actuarial loss recognized in the consolidated statement of income	—	—	398	323
	17,786	15,920	3,334	3,075
Actuarial loss (gain)	33,665	20,140	(1,138)	567
Effect of minimum funding requirement	—	(2,071)	—	—
Loss (gain) recognized in the statement of other comprehensive income for the period	33,665	18,069	(1,138)	567
Cumulative actuarial losses and effect of minimum funding requirements recognized in the statement of other comprehensive income	85,817	52,152	1,252	2,390

**29 Financial instruments and fair values**

Chorus' financial instruments consist of cash and cash equivalents, accounts receivable, long-term investment, ABCP, accounts payable and accrued liabilities, promissory note payable, obligations under finance leases, long-term debt and convertible debentures.

**Measurement categories**

As explained in note 3 (i), financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the statement of income or comprehensive income. Those categories are: fair value through profit or loss; fair value through other comprehensive income; and amortized cost. The following table shows the carrying and fair values of assets and liabilities for each of these categories at December 31, 2012, and December 31, 2011.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**29 Financial instruments and fair values (continued)**

	December 31, 2012		December 31, 2011	
	Carrying Amount \$	Fair Value \$	Carrying Amount \$	Fair Value \$
<b>Financial assets</b>				
Financial assets measured at amortized cost				
Cash and cash equivalents	118,306	118,306	108,068	108,068
Restricted cash	6,017	6,017	10,639	10,639
Accounts receivable <sup>(1)</sup>	75,396	75,396	81,975	81,975
Fair value through profit and loss				
Asset backed commercial paper	1,003	1,003	740	740
Fair value through other comprehensive income				
Long-term investment	—	—	16,351	16,351
<b>Financial liabilities</b>				
Other financial liabilities, carried at amortized cost				
Accounts payable and accrued liabilities (includes current portion of obligations under finance leases) <sup>(1)</sup>	193,773	193,773	222,538	222,538
Dividends payable	18,602	18,602	18,602	18,602
Promissory note payable	—	—	23,002	23,002
Long-term debt	277,446	286,656	173,158	179,671
Obligations under finance leases	6,014	6,014	9,086	9,086
Convertible debentures	76,769	79,034	75,108	77,361

(1) Assets and liabilities, such as commodity taxes, that are not contractual and that arise as a result of statutory requirements imposed by governments, do not meet the definition of financial assets or financial liabilities and are therefore excluded.

**Fair value of financial instruments**

The carrying amounts reported in the statement of financial position for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, dividends payable and the promissory note payable approximate fair values based on the immediate or short-term maturities of these financial instruments. The methods and assumptions used in estimating the fair value of other financial assets and liabilities are as follows:

- Asset backed commercial paper

The ABCP classified as level three is a financial security that currently has no active trading market. Valuation is done based on limited available market information, maturity dates and expected return of capital on a discounted basis. During the year ended December 31, 2012, a valuation gain of \$450 (2011 - \$547) was recorded.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 29 Financial instruments and fair values (continued)

- Long-term investment

For 2011 the fair value of the investment in LARAH was estimated by applying probabilities to various discounted cash flow scenarios developed by the Company. Cash flow projections were developed for five years based on historical financial information and projections by management of LARAH, and included reasonably possible alternative assumptions. Key assumptions in the cash flows models included revenue growth based on growth trends achieved during 2011 and operating margins based on historical trends, adjusted for risks and uncertainties in the operating plans for LARAH. Terminal growth rates of 3% were assumed in the scenarios, based on long-term average growth rates for the commuter airline industry and the local markets. The cash flows were discounted using discount rates from 8.9% to 11.3%. The result of the fair value calculation approximated the original cost of the investment; therefore, no fair value adjustment was recorded. The range of reasonably possible alternative fair values as at December 31, 2011 was \$11,549 to \$21,614.

In 2012 all of the shares in Pluna held indirectly by LARAH, including the portion indirectly owned by Chorus, were transferred to the Government of Uruguay. As a result, in 2012 Chorus recorded a write-down of \$16,351 to the fair value of the investment through other comprehensive loss. See note 11 for further detail.

- Long-term debt

At December 31, 2012, the fair value of the fixed rate term loans is \$286,656. These fair values have been calculated by discounting the future cash flow of the respective long-term debt at the estimated yield to maturity of similar debt instruments.

- Finance leases

The repayment terms that Chorus is committed to make have been discounted at the relevant market interest rates applicable at year end. Interest rates used to calculate fair value are based on the change in the risk-free rate at December 31, 2012, compared to the risk-free rates at the inception of the leases.

- Convertible debentures

Chorus' convertible debentures are listed on the Toronto Stock Exchange and their fair value was determined using the closing price on the last trading day of the year.

