2011/12

ANNUAL REPORTS

BRITISH COLUMBIA FERRY SERVICES INC. & B.C. FERRY AUTHORITY

BRITISH COLUMBIA FERRY SERVICES INC.

B.C. FERRY AUTHORITY

This report contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, fluctuating financial markets, demographics, tax changes, and the requirements of the Coastal Ferry Services Contract.

Forward looking statements included in this document include statements with respect to:

- our short and long-range business plans;
- traffic levels and economic conditions;
- our asset renewal programs for vessels and terminals; and
- the impacts of Bill 47.

In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology.

A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this report are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this report, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances except as may be required by applicable law.

Corporate Profile

BC Ferries is one of the largest ferry operators in the world, providing year-round vehicle and passenger service on 25 routes to 47 terminals, with a fleet of 35 vessels. We are an essential transportation link that connects coastal communities and facilitates the movement of people, goods and services. In fiscal 2012, we carried 20.2 million passengers and 7.8 million vehicles throughout coastal British Columbia.

OUR VISION

To provide a continuously improving west coast travel experience that consistently exceeds customer expectations and reflects the innovation and pride of our employees.

OUR MISSION

To provide safe, reliable and efficient marine transportation services which consistently exceed the expectations of our customers, employees and communities, while creating enterprise value.

OUR VALUES

Safety: Ensure that the safety and security of our customers and staff is a primary concern in all aspects of doing business.

Quality: Be motivated by customer expectations in providing quality facilities and services.

Integrity: Be accountable for all our actions and ensure we demonstrate integrity in our business relations, utilization of resources, treatment of our customers and staff, and in the general conduct of our business.

Partnerships: Work openly and constructively with our various business and community stakeholders to exceed the expectations of our customers and advance each other's interests.

Environment: Ensure that environmental standards are maintained.

Employees: Always deal from a position of honesty, integrity and mutual respect, and ensure that our employees develop to their full potential.

OUR GOALS

In support of our vision, we are focused on five key goals, none more important than safety.

1. **Safety:** To continuously improve the safety of our operations inclusive of vessels, terminals and facilities.
2. **Operational Reliability:** To continuously improve the operational reliability of vessels, terminals and facilities.
3. **Continuous Improvement:** To be better at everything we do.
4. **Value For Money:** To continuously improve value to our customers at every point along the customer experience chain.
5. **Financial Integrity:** To achieve key financial targets, ensuring that sufficient capital and retained earnings are available to revitalize our fleet, facilities and infrastructure, while minimizing fare escalation.

MESSAGE FROM THE CHAIR OF THE BOARD OF DIRECTORS

We take pride in the fact that 88 per cent of passengers reported being satisfied with their overall experience travelling on BC Ferries this year.

On behalf of the Board of Directors of British Columbia Ferry Services Inc., we congratulate the women and men of BC Ferries on another year of providing outstanding service to millions of customers across coastal British Columbia.

We take pride in the fact that 88 per cent of passengers reported being satisfied with their overall experience travelling on BC Ferries this year. Among other attributes, customers gave high marks for safety of ferry operations, staff at the terminal and onboard, as well as selection in the gift shops. These results clearly demonstrate the collective contributions from each and every employee.

On January 1, 2012, the Board appointed Mike Corrigan as President & CEO of BC Ferries. Mr. Corrigan's past business experience, as well as his nine years in the separate roles of Chief Operating Officer and Executive Vice President of Business Development at BC Ferries have prepared him well to take over the helm of the company.

I want to recognize the visionary leadership provided by David L. Hahn who retired as President & CEO on December 31, 2011. During his eight-year tenure, Mr. Hahn was instrumental in transforming BC Ferries into a world class marine transportation system.

I join the British Columbia Ferry Services Inc. Board in extending a special thank you to outgoing Board member, Elizabeth J. Harrison, QC, for many years of valuable service.

In June 2011, amendments were made to the *Coastal Ferry Act* to support a review of BC Ferries by the independent British Columbia Ferries Commissioner. Following his review, the Commissioner released his comprehensive report earlier this year. The Board acknowledges the report along with its recommendations. Subsequent to this Bill 47 was passed to incorporate many of these recommendations into the *Coastal Ferry Act*.

BC Ferries is not immune to the current global economic challenges that face many transportation companies today. Our priorities remain focused on delivering an exceptional travel experience to our passengers, while exercising fiscal responsibility. Strong leadership and diligent management will continue to guide the company through this period of uncertainty. We remain optimistic about the future ahead as we navigate through these challenging times.

DONALD P. HAYES,
Chair of the Board of Directors
British Columbia Ferry Services Inc.

MESSAGE FROM THE PRESIDENT & CEO

The safety and reliability of our operation is my number one priority for both our employees and our customers.

As I look back on the past year, I'm pleased with all we have been able to accomplish in the areas of safety, customer service, and vessel and terminal improvements in this current economic climate. I want to take this opportunity to thank all of our employees as they continue to deliver safe and excellent service to our passengers in all aspects of our business at BC Ferries.

We've successfully wrapped up the second phase of our SailSafe program, a joint initiative with the BC Ferry & Marine Workers' Union. With the sustainment phase now underway, I'm confident that our safety culture will continue to integrate into the fabric of everything we do at BC Ferries. We have over 300 employee ambassadors to help us reach our goal of becoming one of the safest ferry systems in the world.

This year we've achieved exceptional results in some of our key performance indicators that I am very proud of. On-time performance is at an all time high of 91 per cent, coupled with a fleet reliability index of 99.8 per cent. We realized a reduction in fuel consumption of approximately 700,000 litres and employee absenteeism is down to 4 per cent. We've also reduced the number of lost time injuries from 209 to 200 as well as days lost to injuries from 7,981 to 7,425 as compared to the previous year.

On the capital investment side, we delivered approximately $122 million worth of capital projects over the past year, including the *Queen of Burnaby* asset betterment, vessel and terminal sewage treatment program, Denman/Hornby berth rebuilds and the *Queen of Chilliwack* life extension to name just a few. We successfully completed 26 refits at a total cost of $40 million which came in under budget with all ships being delivered back to service on-time and operationally ready to go.

The drop-trailer segment of our Commercial Services Division is one of the most innovative initiatives we have ever taken at BC Ferries and continues to provide strong growth. Our Travel Services Division also continues to perform above our expectations and enables BC Ferries to leverage off our core business to drive incremental ferry traffic as well as commissions. These two lines of business have provided valuable contributions to our bottom line, as we find creative ways to generate revenue from areas other than traditional means through the farebox.

In January, former B.C. Auditor General George Morfitt released a comprehensive report of his findings from a follow-up review on the operational safety audit conducted five years ago. Mr. Morfitt concluded that there has been a significant improvement in the safety culture and practices within BC Ferries and that the company has demonstrated its commitment to customer and employee safety on all fronts.

Also in late January 2012, the British Columbia Ferries Commissioner released a report following a review of BC Ferries, which clearly articulates the challenges ahead if the company continues to operate the same level of service with the same level of government support. The review re-confirmed the company is an efficient and well run operation, and I was encouraged that the Commissioner recognized that much of our cost base, such as soaring fuel prices and environmental and maritime regulatory changes, are beyond the direct control of the company.

In May 2012 in response to the Commissioner's report, the Province of British Columbia enacted Bill 47 which implemented changes to the *Coastal Ferry Act* designed to balance the interests of ferry users, taxpayers and the sustainability of the ferry operator. We look forward to working with the British Columbia Ferries Commissioner and the provincial government on a long term vision for connecting coastal communities. This is an essential step in ensuring the on going viability of the coastal ferry system and keeping fares as affordable as possible.

The BC Ferry & Marine Workers' Union and its members ratified an extension of the collective agreement through to October 31, 2015, which is a positive step in our journey together. The extension provides for a period of stability for our employees and just as importantly, it allows our customers to continue to plan their travels with confidence.

Of concern for all of us is the traffic decline which has been relatively consistent throughout fiscal 2012. It is the largest year-over-year traffic decline that BC Ferries has experienced in recent years. Traffic levels are not expected to rebound in the near term. As always, we will continue to manage our budget as prudently as possible without compromising safe operations.

While we will face challenges ahead in this period of economic uncertainty, I'm confident that we will be successful in our endeavours to continue to deliver a safe and efficient marine transportation system to British Columbians and tourists alike.

The safety and reliability of our operation is my number one priority for both our employees and our customers.

MICHAEL J. CORRIGAN,
President & Chief Executive Officer
British Columbia Ferry Services Inc.

KEY ACCOMPLISHMENTS

Improving the travel experience…

- Reached a fleetwide on-time performance record of 91 per cent.
- Achieved a vessel reliability index of 99.8 per cent.
- Offered CoastSaver promotions Thursday through Sunday from June 2 – 26, 2011 on the three major routes connecting Vancouver Island and the Lower Mainland. Fares were just $39.95 for a passenger vehicle and driver and adult passenger fares were just $9.95 for the same period.
- Introduced new International Entrees to Pacific Buffet menu which include: salmon filet with shitake Dijon sauce, Indian butter chicken and five-spice BBQ pork ribs.
- Generated $76.5 million in ancillary revenue in food and retail sales. While we impress shoppers and diners with new products, these services contribute valuable non-tariff revenue to our bottom line, thus reducing pressure on fares.
- Continued our popular Coastal Naturalist Program on the Tsawwassen – Swartz Bay and Horseshoe Bay – Departure Bay routes for the summer months. In partnership with Parks Canada, the Coastal Naturalists offer customers a real life coastal experience.
- Announced a 90-day, one-time only refund to customers who purchased assured loading tickets between 1984 and July 25, 2011 and no longer want the tickets.
- Redeployed the *Coastal Renaissance* to the Tsawwassen – Swartz Bay route to replace the larger *Spirit of British Columbia* in the off-season in order to better match service levels with traffic demand.
- Launched the new Sitka Breakfast and Salad Bar on the *Coastal Renaissance*.
- Expanded the popular online vessel tracking program to include all routes in BC Ferries system to help customers plan their travels around coastal British Columbia.
- Introduced tasty new menu items on some of our major routes including pulled pork sandwiches and shitake mushroom prawn noodle boxes.
- Implemented marketing promotions for food and retail including seasonal desserts and cosmetic offerings.
- Passages Gift Shops experienced significant growth in fashion apparel through the addition of new lines for women and men.
- Released the results of our 2011 Customer Satisfaction Tracking surveys which indicated that 88 per cent of customers surveyed reported being satisfied with their overall trip experience.

Investing in our vessels and terminals…

- Continued with the implementation of a multi-year $63.1 million sewage and waste water treatment program to upgrade 27 vessels and eight terminals for treatment of sewage generated onboard the vessels. The program involved major modifications and upgrades to ensure that all vessels comply with *Canada Shipping Act, 2001* sewage regulations, which came into effect in May 2012. Wherever possible, the vessels convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels are fitted with compliant marine sanitation devices.
- Commissioned a new state-of-the-art waste water treatment plant at the Langdale terminal.

- At Tsawwassen, completed an $8.7 million project to replace the dolphins, catwalk and sheet pile wall as well as the refurbishment of the hydraulic systems at Berth 5.
- Invested $1.9 million in major berth modifications at the Brentwood Bay terminal to accommodate a larger vessel, the *Klitsa*. Completed a $2.7 million asset betterment project on this vessel, which included new lifesaving systems, new right-angle drives, and a new sewage pump-ashore system. Invested $0.8 million for berth modifications including dolphins, an apron and a queuing lane at Mill Bay terminal.
- Continued with the $15 million major life extension project on the 33-year old *Queen of Chilliwack* that will allow the vessel to continue in service until it is retired in 2017 or later.
- Undertook a $19 million project at Swartz Bay for the upgrade of Berths 4 and 5 including replacement of ramps, ramp abutments, aprons, towers, wingwalls, dolphins and floating leads. Ship-to-shore electrical upgrades and a new waiting shelter were also included. Work on Berth 5 is complete and Berth 4 will be finalized by mid-2012.
- Opened a new foot passenger waiting room at Nanaimo Harbour.
- Constructed a new pedestrian overpass at the Horseshoe Bay terminal, which spans the vehicle holding compound, to improve safety for customers accessing the Horseshoe Bay Village.
- Teamed up with the Sunshine Coast Regional District to construct a new walking route for foot passengers accessing the Langdale terminal from Lower Gibsons. The foot path provides enhanced access and egress for foot passengers to the foot passenger – baggage drop-off area of the terminal.
- The *Queen of Burnaby* underwent an extensive mechanical refit including the overhaul of generators, port main engine, bow thruster and propulsion system; modernization of the elevator system; steel renewal on the main car deck; installation of a new sewage treatment holding tank; new flooring in washrooms; and regulatory surveys.
- Invested $16.9 million into the marine structures at both Gravelly Bay on Denman Island East and Shingle Spit on Hornby Island. A temporary service suspension was required to complete this major project, and as a result alternate service was provided for 18 days during the dock closures.

Building a better BC Ferries…

- Completed phase two of SailSafe, a joint safety initiative with the BC Ferry & Marine Workers' Union.
- Former B.C. Auditor General George Morfitt released a comprehensive report after conducting a follow-up review on the operational safety audit conducted five years ago. Mr. Morfitt reviewed the status of 41 recommendations he made in the original 2007 report. The report cites a significant improvement in the safety culture and practices within the company since 2007.
- British Columbia Ferries Commissioner released a review of BC Ferries. The report reconfirms that BC Ferries is an efficient and well run operation but clearly articulates the challenges ahead if the company continues to operate the same level of service with the same level of funding.
- Launched new bridge simulator training facilities at Swartz Bay, Tsawwassen and Departure Bay. The state-of-the-art bridge simulators enable the development and delivery of affordable, integrated and targeted bridge team training. The training program leverages simulator best practices, minimizes operational impacts and overhead, establishes the infrastructure and lays the foundation for technical and team training for the bridge teams.

KEY ACCOMPLISHMENTS

- Pledged $200,000 for training programs for a new industry-led marine training facility in Esquimalt, B.C.
- Held 30 "Town Hall" sessions with almost 400 employees to collaborate and brainstorm different avenues for improving workplace safety.
- Paid down $45 million in debt consisting of the principal amounts outstanding under the second tranche of the two 12-year, 4.98 per cent loans with the KfW bank group (KfW).
- Issued a Request for Expressions of Interest to determine whether a third party, under contract to BC Ferries, can provide cable ferry service between Buckley Bay on Vancouver Island and Denman Island at a lower cost, while maintaining high levels of safety, quality and reliability. The company has issued a Request for Proposals as the next phase of the procurement process.
- Reached a tentative agreement with the BC Ferry & Marine Workers' Union for a three-year extension, to October 31, 2015, of the Collective Agreement. The agreement has been ratified by the Union membership.
- Sold the *Queen of Prince Rupert*, which was decommissioned in 2010.
- Retired and sold the *MV Mill Bay* after 55 years of valuable service.

Connecting with the communities we serve…

- Performed 28 marine rescues throughout coastal British Columbia.
- Raised $50,000 to help build Jeneece Place through the BC Ferries Media Charity Golf Classic Victoria in June 2011. Over the past six years, this tournament has raised over $300,000 to support children's programs.
- Raised another $50,000 to donate to the First Tee Program of the Vancouver YMCA in September 2011. To date, the BC Ferries Media Charity Golf Classic Vancouver has raised $100,000 for this children's organization.
- Over 100 of our North Coast employees participated in healthy lifestyle challenge benefiting BC Children's Hospital Healthy Buddies program.
- Pledged $88,000 in employee contributions in the 2011 United Way Campaign.
- Donated a used flat-deck truck equipped with a mobile arc welder to help train students in Camosun College's Automechanic, Welding and Heavy Duty/Commercial Transport programs.
- Built a new public float at the Langdale terminal for use by private boaters to address long-standing safety and security concerns. BC Ferries and the Sunshine Coast Regional District negotiated a license agreement which grants the public the right to use and access the float.
- Consulted regularly with our Ferry Advisory Committees. Established a 13th Ferry Advisory Committee for users of the Brentwood Bay – Mill Bay route.
- Sponsored the BC Bike Race, Sport BC, the Powell River Kings Junior "A" Hockey Club and the Victoria Highlanders Football Club.

PERFORMANCE MEASURES

The Board of Directors and management of BC Ferries have implemented comprehensive long-term performance measures to gauge the progress of the business and its ongoing commitment to continuous improvement.

The safety of our passengers and employees is our primary focus:

1 Employee Safety (employee injury frequency rate multiplied by severity rate divided by 1000)

2 Passenger Safety (number of passenger injuries per one million passengers)

	Fiscal 2010		Fiscal 2011		Fiscal 2012		Fiscal 2013
	Actual	**Target**	**Actual**	**Target**	**Actual**	**Target**	**Target**
Employee Safety	**1.54**	2.50	**1.53**	1.56	**1.31**	1.31	1.22
Passenger Safety	**20.16**	21.50	**18.11**	21.50	**15.31**	18.11	15.45

Other important areas of focus include:

3 Reliability (actual round trips divided by scheduled round trips, less weather, medical or rescue related cancellations)

4 Customer Satisfaction Rating

5 Cost per passenger (total operation cost-ancillary revenue) divided by total passengers

6 Earnings before interest, taxes and amortization (EBITDA, in $ millions)

	Fiscal 2010		Fiscal 2011		Fiscal 2012 (CGAAP)		Fiscal 2013 (IFRS)
	Actual	Target	**Actual**	Target	**Actual**	Target	Target
Reliability Index [1]	**99.70%**	99.4 – 99.59%	**99.83%**	99.4 – 99.59%	**99.76**	99.4 – 99.59%	99.5 – 99.69%
Customer Satisfaction	**91%**	84%	**89%**	84%	**88%**	83%	88%
Cost per Passenger	**$ 20.96**	$ 20.67	**$ 21.90**	$ 21.66	**$ 23.04**	$ 23.29	$ 23.85
EBITDA (millions)	**$ 186**	$ 189	**$ 181**	$ 189	**$ 177**	$ 176	$ 206

1 The reliability index has been recalculated for fiscal 2010 and fiscal 2011 to represent actual round trips divided by scheduled round trips less weather, medical or rescue related cancellations.

PROVINCIAL PAYMENTS & RECEIPTS

British Columbia Ferry Services Inc.

PROVINCIAL RECEIPTS & PAYMENTS
FISCAL 2004 THROUGH 2012

($ thousands)	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
Receipts										
Ferry Transportation fees	91,817	91,833	91,849	90,953	103,801	103,294	125,599	125,150	**126,587**	**950,883**
Contracted Routes fee	1,747	1,724	1,700	1,700	1,700	1,939	1,849	1,855	**1,764**	**15,978**
Social Programs fee	12,317	13,414	14,674	15,967	17,248	19,252	22,060	24,018	**26,608**	**165,558**
Federal-Provincial subsidy	23,975	24,343	24,890	25,309	25,856	26,294	26,924	26,924	**27,487**	**232,002**
Contribution to equity									**25,000**	**25,000**
Other [1]				7,000	1,284	4,113	1,620	1,753	**3,302**	**19,072**
Other [2]						20,750				**20,750**
	129,856	131,314	133,113	140,929	149,889	175,642	178,052	179,700	**210,748**	**1,429,243**
Payments										
Debenture repayment [3]		427,701								**427,701**
Interest on debenture	22,480	3,399								**25,879**
Dividends on preferred shares	6,038	6,038	6,038	6,038	6,038	6,038	6,038	6,038	**6,038**	**54,342**
Provincial fuel tax adjustments	75			224	47					**346**
Fuel on northern routes [4]							1,273			**1,273**
	28,593	437,138	6,038	6,262	6,085	6,038	7,311	6,038	**6,038**	**509,541**

1 Contributions used to reduce the balances in the deferred fuel cost accounts.

($ thousands)	2007	2008	2009	2010	2011	2012	Total
One-time payment	7,000						7,000
Reimbursement for fuel costs over the set price on northern routes		2,429		196	1,799	**4,424**	
Contribution equal to the transportation fee reduction related to import duties remission and related GST obtained on the *Northern Adventure*		1,284	1,684	1,620	1,557	**1,503**	7,648
	7,000	1,284	4,113	1,620	1,753	**3,302**	**19,072**

2 $19,550 to allow for a 33% fare reduction and $1,200 additional funding for reimbursement of costs to reinstate previously eliminated off-peak sailings.

3 On April 2, 2003, the assets held by the Province were sold to the newly incorporated British Columbia Ferry Services Inc. in exchange for a $427,701 debenture with interest at 5.18% and 75,477 non-voting 8% cumulative preferred shares. In fiscal 2005, the company issued two $250 million debentures and the proceeds were used to repay the Provincial debt.

4 Fuel costs under the set price on the northern routes.

KEY COST DRIVERS

The major strategic issue facing us when we were established as an independent company on April 1, 2003, was the replacement of our aged assets, specifically vessels, terminals and information technology systems.

In this time we have brought into service seven new vessels, completed upgrades to sixteen vessels, many marine structure replacements and terminal improvements, security upgrades and sewage pump-ashore and waste water treatments. Reflecting this reinvestment in our assets is the resulting increase in interest and amortization expenses, which have grown from $68 million in fiscal 2004 to $193 million in fiscal 2012, an increase of $125 million.

Beginning with the global economic downturn in 2008, we have experienced significant erosion in our traffic, reaching a 21 year low in passenger levels and a 13 year low in vehicle traffic. Concurrently, there has been considerable operating expense increases, most notably fuel with an increase of over 140 per cent, insurance premiums, property taxes, utilities, benefits program rates and labour agreements.

During this time, our focus has been and will continue to be, on providing a safe, reliable and efficient marine transportation service.

($ millions)	**Fiscal 2004 Actual [1]**	**Fiscal 2012 Actuals**
Operations Costs		
Labour	202	257
Fuel [2]	50	121
Materials, Supplies, Contracted Services and Other	33	34
Insurance [3], Property Tax, Utilities and Credit Card Fees	10	23
Maintenance Expenses	84	86
Administration Expenses	32	31
Net Financing and Amortization [4]	68	193

In the coming year, we will continue to pursue opportunities to minimize costs. In addition, we will work with the Provincial Government on service level adjustments and a long term vision for connecting coastal communities. This will assist decision making as we work towards replacing eleven vessels over the next ten years, many of which will have been in service for 55 years, along with the many required marine structure replacements and terminal improvements.

1 The fiscal 2004 figures for Operations, Maintenance and Administration (OM&A) expenses have been adjusted from those figures previously reported to reflect classifications currently used. Total OM&A expenses for fiscal 2004 are identical to those previously reported.

2 Fuel reflects the total cost of fuel net of fuel price hedging gains or losses.

3 Insurance includes gains or losses from our subsidiary, BCF Captive Insurance Subsidiary Ltd.

4 Net Financing includes financing for the *Kuper* owned by our subsidiary, Pacific Marine Leasing Inc.

Management's Discussion & Analysis

Management's Discussion & Analysis of Financial Condition and Results of Operations for the fiscal year ended March 31, 2012

Dated June 15, 2012

The following is our discussion and analysis of the financial condition and results of operations for British Columbia Ferry Services Inc. This discussion and analysis has been prepared based on information available at June 15, 2012. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2012 (fiscal 2012) and March 31, 2011 (fiscal 2011). These documents are available on SEDAR at www.sedar.com and on our Investor webpage at http://www.bcferries.com/about/investors/index.html.

Except where indicated, all financial information herein is expressed in Canadian dollars and determined on the basis of Canadian generally accepted accounting principles.

Business Overview

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world, providing frequent year-round transportation service on 25 routes, supported by 35 vessels and 47 terminals. We also manage ferry transportation service on other remote routes through contracts with independent operators.

Our service is an integral part of British Columbia's coastal transportation system and has been designated by the Province of British Columbia (the Province) as an essential service for purposes of the provincial Labour Relations Code. This designation means our services are considered necessary for the protection of the health, safety and welfare of the residents of British Columbia.

We are a versatile company, providing a wide range of ferry services for our customers. In fiscal 2012, we provided more than 186,000 sailings, carrying 20.2 million passengers and 7.8 million vehicles.

We experienced a 3.5% decline in vehicle traffic and a 2.8% decline in passenger traffic in fiscal 2012 compared to the prior year. For discussion of our traffic levels see "Financial and Operational Overview" and "Outlook – Traffic Levels" below.

Significant events during or subsequent to fiscal 2012:

- On June 2, 2011, the *Coastal Ferry Amendment Act, 2011* (Bill 14) was enacted. Bill 14 established a price cap increase for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012 (as established by the Commissioner) effective April 1, 2012, for the first year of performance term three. (See "Corporate Structure – Economic Regulatory Environment" for more detail).
- On July 26, 2011, we announced a 90-day, one-time only refund to customers who purchased assured loading tickets between 1984 and July 25, 2011 and no longer want the tickets. This decision was made prior to completion of fiscal 2011 and a liability was reflected in the fiscal 2011 financial statements to provide for these refunds. We received approximately 3,500 refund requests during the 90-day period. We have completed our validation of these requests and processing of the refunds. The liability established at March 31, 2011 was sufficient to cover the refunds.
- On September 15 and 22, 2011, we paid down $45 million in debt consisting of the principal amounts outstanding under the second tranche of the two 12-year, 4.98% loans with the KfW bank group (KfW). These loan agreements were also amended to transfer the principal payments on these loans for the next three years to the second tranche, on which interest only is paid at a floating rate. The principal on the second tranche is due at maturity. (See "Liquidity and Capital Resources" for more detail).
- On December 6, 2011, our Board announced the appointment of Michael J. Corrigan as President & CEO effective January 1, 2012. Mr. Corrigan was previously our Chief Operating Officer and has been a senior executive with us since joining the company in 2003 and was responsible for initiating and leading our SailSafe program, a joint initiative with the BC Ferry & Marine Workers' Union that has established a comprehensive safety culture. He was also responsible for our new vessel construction program, overseeing the construction and introduction of seven new and numerous upgraded vessels to the fleet as well as a host of terminal upgrades and improvements. Our previous President & CEO, David L. Hahn, retired December 31, 2011.

- On January 19, 2012, former B.C. Auditor General George Morfitt released a comprehensive report arising from his follow-up of the operational safety audit he conducted five years ago. The report states:

  "There has been, since our 2007 report, a significant improvement in the safety culture and practices within the company. The company directors, management and staff have demonstrated their commitment to safety being number one both for the travelling public and for BC Ferries personnel. We found that awareness about, and actions taken in regards to, safety have increased substantially since we carried out our last review. Considering that many of our recommendations were of a complex nature and necessarily would take a considerable time to implement, the progress to date made by the company in respect of the recommendations is highly commendable."

  (See "Financial and Operational Overview" for more detail).

- On January 24, 2012, the British Columbia Ferries Commissioner (the Commissioner) issued his report to the British Columbia Minister of Transportation and Infrastructure (the Minister) as to how the *Coastal Ferry Act* (the Act) could be amended to balance the interests of ferry users with the financial sustainability of our company. The report states:

  "Amongst the publicly-owned [ferry] systems, BC Ferries appears to be relatively efficient based on the analysis. Indeed, many ferry operators appear to want to emulate some of BC Ferries' practices. The company compares well with farebox recovery and ancillary revenue. Costs appear to be reasonable based on a number of independent reviews and on substantial improvement in several areas since 2003."

  The report makes 24 substantive recommendations covering a wide range of ferry related issues and is available on the Commissioner's website at www.bcferrycommission.com. In May 2012, the Province responded to the Commissioner's recommendations, enacting the *Coastal Ferry Amendment Act 2012* (Bill 47). (See "Corporate Structure – Economic Regulatory Environment" for more detail).

- On February 16, 2012, we reached an agreement with the BC Ferry & Marine Workers' Union for a three year extension, to October 31, 2015, of the Collective Agreement. The agreement allows for wage increases aggregating 6.25% over four and a half years which follow two years of zero increases. This agreement provides stability for our employees and certainty for our customers. (See "Financial and Operational Overview" for more detail).

- On May 3, 2012, we executed a contract for development and analysis of initial design criteria for a cable ferry service on one of our shortest routes between Buckley Bay and Denman Island and in early June 2012, we issued a Request for Proposals (RFP) for detailed design engineering. Also, on May 17, 2012, we issued an RFP from third parties interested in providing passenger and vehicle cable ferry service, under contract to us, at a lower cost than we can provide the service, while maintaining high levels of safety, quality and reliability. The cable ferry is an innovative initiative and is part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our cost effectiveness in delivering safe, reliable and quality ferry service. (See "Outlook – Cable Ferry" for more detail).