#### 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 - valuation based on quoted prices observed in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; inputs other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - valuation techniques with significant unobservable market inputs.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**29 Financial instruments and fair values (continued)**

A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The following table presents the financial instruments recorded at fair value in the consolidated balance sheet, classified using the fair value hierarchy described above:

	2012 \$	2011 \$
<b>Level 3</b>		
Asset backed commercial paper	1,003	740
Long-term investment	—	16,351
	1,003	17,091

The following table presents the changes in level 3 instruments by class of asset for the years ended December 31, 2012 and 2011.

	2012 \$	2011 \$
Start of year	17,091	16,801
Payments received	(187)	(257)
Loss recognized in other comprehensive income	(16,351)	—
Gains recognized in profit or loss	450	547
	1,003	17,091

**Financial risk factors**

Chorus, through its financial assets and liabilities, has exposure to the following risks from its use of financial instruments: interest rate risk, credit risk, liquidity risk and currency risk. Senior management monitors risk levels and reviews risk management activities as they determine to be necessary.

*Interest rate risk*

Investments included in Chorus' cash and cash equivalents earn interest at prevailing and fluctuating market rates, as Chorus' objective is to maintain these balances in highly liquid investments. As at December 31, 2012, Chorus' investments consisted of bankers acceptances and bankers deposit notes issued by three schedule 1 banks.

The 17 term loans with EDC bear fixed interest rates. This debt is therefore not subject to interest rate volatility.

A 1% change in the interest rate would not have a significant impact on the net income of Chorus.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**29 Financial instruments and fair values (continued)**

*Credit risk*

Credit risk arises from cash and cash equivalents, restricted cash, deposits, as well as credit exposure to customers, including outstanding receivables. Chorus manages the credit risk on cash and cash equivalents by ensuring that the counter-parties are governments, banks and corporations with high credit-ratings assigned by international credit-rating agencies. In accordance with its investment policy, Chorus invests excess cash in Government of Canada treasury bills, short-term Canadian and provincial government debt, bankers' acceptance notes, term deposits of Schedule 1 Banks and Schedule 2 Banks rated R-1 high, and commercial paper rated R-1 high.

The maximum exposure to credit risk for cash and cash equivalents, restricted cash, deposits and trade and other receivables approximate the amount recorded on the statement of financial position.

With the exception of trade receivables, Chorus has no financial assets past due. As at December 31, 2012, the total amount of trade receivables was \$61,883 (2011 - \$73,110), net of allowance for bad debts, which has been estimated by management based on prior experience and its assessment of the current economic environment and the specific debtor. The amount of this allowance was reduced to \$nil from prior year. At December 31, 2012, trade receivables of \$59,786 (2011 - \$67,845) were not past due or impaired; \$2,097 (2011 - \$5,286) were past due, but not impaired; and \$nil (2011 - \$21) were impaired. The aging of the latter two categories is as follows:

	2012 \$	2011 \$
Past due but not impaired		
60 - 90 days	343	968
Over 90 days	1,754	4,318
	2,097	5,286
Impaired		
60 - 90 days	—	—
Over 90 days	—	21
	—	21

Chorus continues to work with the entities from which it holds past due receivables to recover the full amount outstanding. Approximately \$58,495 (2011 - \$63,222) of the total receivables are with one company, Air Canada. Accordingly, Chorus is directly affected by the financial and operational strength of Air Canada. Chorus does not believe it is subject to any significant concentration of credit risk other than with Air Canada.

*Liquidity risk*

Cash flow forecasting is performed in respect of each operating entity of Chorus and then aggregated. Chorus monitors rolling forecasts of Chorus' liquidity requirements. Such forecasts take into consideration Chorus' operational cash flow requirement, debt financing plans and compliance with internal balance sheet ratio targets.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**29 Financial instruments and fair values (continued)**

Chorus' objective is to maintain sufficient liquidity to meet liabilities when due. Chorus monitors its cash balances and cash flows generated from operations to meet its liquidity requirements. Letters of credit totaling approximately \$6,017 (December 31, 2011 - \$10,639) have been issued as security for groundhandling, charters and airport fee contracts, lease payments on rental space and aircraft, and certain employee benefits.

The tables below analyze Chorus' non-derivative financial liabilities into relevant maturity groupings based on the remaining period from the statement of financial position date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. The analysis is based on foreign exchange in effect at the consolidated statement of financial position date, and contractual interest rates, and includes both principal and interest cashflows for long-term debt, obligations under finance leases and convertible debentures.