- On May 9, 2012, the Province announced the introduction of amendments to the Act, as well as a payment of $25.0 million relating to fiscal 2012 and a further $54.5 million over the following four fiscal years. (See "Corporate Structure – Economic Regulatory Environment" for more detail).

Corporate Structure

COASTAL FERRY SERVICES CONTRACT (THE CONTRACT)

We operate ferry services under a regulatory regime as defined by the Act, and under the terms set out in the Contract. This 60-year services contract with the Province, which commenced April 1, 2003, stipulates, among other things, the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry transportation fees). The Contract was amended to, among other things, establish the ferry service levels and ferry transportation fees for the second performance term commencing April 1, 2008. The Contract also includes fees for the provision of specific social program services delivered on behalf of the Province. The Contract normally would have been amended for the third performance term commencing April 1, 2012. However, this timeline was deferred by one year as a result of Bill 14 (See discussion below).

Under the terms of the Contract, we also receive an annual amount from the Province based on its agreement with the Government of Canada to fulfill the obligation of providing ferry services to coastal British Columbia. The amount of this payment is adjusted annually based on the Consumer Price Index (CPI) (Vancouver).

ECONOMIC REGULATORY ENVIRONMENT

The office of the Commissioner was created under the Act, enacted by the Province on April 1, 2003. The Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters. The Act requires the Commissioner to undertake regulation in accordance with several principles, including placing priority on the financial sustainability of ferry operators, encouraging ferry operators to adopt a commercial approach to ferry service delivery and moving over time to a greater reliance on a user pay system. In addition, the Commissioner is mandated to consider the interests of ferry users when establishing price caps.

On June 24, 2010, the Province enacted *Miscellaneous Statutes Amendment Act (No. 3), 2010* (Bill 20), amending several statutes including the Act. The amendments responded to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009 and included changes to the governance and regulatory framework within which we operate.

Among other things, Bill 20 amendments to the Act changed the mandate of the B.C. Ferry Authority (the Authority) to include responsibility for the compensation plans of our directors and certain executive officers, such compensation plans to be comparable to public sector organizations; a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of British Columbia Ferry Services Inc. (BC Ferries); and, the subjection of the records of the Authority and BC Ferries to the *Freedom of Information and Protection of Privacy Act.*

The amendments also expanded the regulatory responsibilities of the Commissioner to include: consideration of the interests of ferry users; regulation of our reservation fees; approval and public disclosure of our process for handling customer complaints; and review and public disclosure of our ten year capital plan, our plan for improving efficiency in the next performance term, and our methodology for allocating costs among the regulated routes. These amendments also broadened the Commissioner's role in regulating ferry transportation services where the Commissioner determines that we have an unfair competitive advantage. The amendments have also modified the process by which the Commissioner regulates our activities in seeking additional or alternative service providers on our regulated routes; and require the Commissioner to issue an opinion on our performance and that of the Authority in carrying out our respective legislated responsibilities, as well as our performance in relation to the Contract.

On April 1, 2011, the final year of performance term two, the price cap authorized by the Commissioner increased by 2.7% plus 0.49 times the latest reported annual change in the CPI (British Columbia) on the Major Routes and 5.7% plus 0.73 times the change in the CPI (British Columbia) on all other routes. This translated into a price cap increase of 3.38% on the Major Routes and 6.71% on all other routes. These price cap increases reflect a change in the CPI (British Columbia) of 1.39% applied April 1, 2011.

In March 2011, the Commissioner set preliminary price cap increases for each of the four years of performance term three of 4.15% on the Major Routes and 8.23% on all other routes, effective April 1, 2012. In making these determinations, the Commissioner excluded certain forecasted costs and incorporated a productivity challenge effectively further reducing our allowed costs.

On June 2, 2011, Bill 14 was enacted. Bill 14, among other things:

- establishes a price cap increase for the first year of the third performance term for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012, (as established by the Commissioner), effective April 1, 2012;
- provides for the Commissioner to undertake the usual price cap review proceedings for the balance of the review performance term, being the period from April 1, 2013 to March 31, 2016; and
- prevents us from obtaining extraordinary price cap increases, and requires ministerial approval (as opposed to Commissioner approval) for the discontinuance of ferry services, until October 1, 2012.

Bill 14 also provided the Commissioner with the mandate to conduct a review of the Act before issuance of his final decision on price caps for the balance of the third performance term. This decision is due by September 30, 2012.

On January 24, 2012, the Commissioner issued his report to the Minister as to how the Act could be amended to balance the interests of ferry users with the financial sustainability of our company. The report states:

"Amongst the publicly-owned [ferry] systems, BC Ferries appears to be relatively efficient based on the analysis. Indeed, many ferry operators appear to want to emulate some of BC Ferries' practices. The company compares well with farebox recovery and ancillary revenue. Costs appear to be reasonable based on a number of independent reviews and on substantial improvement in several areas since 2003."

The Commissioner's report made 24 substantive recommendations covering a wide range of ferry related issues and is available on the Commissioner's website at www.bcferrycommission.com.

In May 2012 and in response to the Commissioner's recommendations, the Province enacted legislative changes to the Act (Bill 47), designed to move toward striking a balance among the interests of ferry users, taxpayers and the sustainability of the ferry operator. The changes cover a wide range of ferry related issues including:

- Allowing cross subsidization from the Major Routes to other routes;
- Changing the primary responsibility of the Commissioner from priority placed on the financial sustainability of the ferry operations, to responsibility to protect the interests of ferry users, the taxpayers, and the financial sustainability of the ferry operator; and
- Expanding the Commissioner's authority and responsibilities, to include:
  - Approval of permanent changes to service levels;
  - Authority to order a temporary or permanent service reduction and or deferral of a planned capital expenditure in response to an extraordinary situation, in addition to or instead of an approval of extraordinary price cap increases;
  - The ability to require us to seek his approval in advance of making certain capital expenditures;
  - The responsibility to set price caps sufficient to enable us to meet our debt obligations and maintain access to borrowing rates that in the opinion of the Commissioner are reasonable;
  - Specific legislative authority to establish the deferred fuel cost accounts and the terms and conditions for their use, including fuel surcharges or rebates; and
  - The authority to conduct routine performance reviews and to require us to review our policies and undertake public consultation.

Together with the introduction of amendments to the Act, the Province announced additional payments totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. The first payment of $25.0 million, approved on March 30, 2012, was received April 20, 2012 as a contribution to our equity. A further $54.5 million is expected to be received in annual payments of $21.5 million in fiscal 2013; $10.5 million in fiscal 2014; $11.0 million in fiscal 2015; and $11.5 million in fiscal 2016.

In addition, the Province announced that it will conduct public consultation with ferry dependent communities about adjustments to service levels and trade-offs between service adjustments, fare increases and potential community contributions. The Province also announced that it will seek public input to develop strategies to support a long-term vision for connecting coastal communities. We have offered to provide technical assistance for this process.

Financial and Operational Overview

This section provides an overview of our financial and operational performance over the past three fiscal years.

Year ended March 31 ($ millions)	**2012**	**2011**	**2010**
Total revenue	**738.2**	739.3	732.3
% (decrease) increase	***(0.1%)***	*1.0%*	*7.4%*
Operating expenses	**682.7**	672.2	660.0
Earnings from operations	**55.5**	67.1	72.3
Interest and other	**72.0**	63.3	68.9
Net (loss) earnings and comprehensive (loss) income	**(16.5)**	3.8	3.4

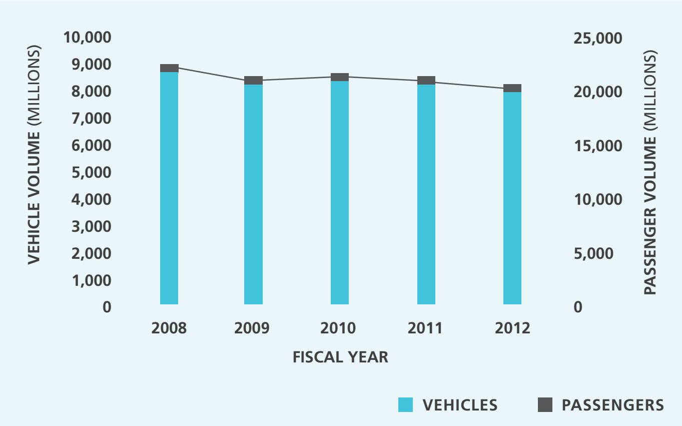
As at March 31	**2012**	**2011**	**2010**
Total assets	**1,819.5**	1,857.6	1,807.0
Total long-term financial liabilities	**1,343.4**	1,387.2	1,363.9
Dividends on preferred shares	**6.0**	6.0	6.0

Our net earnings in fiscal 2012 were $20.3 million lower than in fiscal 2011. Fiscal 2012 net earnings reflect the effects of lower than expected traffic levels and an $8.5 million increase in amortization expense. Our earnings in fiscal 2011 were $0.4 million higher than in fiscal 2010. Fiscal 2011 net earnings reflect the effects of lower than expected traffic levels, $4.2 million lower interest expense credits received through the Government of Canada's Structured Financing Facility (SFF) program, offset by a $9.3 million gain on sale of our former corporate office building.

TRAFFIC

Our traffic levels have historically been relatively stable. However, the long-term traffic trend-line shifted significantly during fiscal 2009, when vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9%, respectively. In fiscal 2009, the Canadian and world economies experienced turbulence in the financial markets and a recessionary period. These declining economic conditions negatively impacted our commercial and discretionary travel markets.

The following graph illustrates our annual vehicle and passenger traffic levels from fiscal 2008 through fiscal 2012:



In fiscal 2010, we experienced a 1.5% increase in both vehicle and passenger traffic levels, as economic conditions began to improve and vehicle fuel prices declined compared to the prior year. The Winter Olympics in Vancouver also had an impact on travel in the latter part of the fiscal year.

In fiscal 2011, our vehicle and passenger traffic declined by 1.6% and 1.4%, respectively, bringing traffic to levels similar to those experienced in fiscal 2009. During fiscal 2011, vehicle fuel prices again climbed while tourism remained lower than in years prior to fiscal 2009.

In fiscal 2012, our vehicle and passenger traffic further declined by 3.5% and 2.8%, respectively. We believe that, while ferry fares are a contributing factor, the root cause of the decline in traffic is the continuing worldwide economic downturn exacerbated by the return of high gasoline prices. The traffic this fiscal year is the lowest vehicle traffic we've experienced in 13 years and the lowest passenger traffic we've experienced in 21 years.

COST CONTAINMENT

In response to the decline in traffic levels and resulting revenues in fiscal 2009, we determined the need to restructure our business to align expenses with reduced revenues while continuing to ensure that safety remains our top priority. This restructuring was in addition to our other cost savings measures that included deferral of filling staff vacancies and reduction of discretionary expenditures. Approximately 77 positions were eliminated. This included termination or early retirement of 28 non-union staff, including several vice-presidents, senior management and director-level employees and 7 union staff. The remaining positions were eliminated through attrition. In fiscal 2010, these proactive measures, along with other initiatives, reduced our operating expenditures by approximately $14 million from previously planned levels. Throughout fiscal 2011, we continued our focus on cost savings measures and reduction of discretionary expenditures.

In response to the lower than anticipated traffic levels and resulting revenue reduction in the first few months of fiscal 2012, we undertook additional cost containment measures which included a hiring freeze of all non-essential positions, a two-year wage and salary freeze for exempt employees, cancellation of discretionary expenses, reduced use of outside contractors and consultants, and elimination of many charitable and community donations. As a result of these cost containment initiatives, our operations, maintenance and administrative expenses were $31 million below previously planned levels as published in our annual Business Plan for fiscal 2012. We continue to manage our costs as prudently as possible without compromising safe operations. We also applied to the Province to reduce up to 400 round trips annually on our major routes. This is approximately 4% of the total annual round trips we make on these routes. The Province did not agree to our request at that time. However, in May 2012, Bill 47 amended the Act to give the Commissioner the authority to approve or direct changes to service levels. We expect to be working with the Commissioner in this regard in the near future.

MANAGEMENT'S DISCUSSION & ANALYSIS

SAFETY & TRAINING

In fiscal 2007, we commissioned former B.C. Auditor General, George L. Morfitt to conduct an independent review of our operational safety policies, procedures and practices. His report contained 41 recommendations. In fiscal 2008, we launched our SailSafe program in partnership with the Union to take our existing safety management system to the next level and to address the recommendations of the Morfitt report. The goal of the program is to achieve world class safety performance. SailSafe engages employees in identifying areas and methods for enhancing current safety practices and ensuring that safety is our first priority each and every day. Since the inception of SailSafe, we have seen significant improvements in overall safety performance, with the number of lost time injuries decreasing by 46% and work days lost to injury decreasing by 35%.

In January 2012, we commissioned Mr. Morfitt to conduct a follow-up review of the operational safety audit he conducted in fiscal 2007. The 73-page comprehensive report included an assessment of our success in implementing the 41 recommendations made in his original 2007 report. His summary overview states:

"There has been, since our 2007 report, a significant improvement in the safety culture and practices within the company. The company directors, management and staff have demonstrated their commitment to safety being number one both for the travelling public and for BC Ferries personnel. We found that awareness about, and actions taken in regards to, safety have increased substantially since we carried out our last review. Considering that many of our recommendations were of a complex nature and necessarily would take a considerable time to implement, the progress to date made by the company in respect of the recommendations is highly commendable."

The implementation of our SailSafe program, and the dedication of our employees to safety, facilitated a change to the corporate culture which has been vital to the success of many of our new safety initiatives and has contributed significantly to our overall productivity and effectiveness.

We have now entered the sustainment phase of the SailSafe program, which makes the formal shift from a safety implementation program to one of monitoring and assessing the 84 action plans implemented in the first two phases. Our goal is to entrench safety in all aspects of our daily operations, embedding safety into our culture.

On June 27, 2011, the Province announced a $550,000 investment to develop training strategies for workers within a new industry-led marine training facility in Victoria. We are one of the industry partners, committing approximately $200,000 to the project. Training programs include skills development training for individuals new to marine trades, an upgrading program and a supervisory training program for experienced workers. Over the next several years, we plan to send approximately 200 employees for training on the shipbuilding and ship repair programs.

On September 28, 2011, we launched our new bridge simulator training facilities at three of our major terminals. The state-of-the-art bridge simulators will enable the development and delivery of affordable, integrated and targeted bridge team training that reduces operational risk. The training program will leverage simulator best practices, minimize operational impacts and overhead, establish the infrastructure and lay the foundation for technical and team training for our bridge teams.

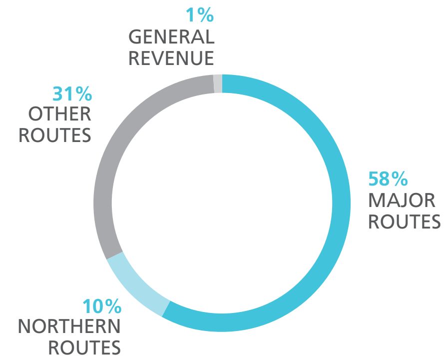
CUSTOMER SERVICE

For fiscal 2012, our on-time departure rate hit an all time high of 91% with a fleet reliability score of 99.8%. This reliability score means that only 0.2% of sailings in fiscal 2012 were cancelled due to mechanical issues related to the vessels or terminals. Improvements in on-time departure rates and reliability scores over the past few years were reflected in the results of our 2010 Customer Service Satisfaction Tracking surveys, which indicated that 89% of customers surveyed reported being satisfied with their overall trip experience. This rating decreased marginally from 91% received in 2009 but remained several points higher than the 82% rating received in 2003. Ratings remain high in all areas except for those relating to customer satisfaction with value received relative to the associated cost. A copy of the full report for each year is available on our website.

COLLECTIVE AGREEMENT

In February 2012, we reached an agreement with the BC Ferry & Marine Workers' Union for a three year extension, to October 31, 2015, of the Collective Agreement which would have otherwise expired October 31, 2012. The original agreement contained wage reopener clauses at April 1, 2011 and April 1, 2012. The three year extension includes zero increases with regard to the April 2011 and April 2012 wage reopeners, effectively providing wage increases aggregating 6.25% over four and a half years with the first increase on October 31, 2012. This agreement provides stability for our employees and uninterrupted ferry service for our customers.

Revenue



Our total revenues over the past three fiscal years are shown in the table below.

In fiscal 2012, the greatest portion of our revenues, 58%, was earned on our three Major Routes connecting Vancouver Island to Vancouver and the Lower Mainland. The revenue from the Northern Routes contributed 10% and Other Routes contributed 31%.

Years ended March 31 ($ millions)	**2012**	2011	2010
Direct Route Revenue			
Vehicle traffic (volume)	***7,837,919***	*8,119,546*	*8,255,409*
Vehicle tariff	**282.8**	284.6	281.2
Passenger traffic (volume)	***20,169,977***	*20,746,222*	*21,035,644*
Passenger tariff	**174.2**	173.5	169.3
Social program fees	**26.6**	24.0	22.1
Catering & on-board	**75.0**	77.3	79.1
Other revenue	**20.1**	22.2	22.3
Total Direct Route Revenue	**578.7**	581.6	574.0
Indirect Route Revenue			
Ferry transportation fees	**128.3**	127.0	127.4
Federal-Provincial subsidy	**27.5**	26.9	26.9
Total Route Revenue	**734.5**	735.5	728.3
Other general revenue	**3.7**	3.8	4.0
Total Revenue	**738.2**	739.3	732.3

Our largest revenue source is vehicle and passenger tariffs. The Commissioner authorized a price cap increase on the Major Routes of 2.7% plus 0.49 times the CPI (British Columbia) and 5.7% plus 0.73 times the CPI (British Columbia) on all other routes effective on each of April 1, 2010 and April 1, 2011. On April 1, 2010, the price caps increased by 2.68% on the Major Routes and 5.68% on all other routes, which incorporated a change in the CPI (British Columbia) of -0.03%. On April 1, 2011, the price caps increased by 3.38% on the Major Routes and 6.71% on all other routes. These price cap increases reflect a change in the CPI (British Columbia) of 1.39%. In response to the changes, we implemented tariff increases up to the new levels authorized.

On October 18, 2010, we implemented an across the board fare reduction of approximately 2%, as a result of the $119.4 million in duty remission and related GST, announced by the Government of Canada on October 1, 2010.

On June 2, 2011, Bill 14 was enacted which, among other things, established a price cap for the first year of the third performance term with an increase for each route group on April 1, 2012, of 4.15% from the weighted average of the tariffs payable as at March 31, 2012. We implemented tariff increases April 1, 2012 to the new levels authorized.

The Commissioner will undertake the usual price cap review proceedings for the balance of the performance term, being the period from April 1, 2013 to March 31, 2016.

From time to time, we utilize promotional fares designed to stimulate growth in traffic or direct traffic towards our less busy sailings. In calculating the price cap, vehicle and passenger tariffs are combined. The utilization of promotional fare incentives and the effects of being over or under the price cap may cause the average vehicle and passenger tariff rate to be under or over the allowed increase in any one period.

Year to year changes for the past two fiscal years for the Major, Northern and Other Routes are discussed separately below.

YEAR TO YEAR COMPARISON OF REVENUES 2012 – 2011

Major Routes

Years ended March 31 ($ thousands)	**2012**	2011	Increase (Decrease)	
Direct Route Revenue				
Vehicle traffic (volume)	***3,546,137***	*3,703,923*	*(157,786)*	*(4.3%)*
Vehicle tariff	**209,770**	211,551	(1,781)	(0.8%)
Passenger traffic (volume)	***10,381,444***	*10,738,599*	*(357,155)*	*(3.3%)*
Passenger tariff	**126,156**	125,948	208	0.2%
Social program fees	**12,788**	11,761	1,027	8.7%
Catering & on-board	**61,068**	63,307	(2,239)	(3.5%)
Reservation fees	**10,669**	11,826	(1,157)	(9.8%)
Parking	**3,489**	3,659	(170)	(4.6%)
Assured loading	**1,797**	2,365	(568)	(24.0%)
Other revenue	**2,160**	2,026	134	6.6%
Total Direct Route Revenue	**427,897**	432,443	(4,546)	(1.1%)
Indirect Route Revenue				
Ferry transportation fees	–	–	–	–
Federal-Provincial subsidy	–	–	–	–
Total Route Revenue	**427,897**	432,443	(4,546)	(1.1%)

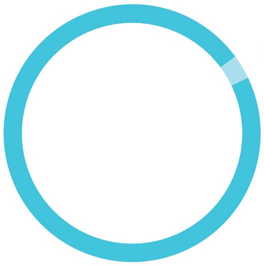
Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island. Both vehicle traffic and passenger traffic decreased in fiscal 2012 from the prior year.

On June 2 through June 26, 2011, our "CoastSaver" program was in place on our three Major Routes. This promotional fare incentive program provided price discounts of more than 30% on passenger and passenger vehicle fares from Thursday through Sunday each week through the duration of the program. Despite this incentive program, traffic on these routes declined. This further reinforced our view that, while the level of ferry fares is a contributing factor, other external factors are primarily responsible for declining traffic levels.

The general decline in vehicle traffic was partially offset by a 54.5% or $2.4 million increase in drop trailer traffic on two of our Major Routes where commercial customers can drop their trailers off at one terminal pick them up at another.

The decrease in traffic, partially offset by higher average fares resulted in a total decrease of $1.6 million in tariff revenue.

Fiscal 2012 revenue from our Major Routes consisted of 97% from customers and 3% from social program fees.



Throughout the eight months ended November 30, 2010, fuel rebates of 2% of tariffs on average were in place on our Major Routes. On December 1, 2010, the fuel rebates were removed due to the increasing cost of fuel. On June 1, 2011 fuel surcharges of 2.5% of tariffs on average were implemented and subsequently increased to 5.0% on average effective December 12, 2011.

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program. Social program fees increased as a result of higher program usage and higher fares. Neither ferry transportation fees nor federal/provincial subsidies are received in support of services provided on our Major Routes.

All vessels that provide service on our Major Routes have a gift shop and options for food service. Both food and gift shop sales decreased mainly as a result of lower passenger traffic. In our gift shops, sales of quality apparel remain strong, increasing $0.7 million or 15.6% from the prior year, while consistent with the industry trend, sales of books and magazines continued their decline.

Reductions in fees for reservations and parking were mainly as a result of lower traffic levels.

Fees for assured loading were lower due to a drop in usage of this product which is partly due to the reduced traffic levels.

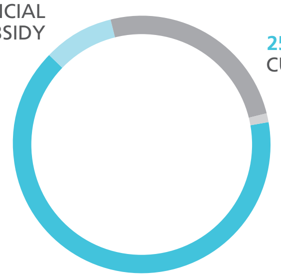
Other revenue increased mainly as a result of an increase in hostling fees from our drop-trailer service for commercial customers.

Northern Routes

Years ended March 31 ($ thousands)	2012	2011	Increase (Decrease)	
Direct Route Revenue				
Vehicle traffic (volume)	***27,573***	*29,353*	*(1,780)*	*(6.1%)*
Vehicle tariff	**7,878**	7,987	(109)	(1.4%)
Passenger traffic (volume)	***80,642***	*85,973*	*(5,331)*	*(6.2%)*
Passenger tariff	**7,075**	7,349	(274)	(3.7%)
Social program fees	**961**	962	(1)	(0.1%)
Catering & on-board	**2,108**	2,200	(92)	(4.2%)
Stateroom rental	**1,061**	1,008	53	5.3%
Hostling & other	**212**	401	(189)	47.1%
Total Direct Route Revenue	**19,295**	19,907	(612)	(3.1%)
Indirect Route Revenue				
Ferry transportation fees	**48,577**	47,139	1,438	3.1%
Federal-Provincial subsidy	**6,800**	6,660	140	2.1%
Total Route Revenue	**74,672**	73,706	966	1.3%

Our Northern Routes consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island.

Fiscal 2012 revenue from our Northern Routes consisted of 25% from customers and 75% from the Province (1% social program fees, 65% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).



Both vehicle and passenger traffic decreased from fiscal 2011. The lower traffic levels, partially offset by higher average tariff rates resulted in a total tariff revenue decrease of $0.4 million. There are no fuel surcharges or rebates in place on our Northern Routes.

Social program fees remained at a similar level to the prior year as a result of lower program usage mainly offset by higher fares.

Catering and on-board revenue decreased as a result of lower passenger traffic, partially offset by higher average spending per passenger. Although passenger traffic was lower, stateroom usage and rental fees increased.

The reduction in hostling and other revenue is mainly due to $178 thousand in charter fees received in fiscal 2011.

We receive ferry transportation fees for these routes under the Contract. These fees are higher in fiscal 2012, reflecting an increase in funding related to the *Queen of Chilliwack* life extension, partially offset by the impact of lower net book value of the vessels used on these routes. The transportation fees decrease as the vessel assets are amortized.

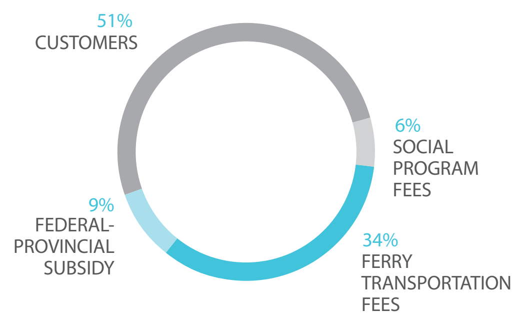
The total Federal-Provincial subsidy increased by 2.1% reflecting the change in the annual CPI (Vancouver).

Other Routes

Years ended March 31 ($ thousands)	2012	2011	Increase (Decrease)	
Direct Route Revenue				
Vehicle traffic (volume)	***4,264,209***	*4,386,270*	*(122,061)*	*(2.8%)*
Vehicle tariff	**65,171**	64,981	190	0.3%
Passenger traffic (volume)	***9,707,891***	*9,921,650*	*(213,759)*	*(2.2%)*
Passenger tariff	**40,953**	40,232	721	1.8%
Social program fees	**12,859**	11,295	1,564	13.8%
Catering & on-board	**10,702**	10,811	(109)	(1.0%)
Reservation fees	**1,259**	1,403	(144)	(10.3%)
Parking & other	**530**	496	34	6.9%
Total Direct Route Revenue	**131,474**	129,218	2,256	1.7%
Indirect Route Revenue				
Ferry transportation fees	**79,773**	79,866	(93)	(0.1%)
Federal-Provincial subsidy	**20,687**	20,264	423	2.1%
Total Route Revenue	**231,934**	229,348	2,586	1.1%

Our Other Routes consist of 19 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of service on the unregulated routes, which are included in the ferry transportation fees in the above table.

Fiscal 2012 revenue from our Other Routes consisted of 51% from customers and 49% from the Province (6% social program fees, 34% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).



Both vehicle and passenger traffic decreased from the prior year. The increased average fares more than offset the decrease in traffic, resulting in a total tariff revenue increase of $0.9 million.

On December 12, 2011, a fuel surcharge of 2.5% of tariffs on average was implemented on the Horseshoe Bay – Langdale Route while the majority of the Other Routes maintained the 5% surcharge that was put in place on June 1, 2011, due to the rising cost of fuel.

Reimbursements from the Province for social program fees increased as a result of higher fares and higher program usage.

Revenue from catering and on-board services decreased as a result of lower passenger traffic on the routes that provide catering services, partially offset by higher average spending per passenger.

Fees for reservations decreased primarily as a result of lower usage and lower traffic levels.

The total Federal-Provincial subsidy increased by 2.1% reflecting the change in the annual CPI (Vancouver).

YEAR TO YEAR COMPARISON OF REVENUES 2011 – 2010

Major Routes

Years ended March 31 ($ thousands)	2011	2010	Increase (Decrease)	
Direct Route Revenue				
Vehicle traffic (volume)	*3,703,923*	*3,739,735*	*(35,812)*	*(1.0%)*
Vehicle tariff	211,551	209,530	2,021	1.0%
Passenger traffic (volume)	*10,738,599*	*10,804,836*	*(66,237)*	*(0.6%)*
Passenger tariff	125,948	122,697	3,251	2.6%
Social program fees	11,761	10,774	987	9.2%
Catering & on-board	63,307	64,226	(919)	(1.4%)
Reservation fees	11,826	12,245	(419)	(3.4%)
Parking	3,659	3,605	54	1.5%
Assured loading	2,365	2,365	–	–
Other revenue	2,026	2,035	(9)	(0.4%)
Total Direct Route Revenue	432,443	427,477	4,966	1.2%
Indirect Route Revenue				
Ferry transportation fees	–	–	–	–
Federal-Provincial subsidy	–	–	–	–
Total Route Revenue	432,443	427,477	4,966	1.2%

Both vehicle traffic and passenger traffic decreased in fiscal 2011 from the prior year. The general decline in vehicle traffic was partially offset by a 57.7% or $2.0 million increase in drop trailer traffic.