	Balance - December 31, 2012			
	Less than 3 months \$	3 months to 1 year \$	2 - 5 years \$	Over 5 years \$
<b>Principal</b>				
Trade payables and accrued liabilities <sup>(1)</sup>	187,579	—	—	—
Finance leases	699	2,176	6,014	—
Long-term debt	3,978	16,303	90,452	166,713
Convertible debentures	—	—	80,210	—
	192,256	18,479	176,676	166,713
<b>Interest</b>				
Finance leases	191	480	527	—
Long-term debt	1,812	7,589	30,242	19,622
Convertible debentures	1,905	5,715	7,620	—
	3,908	13,784	38,389	19,622

	Balance - December 31, 2012			
	Less than 3 months \$	3 months to 1 year \$	2 - 5 years \$	Over 5 years \$
<b>Total principal and interest</b>				
Trade payables and accrued liabilities <sup>(1)</sup>	187,579	—	—	—
Finance leases	890	2,656	6,541	—
Long-term debt	5,790	23,892	120,694	186,335
Convertible debentures	1,905	5,715	87,830	—
	196,164	32,263	215,065	186,335

(1) Excludes commodity taxes and deferred lease inducements as they do not meet the definition of a financial liability. Debenture interest is included in convertible debentures within the table.

Notes to the Consolidated Financial Statements  
For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

**29 Financial instruments and fair values (continued)**

*Currency risk*

Chorus receives revenue and incurs expenses in US and Canadian currency, and as a result, is subject to fluctuations as foreign exchange rates fluctuate. Chorus manages its exposure to currency risk by billing for its services within the CPA in the underlying currency related to the expenditure. Accordingly, the primary exposure results from balance sheet fluctuations of US denominated cash, accounts receivable, accounts payable, and in particular, obligations under finance leases and long-term debt, which are long-term and so are subject to larger unrealized gains or losses. Chorus mitigates this currency risk by maintaining a balance of US dollars which is used to pay down US denominated liabilities and replenishes the balance through US denominated revenues. The amount of US dollar denominated assets was \$48,228 and US denominated liabilities was \$337,258 at December 31, 2012. A 1¢ change in the US exchange rate would result in a change in the unrealized gain or loss of approximately \$2,890.

**30 Capital management**

Chorus' capital consists of cash and cash equivalents, restricted cash, long-term debt, convertible debentures and shareholders' equity (excluding accumulated other comprehensive income).

The total capital as at December 31, 2012 and December 31, 2011 is calculated as follows:

	Year ended December 31,	
	2012	2011
	\$	\$
Cash and cash equivalents	(118,306)	(108,068)
Restricted cash	(6,017)	(10,639)
Long-term debt (including current portion)	277,446	173,158
Convertible debentures (including equity portion)	86,266	84,605
Capital	3,628	1,572
Contributed surplus	1,051,305	1,050,907
Deficit	(932,315)	(918,832)
<b>Total capital</b>	<b>362,007</b>	<b>272,703</b>

Chorus' main objectives when managing capital are:

- to provide a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business;
- to maintain a flexible capital structure that optimizes the cost of capital at acceptable risk and preserves the ability to meet financial obligations;
- to ensure sufficient liquidity to pursue its growth strategy and undertake selective investment; and
- to provide a return on investment to its shareholders.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 30 Capital management (continued)

In managing its capital structure, Chorus monitors performance throughout the year having regard to anticipated cash dividends, working capital requirements, maintenance and growth capital expenditures, available cash on deposit and, where applicable, long-term borrowings. As at December 31, 2012, the Jazz Group had external debt covenants as described in note 18. In managing its capital structure, Chorus monitors performance throughout the year having regard to financial metrics within these covenants. Chorus manages its capital structure and may make adjustments to it, in order to support its broader corporate strategy or in response to changes in economic conditions and risk. In order to maintain or adjust its capital structure, Chorus may adjust the amount of dividends paid to shareholders, purchase shares for cancellation pursuant to normal course issuer bids, issue new shares, or issue new debt.

### 31 Contingencies

The CBCA provides that the Directors will act honestly and in good faith with a view to the best interest of Chorus and in connection with that duty, will exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The CBCA and bylaws of Chorus provide that each Director will be entitled to indemnification from Chorus in respect of the exercise of the Director's power and the discharge of the Director's duties, provided that the Director acted honestly and in good faith with a view to the best interests of all shareholders, or in the case of a criminal or administrative action proceeding that is enforced by a monetary penalty, where the Director had reasonable grounds for believing that his/her conduct was lawful. Chorus has agreed to indemnify its Directors and Officers against certain costs and damages incurred by the Directors and Officers as a result of lawsuits or any other judicial, administrative or investigative proceeding in which the Directors and Officers are sued as a result of their service. The Directors and Officers are covered by directors' and officers' liability insurance. No claims with respect to such occurrences have been made and, as such, no amount has been recorded in these financial statements with respect to these indemnifications.