Higher average fares more than offset the decrease in traffic, resulting in a total increase of $5.3 million in tariff revenue.

Social program fees increased as a result of higher program usage and higher fares.

Both food and gift shop sales decreased as a result of lower average spending per passenger and lower passenger traffic. The HST implemented July 1, 2010, increased the price to our customers of our food and certain retail offerings. In our gift shops, sales of quality apparel increased $0.5 million or 12.5% while, consistent with the industry trend, sales of books and magazines continued their decline.

Fees for reservations declined as a result of lower traffic levels.

Northern Routes

Years ended March 31 ($ thousands)	2011	2010	Increase (Decrease)	
Direct Route Revenue				
Vehicle traffic (volume)	*29,353*	*31,139*	*(1,786)*	*(5.7%)*
Vehicle tariff	7,987	8,006	(19)	(0.2%)
Passenger traffic (volume)	*85,973*	*88,190*	*(2,217)*	*(2.5%)*
Passenger tariff	7,349	7,106	243	3.4%
Social program fees	962	874	88	10.1%
Catering & on-board	2,200	2,375	(175)	(7.4%)
Stateroom rental	1,008	1,064	(56)	(5.3%)
Hostling & other	401	238	163	68.5%
Total Direct Route Revenue	19,907	19,663	244	1.2%
Indirect Route Revenue				
Ferry transportation fees	47,139	47,590	(451)	(0.9%)
Federal-Provincial subsidy	6,660	6,660	–	–
Total Route Revenue	73,706	73,913	(207)	(0.3%)

Total revenue on our Northern Routes decreased marginally from the prior year.

Both vehicle and passenger traffic decreased from fiscal 2010. Higher average tariff rates, partially offset by lower traffic levels resulted in a total tariff revenue increase of $0.2 million.

Social program fees increased as a result of higher fares and increased program usage.

Catering and on-board revenue and stateroom rental decreased as a result of lower average spending per passenger and lower passenger traffic. The HST implemented July 1, 2010, increased the price to our customers of our food and certain retail offerings.

The ferry transportation fees relate, in part, to the capital cost of the vessels serving these routes and decrease as the related vessel assets are amortized.

The total Federal-Provincial subsidy is equal to the prior year reflecting no change in the annual CPI (Vancouver).

Other Routes

Years ended March 31 ($ thousands)	2011	2010	Increase (Decrease)	
Direct Route Revenue				
Vehicle traffic (volume)	*4,386,270*	*4,484,535*	(98,265)	(2.2%)
Vehicle tariff	64,981	63,646	1,335	2.1%
Passenger traffic (volume)	*9,921,650*	*10,142,618*	(220,968)	(2.2%)
Passenger tariff	40,232	39,523	709	1.8%
Social program fees	11,295	10,411	884	8.5%
Catering & on-board	10,811	11,395	(584)	(5.1%)
Reservation fees	1,403	1,333	70	5.3%
Parking & other	496	490	6	1.2%
Total Direct Route Revenue	129,218	126,798	2,420	1.9%
Indirect Route Revenue				
Ferry transportation fees	79,866	79,858	8	–
Federal-Provincial subsidy	20,264	20,264	–	–
Total Route Revenue	229,348	226,920	2,428	1.1%

Both vehicle and passenger traffic decreased from the prior year. Higher average fares, partially offset by the decrease in traffic, resulted in a total tariff revenue increase of $2.0 million.

Reimbursements from the Province for social program fees increased as a result of higher fares and higher usage in most programs.

Revenue from catering and on-board services decreased as a result of lower average spending per passenger and lower passenger traffic. The HST implemented July 1, 2010, increased the price to our customers of our food and certain retail offerings.

Fees for reservations increased primarily as a result of higher usage.

Total Federal-Provincial subsidy is equal to the prior year reflecting no change in the annual CPI (Vancouver).

Expenses

Expenses for the past three fiscal years are summarized in the tables below:

Years ended March 31 ($ millions)	2012	2011	2010
Operating expenses			
Operations	**413.3**	411.1	398.8
Maintenance	**86.3**	85.7	85.6
Administration	**31.0**	31.2	30.3
Total operations, maintenance & administration	**530.6**	528.0	514.7
% Increase	***0.5%***	*2.6%*	*2.5%*
Cost of retail goods sold	**29.1**	29.7	30.1
Amortization	**123.0**	114.5	115.2
Total operating expenses	**682.7**	672.2	660.0
% Increase	***1.6%***	*1.8%*	*5.7%*

In response to the decline in traffic levels experienced in three of the most recent five fiscal years, we've taken proactive measures to contain and reduce expenses while continuing to ensure that safety remains our top priority.

Years ended March 31 ($ millions)	2012	2011	2010
Interest and other			
Interest expense			
Bond interest	**63.4**	63.3	63.3
KfW bank group (KfW) loans	**9.4**	10.5	11.2
Interest on capital lease	**2.4**	1.2	–
Short-term loans	**0.2**	0.2	0.3
Interest on deferred accounts	**–**	0.3	0.3
Structured Financing Facility program	**(1.5)**	(0.5)	(4.7)
Capitalized interest	**(2.0)**	(2.9)	(2.8)
Total interest expense	**71.9**	72.1	67.6
(Gain) on foreign exchange	**(0.2)**	(0.2)	(0.1)
Loss (gain) on disposal of capital assets	**0.3**	(8.6)	1.4
Total interest and other	**72.0**	63.3	68.9

YEAR TO YEAR COMPARISON OF EXPENSES 2012 – 2011

The $2.2 million increase in fiscal 2012 operations expenses consists of:

- $4.0 million or 4.1% increase in fuel expense as a result of higher fuel prices, partially offset by a 0.4% decrease in fuel consumption;

  Partially offset by:

  - $0.8 million reduction in advertising and public relations; and
  - $1.0 million reduction in a number of miscellaneous items.

The $0.6 million increase in maintenance costs reflects an increase in vessel maintenance reflecting the variations in vessel refit scheduling, mainly offset by reductions in terminal maintenance. We completed 26 refits in fiscal 2012 and had one in progress at March 31, 2012.

Administration expenses remained at a similar level to the prior year.

Amortization increased $8.5 million reflecting higher amortization resulting from the new capital assets entering service during fiscal 2012. (See "Investing in our Capital Assets" below for details of capital asset expenditures in fiscal 2012).

Interest expenses decreased $0.2 million primarily due to:

- $1.0 million in higher interest rate support through the SFF program offered by the Government of Canada, reflecting the funding related to the life extension of the *Quadra Queen II*; and
- $1.1 million less interest due to principal repayments of $45 million on the 12-year amortizing KfW loans and $9 million on the 2.95% loan. (See "Liquidity and Capital Resources – Long-Term Debt" below for more detail);

  Partially offset by:

  - $1.2 million increased interest on the capital lease of the new corporate office building reflecting a full year of the lease being in effect compared to a partial year in fiscal 2011; and
  - $0.9 million less interest capitalized.

On November 1, 2010, our former corporate office building was sold for $11.0 million, resulting in a gain on sale of $9.3 million being recognized in fiscal 2011.

YEAR TO YEAR COMPARISON OF EXPENSES 2011 – 2010

The $12.3 million increase in fiscal 2011 operations expenses consists of:

- $6.7 million increase in wages and benefits, including:

  - Approximately $6.4 million in bargaining unit wage rate increases (averaging about 3%) in accordance with the Collective Agreement; $0.4 million increase in long-term disability premiums; $1.5 million additional labour for the full year operation of the operations and security centre, opening of our travel centre and expanded drop trailer operations; partially offset by a $1.5 million reduction in incentive compensation;

- $2.9 million or 3.1% increase in fuel expense as a result of higher fuel prices, partially offset by a 0.5% decrease in fuel consumption; and
- $2.7 million increase consisting of $0.4 million due to the July 1, 2010 implementation of HST; $0.3 million in credit card service fees; $0.3 million in lease costs; and a further $1.7 million in a number of miscellaneous items.

The $0.1 million increase in maintenance costs reflects an estimated $2.6 million increase due to the implementation of HST; mainly offset by reductions due to variations in vessel refit scheduling and lower costs with maximizing maintenance performed while vessels were afloat. We completed 19 refits in fiscal 2011 and had a further four in progress at March 31, 2011.

Administration expenses increased $0.9 million mainly as a result of an estimated $0.3 million incurred to implement the changes arising from Bill 20; $0.2 million due to the implementation of HST; and costs relating to the move to the new corporate office building.

Amortization decreased $0.7 million reflecting $4.5 million lower amortization of our four vessels built in Germany due to the reduced capital cost resulting from the receipt of $119.4 million in duty remission and related GST; partially offset by higher amortization resulting from the new capital assets entering service during fiscal 2011.

Interest expenses increased $4.5 million primarily due to:

- $4.2 million in lower interest rate support through the SFF program offered by the Government of Canada, reflecting the completion of the funding related to the purchase of the *Island Sky* and the life extension of the *Queen of New Westminster*; partially offset by funding related to the life extension of the *Quinsam*; and
- $1.2 million interest on capital lease of the new corporate office building;

  Partially offset by:

  - $0.7 million less interest due to lower interest rates on the Tranche B than on the Tranche A components of the 12-year KfW loans and the $9 million principal repayment on the 2.95% loan. (See "Liquidity and Capital Resources – Long-Term Debt" below for more detail).

On November 1, 2010, our former corporate office building was sold for $11.0 million, resulting in a gain on sale of $9.3 million. This gain was partially offset by the $0.2 million write down of the *Queen of Prince Rupert*, reflecting market conditions and management expectations and $0.5 million relating to several other asset disposals.

DEFERRED FUEL COST ACCOUNTS

In September 2004, the Commissioner issued an Order authorizing our use of deferred fuel cost accounts to mitigate the effect of volatility in fuel oil prices on our earnings.

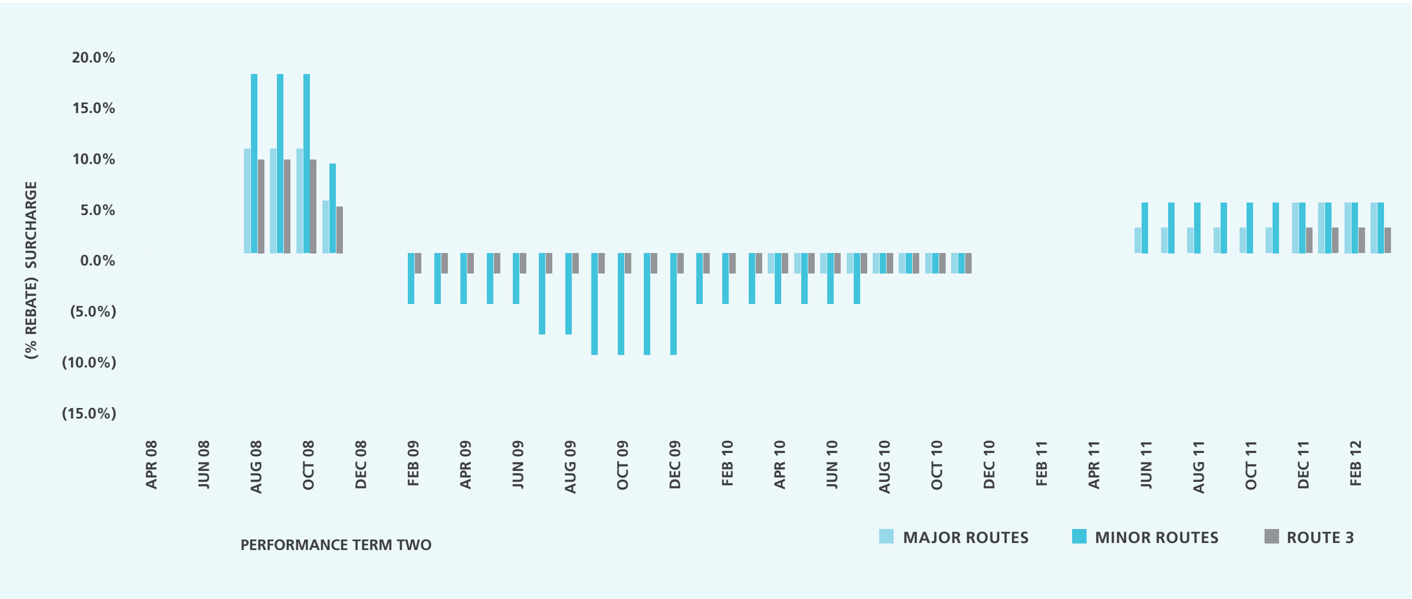
Commencing April 1, 2004, the Commissioner established set prices for fuel for each of the years until March 31, 2008. At the start of each fiscal year, the set prices increased by the CPI (Vancouver). On March 30, 2007, the Commissioner authorized the continued use of inflation-adjusted set prices and deferred fuel cost accounts for the second performance term beginning April 1, 2008 and on March 31, 2011, authorized their continuation for the third performance term beginning April 1, 2012.

For the Northern Routes, the per litre cost of fuel included in the determination of price caps (the set price) and one-half of the first 5 cents per litre of difference between the actual price paid per litre (including realized hedge gains and losses) and the set price is recorded in expense. The remaining one-half of the first 5 cents per litre of difference is recorded in the deferred fuel cost accounts. Any difference beyond 5 cents per litre is recovered from or paid to the Province. The total to be received from the Province relating to fuel costs on the Northern Routes was $1.8 million for fiscal 2012 ($0.2 million received from the Province for fiscal 2011).

For all other routes, differences in fuel costs arising from our actual price paid per litre (including realized hedge gains and losses) being higher or lower than the set price included in base tariffs less one-half of the first 5 cents per litre of difference are charged or credited to the deferred fuel cost accounts.

There is a mechanism in place to allow price cap adjustments to provide for implementation of fuel surcharges or rebates when appropriate. Throughout the first eight months of fiscal 2011, fares on many of our routes with the exception of our Northern Routes were reduced by fuel rebates ranging from 2% to 5% on average. Due to the increasing cost of fuel, on December 1, 2010, the fuel rebates were removed and on June 1, 2011 fuel surcharges of 2.5% of tariffs on average on our Major Routes and 5% of tariffs on average on many of our other routes were implemented. Subsequently, on December 12, 2011, fuel surcharges on the Major Routes were increased to 5% of tariffs on average. In fiscal 2012, we collected $13.1 million in fuel surcharges from customers while in fiscal 2011 we refunded $8.6 million in rebates. These amounts were applied to the outstanding deferred fuel cost account balances. There were no fuel rebates or surcharges on our Northern Routes in place throughout the second performance term.

The following graph illustrates the fuel surcharges and rebates in place throughout the second performance term:



Under an agreement reached during fiscal 2008, the Province has agreed to make contributions which are applied to the deferred fuel cost accounts. These contributions, totalling $1.5 million in fiscal 2012 and $1.6 million in fiscal 2011, are equal to the amount by which annual ferry transportation fees payable by the Province were reduced as a result of the lower cost of the *Northern Adventure* due to remission and refund of import duties paid. These reductions in the deferred fuel cost accounts benefit our customers through reduced fuel surcharges or earlier fuel rebates.

The Commissioner considered $18.5 million of unrecovered first performance term deferred fuel costs in determination of the price caps set for the four years beginning April 1, 2008, for which recovery occurred over this four year period. The actual closing balance in the deferral accounts at March 31, 2008 was $11.9 million. The difference in these amounts, a credit of $6.6 million, formed the opening balances of the deferred fuel cost accounts for the second performance term.

On March 31, 2012, the end of our second performance term, the balance of unrecovered deferred fuel costs in our deferred fuel cost accounts totalled $1.3 million ($2.8 million at March 31, 2011). The Commissioner is currently reviewing the use of deferred fuel cost accounts to mitigate the effect of volatility in fuel oil prices on our earnings. We expect that the fuel cost deferral accounts will continue and the balance at March 31, 2012 will be recovered during the third performance term.

All of the Commissioner's orders can be viewed at www.bcferrycommission.com.

Liquidity and Capital Resources

LIQUIDITY AND CAPITAL RESOURCES

We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues.

Our ongoing capital expenditures are expected to remain at a level significantly lower than in fiscal years 2007 through 2009. Over the next five years we expect our operational cash requirements will be met through operating cash flows and by accessing our credit facility from time to time. At March 31, 2012, our unrestricted cash and cash equivalents totalled $8 million and short-term investments totalled $27 million.

In May 2012, the Province announced additional payments totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. Of this, $25 million was received in April 2012 with the remaining balance to be received over fiscal years 2013 through 2016.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at March 31, 2012, were A (DBRS) with a stable trend and A+ (Standard & Poor's) with a negative outlook, downgraded from a stable outlook.

Maintaining these credit ratings may be challenging, given declining traffic. Bill 47 requires the Commissioner to set price caps sufficient to allow us to meet our debt obligations and maintain access to borrowing rates that in the opinion of the Commissioner are reasonable.

On February 14, 2012, Standard & Poor's affirmed our 'A+' long-term issuer credit and senior unsecured debt ratings. However, the rating agency also concluded:

"The outlook revision reflects our view that recent traffic declines may continue over the near-to-medium term and the uncertainty that exists with respect to BCFS' regulatory framework and its subsequent impact on the company's funding model and ability to manage its business. In the next two years, favorable regulatory decisions by the government and the commissioner that bolster BCFS' operating and financial risk profile could result in an outlook revision to stable. Alternatively, adverse regulatory decisions or a continued deterioration in the company's financial performance could result in a downgrade."

On May 11, 2012, DBRS issued a press release concluding:

"Additional readings and royal assent are still required for Bill 47 to become law, and as yet no changes have been made to the Act. However, if adopted as presented, on balance the proposed changes are seen by DBRS as a slight erosion of the operating framework that would introduce an element of uncertainty to the credit profile of BC Ferries."

LONG-TERM DEBT

Our long-term debt is summarized below:

Amount outstanding as at March 31 ($ millions)	Effective interest rate	2012	2011	2010
Senior Secured Bonds				
5.74%, Due May 2014	5.92%	**250**	250	250
6.25%, Due October 2034	6.41%	**250**	250	250
5.02%, Due March 2037	5.06%	**250**	250	250
5.58%, Due January 2038	5.62%	**200**	200	200
6.21%, Due December 2013	6.33%	**140**	140	140
12 Year Loans				
Tranche A, Due March 2020	5.17%	**60**	68	75
Tranche B, Due March 2020	1.48%*	**6**	22	15
Tranche A, Due June 2020	5.18%	**62**	69	77
Tranche B, Due June 2020	1.47%*	**5**	21	13
2.95% Loan, Due January 2021	3.08%	**81**	90	99
		1,304	1,360	1,369

* Floating rate as at March 31, 2012

MANAGEMENT'S DISCUSSION & ANALYSIS

In May 2004 we entered into a master trust indenture. This indenture established common security and a set of common covenants for the benefit of our lenders. Our financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu.* We do not currently view common share equity as a potential source of capital and have no intention of offering common shares to the public or other investors.

We are also party to a credit agreement with a syndicate of Canadian banks that is secured under the master trust indenture. Under this agreement, we have available a revolving facility in the amount of $155 million. The agreement was amended on April 20, 2012 to extend the maturity date of the facility from May 2013 to April 2017, as well as to modify certain other terms of the facility. The facility is available to fund capital expenditures and other general corporate purposes. At March 31, 2012, draws on this credit facility totalled $17.7 million, bearing an average interest rate of 1.9%.

We have issued five senior secured bond offerings to date with interest payable semi-annually. The bonds are redeemable in whole or in part, at our option.

Secured under the master trust indenture, we entered into three 12-year amortizing loan agreements with KfW. Two of these loans are at a fixed interest rate of 4.98%, payable quarterly. These agreements defer the principal payments for the first three years to a second tranche (Tranche B) on which interest is payable at a floating rate and the principal is due at maturity. The third loan is at a fixed interest rate of 2.95%, payable semi-annually.

Receipt of $119.4 million of duty remission on our four foreign built vessels provided us with financial flexibility. As a result of this flexibility, in the three months ended September 30, 2011, we paid down $45 million in debt consisting of the principal amounts outstanding on Tranche B of the two 12-year, 4.98% loans with KfW bank group. These loan agreements were also amended to provide for the principal payments on these loans for the next three years being funded by draws on Tranche B, on which interest only is paid at a floating rate. The principal on Tranche B is due at maturity (March 2020 and June 2020).

TERMINAL LEASES

We entered into a master agreement with the BC Transportation Financing Authority (BCTFA) effective March 31, 2003, as part of the restructuring of our company. In return for the transfer of ownership interest in all ferry terminals from the former British Columbia Ferry Corporation to the BCTFA at the time of the corporate restructuring, we received recognition of prepayment of rent under terminal leases.

The leases grant us exclusive access and use of ferry terminal properties for a period of 60 years commencing April 1, 2003. The leases are renewable for an additional period of 20 years at a total cost of $20 per lease provided the Contract is renewed. We must manage, maintain and develop the terminals at our own cost.

Since the original transfer, a total of $11.7 million of additional lands at Horseshoe Bay, Swartz Bay and Departure Bay have been added to the existing terminal leases in exchange for highway improvements.

If we fail to meet our obligations under the terminal leases or default under the Contract, the BCTFA may at its option re-enter and take possession of the ferry terminal properties and at its option terminate the leases. The BCTFA has entered into an acknowledgement agreement with the Trustee under the master trust indenture, which sets out certain limitations on the use of this option.

OTHER LONG-TERM LIABILITIES

Other long-term liabilities consist primarily of accrued post-retirement and post-employment benefits.

SOURCES & USES OF CASH

Our liquidity needs are met through a variety of sources, including cash generated from operations, issuance of bonds, and borrowings under our credit facility. Our primary uses of funds are operational expenses, capital asset acquisitions and upgrades, and payments on our long-term debt.

Sources and uses of cash and cash equivalents for fiscal 2012 and 2011 are summarized in the table below:

Year ended March 31 ($ millions)	2012	2011
Net (loss) earnings	**(16.5)**	3.8
Items not involving cash:		
Amortization	**123.0**	114.5
Other non-cash charges	**(2.7)**	(6.7)
Regulatory costs deferred	**(3.0)**	(7.5)
Change in non-cash operating working capital	**(0.3)**	1.4
Cash provided by operating activities	**100.5**	105.5
Cash used in financing activities	**(49.2)**	(12.1)
Cash used in investing activities	**(76.9)**	(70.7)
Total (decrease) increase in cash	**(25.6)**	22.7

In fiscal 2012, cash provided by operating activities included $3.0 million of cash used to increase long-term regulatory costs deferred as follows:

- $17.6 million in fuel and interest costs deferred;

  Partially offset by:

  - $13.1 million in fuel surcharges;
  - $1.5 million in other payments from the Province credited to deferred fuel accounts.

Cash provided by operating activities also included an increase in non-cash operating working capital of $0.3 million. This increase in non-cash operating working capital was primarily due to:

- $1.1 million increase in operating accounts receivable;
- $2.1 million increase in total operating inventories reflecting a $1.4 million increase in general inventories for refits and maintenance items, $0.5 million in fuel reflecting a higher price of fuel for our vessels, partially offset by a lower volume, and $0.2 million in other items;
- $1.8 million decrease in deferred revenue reflecting the assured loading ticket refunds, partially offset by an increase in stored value card liabilities and advertising revenue;
- $1.7 million decrease in payables and accrued liabilities relating to refit and maintenance and other operating activities; and
- $1.1 million increase in prepaid fuel expense;

The above items, which increased working capital, were partially offset by:

- $2.4 million increase in regulatory liabilities reflecting tariff revenues collected in excess of price caps at March 31, 2012;
- $3.7 million decrease in current regulatory assets with first performance term fuel deferral balances at March 31, 2011 of $4.8 million now completely amortized and $1.1 million reflecting the return to customers through discount fare promotions of tariff revenues collected in excess of price caps at March 31, 2011;
- $1.0 million increase in accrued employee costs; and
- $0.4 million increase in current employee future benefits.

Cash used in financing activities consisted of:

- $45.0 million prepayment of the principal amounts outstanding on the second tranche of the two 12-year, 4.98% loans with KfW bank group;
- $9.0 million principal repayment on the 2.95% loan;
- $6.0 million dividend on preferred shares;
- $1.9 million principal repayment on the 12-year, 4.98% loan with an effective interest rate of 5.17%; and
- $1.1 million payment of capital lease obligations;

  Partially offset by $13.8 million in draws on our $155 million credit facility.

Cash used in investing activities consisted primarily of:

- $115.3 million used to purchase capital assets (See "Investing in Our Capital Assets" below for detail of significant purchases); and
- $0.1 million in other items;

  Partially offset by:

  - $37.2 million sale of short-term investments; and
  - $1.3 million reduction in debt service reserves.

Fourth Quarter Results

The following provides an overview of our financial performance for the three months ended March 31, 2012, compared to the three months ended March 31, 2011.

The fourth quarter reflects a seasonal reduction in traffic levels which we utilize to perform upgrades and major maintenance and refit programs as well as to undertake mandatory inspections on the majority of our vessels.

			Variance	
Three months ended March 31 ($ millions)	**2012**	**2011**	**$**	**%**
Total revenue	**138.2**	140.7	(2.5)	(1.8%)
Operating expenses	**165.3**	161.7	(3.6)	(2.2%)
Loss from operations	**(27.1)**	(21.0)	(6.1)	(29.0%)
Interest and other	**18.1**	18.0	(0.1)	(0.6%)
Net loss	**(45.2)**	(39.0)	(6.2)	(15.9%)

REVENUE

Our total revenues have decreased as shown in the following table:

			Increase (Decrease)	
Three months ended March 31 ($ millions)	**2012**	**2011**	**$**	**%**
Direct Route Revenue				
Vehicle traffic (volume)	***1,502,231***	*1,555,687*	*(53,456)*	*(3.4%)*
Vehicle tariff	**51.5**	54.4	(2.9)	(5.3%)
Passenger traffic (volume)	***3,666,163***	*3,744,938*	*(78,775)*	*(2.1%)*
Passenger tariff	**29.5**	30.6	(1.1)	(3.6%)
Social program fees	**5.7**	5.1	0.6	11.8%
Catering & on-board	**13.2**	13.3	(0.1)	(0.8%)
Other revenue	**3.4**	2.2	1.2	54.5%
Total Direct Route Revenue	**103.3**	105.6	(2.3)	(2.2%)
Indirect Route Revenue				
Ferry transportation fees	**27.0**	27.1	(0.1)	(0.4%)
Federal-Provincial subsidy	**6.9**	6.7	0.2	3.0%
Total Route Revenue	**137.2**	139.4	(2.2)	(1.6%)
Other general revenue	**1.0**	1.3	(0.3)	(23.1%)
Total Revenue	**138.2**	140.7	(2.5)	(1.8%)

Average tariff revenue per vehicle decreased $0.69 or 2.0% in the quarter compared to the prior year while average tariff revenue per passenger decreased $0.12 or 1.5%. Fares collected during the fourth quarter of fiscal 2012 were in excess of price cap by $2.4 million. In the fourth quarter of fiscal 2011, $4.4 million was refunded to our customers through fare reductions. At March 31, 2012, $2.5 million was recorded on our balance sheet as a regulatory liability ($1.1 million at March 31, 2011) and will be reflected in future fare reductions. The reduction in traffic and the lower average fares resulted in a decrease of $4.0 million in tariff revenue.

Social program fees increased mainly as a result of higher usage on our Other Routes while catering and on-board revenues decreased as a result of lower passenger traffic, partially offset by a higher average spending per passenger.

The increase in other revenue reflects adjustments to assured loading tickets revenue in the fourth quarter of the prior year.

Ferry transportation fees were lower on the Northern Routes, reflecting the reduction in fees as the vessel assets are amortized.

Other general revenue decreased mainly as a result of lower interest income.