Chorus and Air Canada were unable to reach an agreement in 2010 on the results of the 2009 Benchmark. On February 2, 2011, Chorus and Air Canada agreed to proceed to binding arbitration in respect of the 2009 Benchmark. For further details, including amounts claimed by Air Canada, see note 25 - Economic Dependence.

In February 2006, Chorus commenced proceedings before the Ontario Superior Court of Justice ("Ontario Court") against the Toronto Port Authority ("TPA"), Porter Airlines Inc. ("Porter") and other defendants (collectively with Porter, the "Porter Defendants") after Chorus became aware that it would be excluded from operating flights from Toronto City Centre (Island) Airport (the "TCCA"). On October 26, 2007, Porter counterclaimed against Chorus and Air Canada alleging various tort claims, including conspiracy, and violations of competition law, including that Chorus and Air Canada's commercial relationship contravenes Canadian competition laws, and claiming \$850,000 in damages. Concurrently with the Ontario Court proceedings, Chorus commenced judicial review proceedings against the TPA before the Federal Court of Canada ("Federal Court") relating to Chorus' access to the TCCA. The Porter Defendants were granted intervener and party status in these proceedings. In January of 2008, in the Federal Court proceedings, Porter filed a defence and counterclaim against Chorus and Air Canada making allegations and seeking damages similar to those in the Ontario Court counterclaim. On October 16, 2009, Chorus discontinued its action in the Ontario Court against the Porter Defendants and the TPA. On the same date, the counterclaim filed by Porter in the Ontario Court against Chorus and Air Canada was stayed pending the outcome of the proceeding in Federal Court. On March 29, 2010, Chorus discontinued its action in the Federal Court against the TPA, in which the Porter Defendants intervened and were made parties. On May 14, 2010 Porter discontinued its counterclaim in the Federal Court. The counterclaim against Chorus and Air Canada brought by Porter in the Ontario Court was reinstated on February 22, 2011. Chorus maintains that Porter's counterclaim is without merit. The counterclaim will be vigorously contested by Chorus in court. If Chorus is not successful in defending the counterclaim, it could be subject to a material damages award. It is not practicable to determine an estimate of the possible financial effect, uncertainties related to the amount or timing of any outflows or the possibility of any reimbursement. Accordingly, no amounts have been recorded in the accounts of Chorus related to this claim.

## Notes to the Consolidated Financial Statements For the years ended December 31, 2012 and 2011

---

(expressed in thousands of Canadian dollars, except shares and earnings per share)

### 31 Contingencies (continued)

Various other lawsuits and claims that have arisen in the normal course of business are pending by and against Chorus. The provisions that have been recorded are not material. It is the opinion of management that final determination of these claims will not have a material adverse effect on the financial position or the results of Chorus.

Chorus enters into various operating agreements and real estate licenses or leases, which in some cases permit Chorus to use certain premises and/or operate at certain airports, and which in other cases lease space in Chorus' facilities to its tenants. It is common in such commercial license or lease transactions for the licensee or tenant to agree to indemnify the landlord for tort liabilities that arise out of or relate to its use or occupancy of the licensed or leased premises. In certain cases, this indemnity extends to related liabilities arising from the negligence of the indemnified parties, but generally excludes any liabilities caused by their gross negligence or willful misconduct. In addition, the licensee or tenant, as the case may be, typically indemnifies the landlord for any environmental liability that arises out of or relates to its use or occupancy of the leased or licensed premises.

In aircraft and engine financing or leasing agreements, Chorus typically indemnifies the financing parties, Directors acting on their behalf and other related parties and/or lessors against liabilities that arise from the manufacture, design, ownership, financing, use, operation and maintenance of the aircraft and engines and for tort liability, whether or not these liabilities arise out of or relate to the negligence of these indemnified parties, but generally excludes any liabilities caused by their gross negligence or willful misconduct. In addition, in aircraft and engine financing or leasing transactions, including those structured as leveraged leases, Chorus typically provides indemnities in respect of certain tax consequences.

When Chorus, as a customer, enters into technical service agreements with service providers, primarily service providers who operate an airline as their main business, Chorus has from time to time agreed to indemnify the service provider against liabilities that arise from third party claims, whether or not these liabilities arise out of or relate to the negligence of the service provider, but generally excluding liabilities that arise from the service provider's gross negligence or willful misconduct.

### 32 Subsequent event

On February 15, 2013, Chorus took delivery of the first of the six additional Q400 aircraft. It will enter into service by March 1, 2013. As described in note 26 - Commitments, Chorus has secured EDC financing for this delivery. The term loan is repayable by Chorus to EDC in semi-annual instalments of US\$973, matures in February 2025 and is secured primarily by one Q400 aircraft and two PW150A engines.