EXPENSES

Expenses are shown in the following table:

			Increase (Decrease)	
Three months ended March 31 ($ millions)	**2012**	**2011**	**$**	**%**
Operations	**95.8**	95.9	0.1	0.1%
Maintenance	**23.2**	22.4	(0.8)	(3.6%)
Administration	**8.3**	8.9	0.6	6.7%
Cost of retail goods sold	**5.2**	5.2	–	–
Amortization	**32.8**	29.3	(3.5)	(11.9%)
Total operating expenses	**165.3**	161.7	(3.6)	(2.2%)
Interest & other	**18.1**	18.0	(0.1)	(0.6%)
Total expenses	**183.4**	179.7	(3.7)	(2.1%)

The decrease in operations costs is due to reductions in several areas, mainly offset by an increase of $0.6 million in fuel expense as a result of higher fuel prices and a 1.2% increase in fuel consumption mainly due to vessel redeployment.

The increase in maintenance costs reflects variations in vessel refit scheduling.

Administration costs decreased mainly due to reductions in contracted services and legal fees.

Amortization increased as a result of the new assets that have come into service.

Interest expenses have remained at a similar level to the prior year with lower interest on long-term debt and additional SFF funding mainly offset by less interest capitalized.

Investing in our Capital Assets

ASSETS ACQUIRED UNDER CAPITAL LEASE

In September 2010, agreements which constitute a capital lease for space in our new corporate office building in downtown Victoria took effect following the completion of construction of the new building.

The initial term of the lease is 15 years, with four renewal options of five years each. In November, 2010, we advanced $24.2 million to the developer of the property for a term of 15 years, secured by a second mortgage on the property. The loan agreement provides for interest equal to one-half of the net cash flow from the property, subject to minimum and maximum percentage rates of interest. Over the term of the loan, interest is expected to approximate the market rate when the loan was made. Incidental to the loan, we were granted an option to purchase up to 50% of the owner's equity interest in the new building at a price of $24.2 million. Final adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to $24.5 million. The purchase option expires at the end of the loan term.

Assets totalling $49.2 million representing the present value of the future minimum payments under these agreements, including the purchase option, were added to our capital assets in September 2010. The value of our capital assets was increased by $0.3 million in the three months ended June 30, 2011, to reflect the final cost adjustments.

CAPITAL EXPENDITURES

Capital expenditures in the three and twelve months ended March 31, 2012, totalled $31.6 million and $122.2 million, respectively.

March 31, 2012 ($ millions)	3 Months	12 Months
Vessel upgrades and modifications	17.2	48.5
Terminal marine structures	5.4	44.0
Information technology	6.1	18.6
Terminal and building upgrades and equipment	2.9	11.1
Total capital expenditures	31.6	122.2

VESSEL UPGRADES AND MODIFICATIONS

Capital expenditures for vessel upgrades and vessel modifications in the three and twelve months ended March 31, 2012, included the following:

March 31, 2012 ($ millions)	3 Months	12 Months
Sewage treatment upgrade program	8.8	20.7
Queen of Chilliwack life extension	3.2	8.2
Queen of Burnaby asset betterment	0.2	5.0
Other projects	5.0	14.6
	17.2	48.5

Implementation of a $43 million multi-year sewage and waste water treatment program to upgrade 27 vessels for treatment of sewage generated onboard the vessels is nearing completion. The program involves major modifications and upgrades to ensure that all vessels comply with *Canada Shipping Act, 2001* sewage regulations, which were effective May 3, 2012. Wherever possible, the vessels convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels have been fitted with compliant marine sanitation devices. All vessels in service are in compliance with the new regulations.

The project to extend the life of the 33-year-old *Queen of Chilliwack* began in December 2010, with the first phase of a two-phase project that will allow the vessel to continue in service until it is retired in 2017 or later. The first phase of this $15 million project, completed during the first quarter of fiscal 2012, included new car deck watertight doors, new propeller seals, new instrumentation and control systems, new sewage treatment holding tank and pump out system, and new lifesaving systems. The second phase began in early January 2012 and includes the installation of three new generators, electrical and HVAC system upgrades, and renewal of the propulsion control system. The vessel is expected to return to service for the summer season. Ferry transportation fees for the Northern Routes increased $1.8 million in fiscal 2012 as a result of this life extension.

On December 16, 2011, the *Queen of Burnaby* returned to service after completion of a $5 million asset improvement project as well as a $3 million refit. The vessel underwent an extensive mechanical refit including the overhaul of generators, port main engine, bow thruster and propulsion system; modernization of the elevator system; steel renewal on the main car deck; abatement of asbestos containing material; new flooring in washrooms; and regulatory surveys.

TERMINAL MARINE STRUCTURES

Capital expenditures for terminal marine structures in the three and twelve months ending March 31, 2012, included the following:

March 31, 2012 ($ millions)

Terminal	Description	3 Months	12 Months
Swartz Bay	Berth 4 and 5 replacement and refurbishment	1.9	14.2
Hornby Island	Replacement of ramp, wingwalls, towers & dolphins	0.8	9.0
Tsawwassen	Refurbishment of decks and berth 5 upgrades	0.1	8.0
Denman Island	Replacement of ramp, wingwalls, towers & dolphins	0.7	5.9
Various	Other projects	1.9	6.9
		5.4	44.0

The $19 million project at Swartz Bay for the upgrade of berths 4 and 5 includes replacement of ramps, ramp abutments, aprons, towers, wingwalls, dolphins and floating leads as well as electrical upgrades and a new waiting shelter. Berth 5 is complete and berth 4 is expected to be complete in mid 2012.

At Shingle Spit on Hornby Island and at Gravelley Bay on Denman Island, major marine structure replacement programs were completed in November 2011. The combined $18 million multi-year projects included replacement of the wingwalls, ramps, ramp abutments, aprons, trestles, towers, and dolphins.

At Tsawwassen Terminal, a $9 million project to replace the dolphins, catwalk and sheet pile wall as well as refurbishment of the hydraulic systems at berth 5 and a $1 million project for deck coating of two berths have been completed.

INFORMATION TECHNOLOGY

Capital expenditures for information technology in the three and twelve months ending March 31, 2012, included the following:

March 31, 2012 ($ millions)	3 Months	12 Months
Customer service program	1.8	6.3
Computer hardware upgrades	2.4	3.4
Other projects	1.9	8.9
	6.1	18.6

The $39 million customer service program will replace our aged point of sale and reservations systems and allow us to respond in a more timely fashion to changing business needs and to support marketing, travel services, and pricing initiatives. This program will also include terminal ticketing automation and customer relationship management systems. This five year program will be completed and implemented in stages starting in fiscal 2014, and is expected to be fully completed by fiscal 2016, and will significantly improve our ability to efficiently respond to the changing needs of our customers.

Computer hardware upgrades continue as we proceed through our programs for replacement of aged computers, servers, cash registers and printers.

Other projects include bridge simulation training centres at three of our major terminals to enable the development and delivery of affordable, integrated and targeted bridge team training that reduces operational risk. The training program will leverage simulator best practices, minimize operational impacts and overhead, establish the infrastructure and lay the foundation for technical and team training for our bridge teams.

Other projects completed during the fiscal year include an electronic document management system for the control, revision and publication of operations manuals even when onboard a vessel, website enhancements, and privacy and archiving projects.

Other projects currently underway include enhancements for improved supply chain management and a payroll system replacement initiative to replace both our payroll and labour distribution systems to provide added reliability and significant processing efficiencies and flexibility. We are also in the process of upgrading our computer operating systems and office software.

TERMINAL AND BUILDING UPGRADES AND EQUIPMENT

Capital expenditures for terminal and building upgrades and equipment in the three and twelve months ending March 31, 2012, included the following:

March 31, 2012 ($ millions)	3 Months	12 Months
Vehicles, machinery & equipment	1.6	3.2
Terminal waste water program	0.1	2.8
Other terminal projects	1.2	5.1
	2.9	11.1

As part of the $20 million multi-year sewage and waste water treatment program for treatment of sewage generated onboard our vessels, installation of pump ashore infrastructure is in service at six terminals where sewage is collected and transferred to the municipal infrastructure. A treatment plant has been installed at one terminal where there is no municipal infrastructure to connect with and installation of pump ashore infrastructure at the final terminal is underway. As part of the federal government's Infrastructure Stimulus Fund program, we received $3.2 million in fiscal 2011 and a further $5.5 million in fiscal 2012, relating to sewage pump-ashore projects and other major terminal projects.

The costs incurred for vehicles, machinery, and equipment are primarily for upgrades to the electrical equipment at our maintenance facility and the purchase of a crane truck as well as electrical sub-metering at five of our terminals to take advantage of potential electricity conservation and reduction opportunities.

Other projects include seismic upgrades of certain of our maintenance facilities and security upgrades at some of our terminals.

Summary of Quarterly Results

The table below compares earnings by quarter for the most recent eight quarters:

Quarter Ended (unaudited) ($ millions)	Mar 12	Dec 11	Sep 11	Jun 11	Mar 11	Dec 10	Sep 10	Jun 10
Total revenue	138.2	161.3	252.0	186.7	140.7	162.3	246.0	190.3
(Loss) earnings from operations	(27.1)	(5.2)	75.4	12.4	(20.9)	(3.3)	72.5	18.9
Net (loss) earnings and comprehensive (loss) income	(45.2)	(23.1)	57.3	(5.5)	(39.0)	(12.4)	54.3	0.9

Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal reduction in traffic. We utilize these periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters:

Outlook

TRAFFIC LEVELS

Ferry traffic levels are affected by a number of factors, such as the economy, weather, transportation costs (including vehicle gasoline prices and ferry fares), the value of the Canadian dollar, global security, tourism levels, disposable personal income, demographics, and population growth. We are uncertain as to the individual or cumulative impact these items may have on our traffic levels. We are also uncertain as to the cumulative impact that tariff rate increases and the implementation and removal of fuel surcharges or rebates may have.

A summary of vehicle and passenger traffic over the last five years is shown below and a discussion of the changes over the years is discussed above in the "Financial and Operational Overview".

(thousands)	2012	2011	2010	2009	2008
Vehicle Traffic by fiscal year					
Major routes	**3,546.1**	3,703.9	3,739.7	3,696.3	3,912.3
Other routes	**4,264.2**	4,386.2	4,484.6	4,402.4	4,632.6
Northern routes	**27.6**	29.4	31.1	31.7	33.8
Total	**7,837.9**	8,119.5	8,255.4	8,130.4	8,578.7
(Decrease) increase	***(3.5%)***	*(1.6%)*	*1.5%*	*(5.2%)*	*0.7%*

(thousands)	2012	2011	2010	2009	2008
Passenger Traffic by fiscal year					
Major routes	**10,381.4**	10,738.6	10,804.8	10,664.2	11,304.0
Other routes	**9,707.9**	9,921.6	10,142.6	9,969.3	10,382.7
Northern routes	**80.7**	86.0	88.2	94.0	101.8
Total	**20,170.0**	20,746.2	21,035.6	20,727.5	21,788.5
(Decrease) increase	***(2.8%)***	*(1.4%)*	*1.5%*	*(4.9%)*	*0.5%*

Based on levels experienced during the school spring break and Easter, we feel that there is some risk that we may see further traffic declines in fiscal 2013. Over the near term we expect traffic levels to stabilize at these new levels and over the next few years we anticipate a limited recovery in discretionary traffic levels resulting in no significant increase or decrease in overall traffic volume on all our routes.

MARKET OPPORTUNITIES

We are constantly looking for innovative ways to serve our customers and actively pursue opportunities for growth.

Our drop trailer service, launched in March 2009, operates on two of our Major Routes. Our commercial customers on these routes can drop their trailers off at one terminal and pick them up at another. This drop trailer service is the fastest growing segment of our market with increases over the past two years of 54% and 58%, respectively. The service also improves our overall productivity by utilizing otherwise unused capacity. We expect to see modest growth in drop-trailer traffic over the next few years as general economic conditions improve and our overall commercial market share remains relatively stable.

In May 2010, we opened our vacations centre conveniently located in the tourist sector of downtown Vancouver. Through the use of our travel centre and an integrated marketing approach, we are able to leverage off of our core business to drive incremental ferry traffic as well as generate commissions from the related services. Using a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options. This segment of our business has crossed over the breakeven threshold and we expect it to continue to make a positive contribution to our earnings in the future. As the economy strengthens, we expect to see modest growth in sales of vacation packages, leading to increased traffic volumes as well as incremental non-tariff revenue.

ASSET RENEWAL PROGRAM

We have one of the largest fleets in the world. The average age of our assets was among the oldest of major ferry operators worldwide. To address this, we instituted a multi-year major fleet and asset renewal program which involved upgrading and replacing a large share of our fleet and terminal assets. The most significant portion of our asset renewal program was completed during fiscal 2010.

Over a number of years, this program saw seven new vessels being added to our fleet, many other vessels significantly upgraded and numerous improvements to our terminal assets. The entry of the new vessels into service and asset revitalization has reduced the average age of our major vessels from 33 years to 19 years and assists in maintaining operational reliability.

Our next significant vessel renewal program will be focused on our minor and intermediate sized vessels contemplated for replacement within the next two performance terms. These vessels currently have an average age of 36 years. As the identified replacement dates approach, we will undertake a full review of these vessels to determine if any are candidates for life extension rather than replacement. Over the next five years, we expect to replace or life-extend five vessels, one of which is expected to be replaced with a cable ferry.

Significant upgrades at our terminals that support our Major Routes are expected to be substantially complete by the end of fiscal 2013 and work will commence on replacing marine structures, buildings and other improvements at our terminals that support our other routes.

CABLE FERRY

In fiscal 2011, we completed our review of the feasibility of using cable ferry technology on one of our shortest routes. Preliminary indications were that using a cable ferry is both technically and financially feasible. An independent review of the proposed cable ferry service supports the proposed service on our route operating between Buckley Bay and Denman Island. Cable ferry technology uses small engines in combination with drive and guide cables to move the vessel. Not only do cable ferries have a lower capital cost than conventional ferries, but a reduction in operating costs would also be expected. We have received regulatory and environmental approvals from the Department of Fisheries and Oceans under the *Canadian Environmental Assessment Act*. We are currently undertaking engineering analysis of the proposed cable ferry system. In May 2012, we executed a contract for development and analysis of initial design criteria, and in early June 2012, we issued an RFP for detailed design engineering. Also, in May 2012, we issued an RFP to seek an alternative service provider for provision of the passenger and vehicle cable ferry service, including the design, build, operation and maintenance of the cable ferry system and related terminals. Our engineering analysis will assist in the evaluation of the proposals from the alternative service providers. Safety, reliability and quality of service will continue to be important considerations throughout this project. This initiative is part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our effectiveness in delivering safe, reliable, and quality ferry service.

FUEL CONVERSION

We are also currently determining the feasibility of converting the fuel used on certain of our vessels from marine diesel oil to liquefied natural gas (LNG). The LNG industry has an excellent safety record. The fuel has been used in the marine industry for more than a decade. We believe that conversion to LNG would reduce emissions and significantly reduce fuel costs. However, the costs to convert vessels to LNG are significant. We will consider implementing LNG for any new-build vessels and for any existing vessel life-extension or mid-life upgrade projects.

ALTERNATIVE SERVICE PROVIDERS

In an effort to reduce costs on our regulated routes, from time to time we test the market to determine if another operator, under contract to us, could provide safe, reliable and high quality service that is more cost-effective. In addition, under section 69 of the Act the Commissioner has the authority to require us to provide a plan to seek alternative service providers.

FINANCIAL OUTLOOK

We do not anticipate that economic conditions or our traffic levels will improve in the near term and are continuing our program of cost containment and deferrals, while maintaining safe, reliable service.

We are currently forecasting a net loss for fiscal 2013, the first year of performance term three, largely driven by significantly lower traffic levels than those originally included in setting our performance term three price caps. Despite the loss, we have no plans to reduce our refit and maintenance programs, training and safety programs or capital programs. We expect to return to profitability in fiscal 2014, assuming a combination of ferry transportation fee increases, reasonable adjustments to service levels and modest increases in fares, coupled with a gradual improvement in the overall economy and continued cost management.

Financial Risks and Financial Instruments

Exposure to credit risk, liquidity risk and market risk arises in the normal course of our business. We manage market risk arising from the volatility in foreign currency, interest rate, and fuel price exposures in part through the use of derivative financial instruments including forward contracts, swaps and options. We do not utilize derivative financial instruments for trading or speculative purposes.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where the market prices are not available, fair values are estimated using discounted cash flow analysis based on our current borrowing rate for similar borrowing arrangements.

CREDIT RISK

We limit our exposure to credit risk on cash and investments by investing in liquid securities with high credit quality counterparties, placing limits on tenor of investment instruments and instituting maximum investment limits per counterparty. We manage credit exposure related to financial instruments by dealing with high credit quality institutions, in accordance with established policy and parameters and by an ongoing review of our exposure to counterparties. Counterparty credit rating and exposures are subject to approved credit limits and are monitored by us on an ongoing basis. Counterparties with which we have significant derivative transactions must be rated single A or higher. We do not expect any counterparties to default on their obligations.

Our credit risk from trade customers is limited by having a large and diversified customer base and is managed through the review of third-party credit reports, utilizing pre-authorized payment plans, monitoring of aging of receivables, and collecting deposits and adjusting credit terms for higher risk customers. Amounts due from the Province and the Government of Canada are considered low credit risk. At March 31, 2012, 82% of our accounts receivable was comprised of amounts due from the Province and the Government of Canada.

LIQUIDITY RISK

We target a strong investment grade credit rating to maintain capital market access at reasonable interest rates. Our financial position could be adversely affected if we fail to arrange sufficient and cost effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. This is subject to numerous factors, including the results of our operations, our financial position, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions. In May 2012, the Province announced additional payments totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. Of this, $25 million was received in April 2012 with the remaining balance to be received over fiscal years 2013 through 2016. This will provide us with additional cash and strengthen our balance sheet.

We deem liquidity risk to be low at this time as we do not foresee the need to access the capital markets for at least the next two years.

We manage liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of debt service reserves. Our credit ratings at March 31, 2012, were A (DBRS) with a stable trend and A+ (Standard & Poor's) with a negative outlook.

MARKET RISK

INTEREST RATE

Our exposure to interest rate risk is limited to our short-term borrowings and floating rate debt and interest rate movement beyond the term of the maturity of fixed rate short-term investments. To manage this risk, we maintain between 70% and 100% of our debt portfolio in fixed rate debt, in aggregate. In addition, we may enter into interest rate agreements to manage our exposure on debt instruments. A 50 basis point change in interest rates would not have had a significant effect on our fiscal 2012 earnings.

FOREIGN CURRENCY

We are also exposed to risk from foreign currency prices on financial instruments, such as accounts payable denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, we review our foreign currency denominated commitments and hedge through derivative instruments as necessary. A 10% change in the US dollar or Euro foreign exchange rates would not have had a significant effect on our fiscal 2012 earnings.

FUEL PRICE

Our exposure to fuel price risk is associated with the changes in the market price of marine diesel fuel. Fuel costs have fluctuated significantly over the past few years and there is uncertainty of the cost of fuel in the future.

To mitigate the effect of volatility in fuel oil prices on our earnings, we use deferred fuel cost accounts. (See "Expenses – Deferred Fuel Cost Accounts" above for more detail).

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. There is uncertainty of the impact on future ferry traffic levels if fuel surcharges and therefore total tariff levels rise significantly. There is a risk of a decline in ferry traffic levels as a result of increasing customer costs resulting from the implementation of fuel surcharges.

We also may manage our exposure to fuel price volatility by entering into hedging instruments in order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Pursuant to our Financial Risk Management Policy, the term of the contracts is not to extend beyond three years. This policy limits hedging to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period, 90% of anticipated monthly fuel consumption for the 12 month period thereafter, and to 85% of anticipated monthly fuel consumption for the remaining 12 month period. At March 31, 2012, we did not have any outstanding fuel swaps. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs.

The fair value of all financial instruments included above, with the exception of long-term debt, approximate their carrying amounts due to the nature of the item and/or the short time to maturity.

DERIVATIVES

We hedge our exposure to fluctuations in fuel prices and foreign currency exchange rates from time to time through the use of derivative instruments. At March 31, 2012 we held six foreign exchange forward contracts with a carrying and fair value of $12 thousand while at March 31, 2011 we held five such contracts with a carrying and fair value of $23 thousand. There were no commodity derivatives in place at March 31, 2012 or March 31, 2011.

The fair value of commodity derivatives would reflect only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. The fair values would reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. Any gains or losses related to fuel commodity swaps would be charged to our deferred fuel cost accounts.

NON-DERIVATIVE FINANCIAL INSTRUMENTS

The carrying and fair values of non-derivative financial instruments at March 31, 2012, and 2011 are as follows:

($ millions)	2012 Carrying Value	2012 Fair Value	2011 Carrying Value	2011 Fair Value
Financial Assets				
Cash and cash equivalents	**7.7**	**7.7**	33.3	33.3
Restricted short-term investments	**35.7**	**35.7**	37.0	37.0
Other short-term investments	**26.9**	**26.9**	64.1	64.1
Accounts receivable	**42.3**	**42.3**	20.6	20.6
Loan receivable	**24.5**	**24.5**	24.2	24.2
	137.1	**137.1**	179.2	179.2
Financial Liabilities				
Accounts payable and accrued liabilities	**52.0**	**52.0**	51.2	51.2
Short-term debt	**17.7**	**17.7**	3.9	3.9
Interest payable on long-term debt	**18.2**	**18.2**	18.3	18.3
Accrued employee costs	**49.2**	**49.2**	48.2	48.2
Long-term debt, including current portion	**1,294.2**	**1,491.0**	1,349.1	1,464.0
	1,431.3	**1,628.1**	1,470.7	1,585.6

The fair value of all financial instruments included above, with the exception of long-term debt, approximate their carrying amounts due to the nature of the item and/or the short time to maturity.

The carrying value of long-term debt is measured at amortized cost using the effective interest rate method. Fair value is calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues, or by using available quoted market prices.

Business Risk Management

We continue to employ a variety of commonly accepted methodologies to identify, assess and mitigate risks. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business.

We do not believe that material uncertainties exist in regards to our future. As part of our risk management strategies, we have considered many items such as profitability levels, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to weather the economic downturn and ensure a viable, profitable future.

CUSTOMER DEMAND

Our vehicle and passenger traffic levels in fiscal 2012, as compared to the prior year, declined 3.5% and 2.8%, respectively. The decline in traffic was experienced across the Major, Northern and Other Routes.

Impacting our traffic levels is the increased value of the Canadian dollar. More Canadians are travelling to the United States and fewer Americans are travelling to Canada. Many other factors affect customer demand, including current economic conditions, levels of tourism and discretionary travel. The cost of transportation, including the price of fuel at the pump and ferry fares (including the implementation and removal of fuel surcharges or rebates), disposable personal income, heightened global security and weather conditions may have a negative effect on discretionary travel and levels of tourism.

We are uncertain as to the individual or cumulative impact these items may have on our revenue. No assurance can be given as to the level of traffic on our system and the resulting tariff revenues.

Risk mitigation: We are constrained by the Contract, which stipulates, among other things, the number of round trips that must be provided for each regulated ferry route. Within these constraints, we actively manage our capacity in an efficient and effective manner to ensure we can react quickly to changing levels of demand within the restrictions of the Contract. We have also applied for reductions to the required number of round trips stipulated in the Contract. This would allow us some flexibility in eliminating trips that have been historically underutilized. Vessel planning strategies are in place and we regularly review and update our short and long-term financial and operating plans to ensure appropriate alignment of expenses with revenue.

MANAGEMENT'S DISCUSSION & ANALYSIS

SECURITY OF INFORMATION

Deliberate or inadvertent release of personal information, whether in paper or electronic format, could have an adverse effect on the lives of our employees and customers as well as negatively impact our reputation. A significant loss of confidential management information could also negatively impact our financial position and results of operations.

Risk mitigation: Governance is in place for ensuring information privacy.

Security initiatives are well under way regarding information technology. The adequacy of policies, processes and standards is under review and a comprehensive plan for incident response is in place. Standard procedures for access and use of private data have been implemented. Multiple levels of technology controls are in place and networks, websites and databases are monitored to detect potential issues.

Communication to employees of their responsibility to protect private information is ongoing and a formal awareness program is being designed. Education and training programs are being reviewed and formalized.

SECURITY

Deliberate, malicious acts could cause death, injury or property damage. The occurrence of a major incident or mishap could negatively affect the propensity for the public to travel, reducing our ferry traffic levels. It could also lead to a substantial increase in insurance and security costs.

Any resulting reduction in tariff revenues and/or increases in costs could have a material adverse effect on our business prospects, financial condition and results of operations.

Risk mitigation: Security initiatives are in place to counter intentional attacks. Our 24-hour operations and security centre provides enhanced situational awareness and assessments, increased security monitoring, and a coordinated response during any incidents.

We are committed to our multi-year project to upgrade security at our terminals. This project primarily involves fencing, gating, lighting, access controls, and closed circuit television, as well as upgrades to foot passenger ticketing areas, baggage screening, and the use of canine patrols.

We also have a sound conventional insurance program designed to mitigate the financial impact of a major incident. However, there can be no guarantee that the insurance coverage will be sufficient to cover all such incidents.

ECONOMIC REGULATORY ENVIRONMENT

We cannot predict what changes the Province may make to the Act or to other legislation, nor can we predict how the Commissioner's interpretation and administration of the Act may change over time. Such changes may impact our profitability. (See "Corporate Structure – Economic Regulatory Environment" above for more detail).

The Province has established price caps for fiscal 2013, the first year of performance term three by legislation. The legislated price caps for our non-Major Routes are lower than the preliminary price caps proposed by the Commissioner in September 2011. In May 2012, the Province announced increases to ferry transportation fees in order to compensate us for the legislated reduction in price caps for the non-Major Routes and to reduce the pressure for future fare and price cap increases. Final price caps for the remainder of performance term three are expected to be established by the Commissioner by September 30, 2012. There remains uncertainty in the Commissioner's future price cap rulings.

Risk mitigation: We strive to maintain regular and open communications and positive relationships with the Province, the Commissioner, the Deputy Commissioner and local Ferry Advisory Committees that represent the interests of the communities we serve.

ACCESS TO CAPITAL MARKETS

Our ability to arrange sufficient, cost-effective and timely debt financing could be materially adversely affected by numerous factors; our economic regulatory environment, our results of operations and financial position, market conditions, our credit ratings and general economic conditions.

Any failure or inability to borrow on satisfactory terms when required could impair our ability to repay maturing debt, fund necessary capital expenditures and meet other obligations and requirements and, as a result, could have a material adverse effect on our ongoing operations.

Risk mitigation: We strive to communicate to our stakeholders the importance of our financial viability within our economic regulatory framework and our commitment to maintaining financial strength, in order to access these important markets.

SAFETY

The safety of the public and our employees is our highest priority. However, there is a risk to passenger and employee safety and/or property damage as a result of the ineffectiveness of policy and procedures, equipment, maintenance, training, supervision, facility design and security measures.

We also have significant food and beverage sales, both on our vessels and at our terminals, and there is a risk of a foodborne illness contracted from contaminated products purchased from our food services.

A significant damage, injury or illness event could have an adverse effect on the lives of our employees and customers, our ability to meet operational service requirements, the environment, staff morale, our reputation and our financial position and results of operations.

Risk mitigation: In fiscal 2007, we commissioned former B.C. Auditor General, George L. Morfitt to conduct an independent review of our operational safety policies, procedures and practices. Arising from this review he made 41 recommendations for improvements. In fiscal 2012, Mr. Morfitt conducted a follow-up review on the status of those recommendations. His comprehensive report concluded that we continue to operate a safe system and in the summary overview states:

"There has been, since our 2007 report, a significant improvement in the safety culture and practices within the company. The company directors, management and staff have demonstrated their commitment to safety being number one both for the travelling public and for BC Ferries personnel."

Our safety program, SailSafe, which was launched in fiscal 2008 and involves all employees, has been successful in changing our culture of safety awareness. The objective of the SailSafe program is to ensure that safety is kept as the primary concern in the minds of our employees each and every day. As part of the SailSafe program, we have upgraded our safety management system including the introduction of an operational risk assessment and management process.

Our food storage, handling, preparation and cooking procedures are aligned with the hazard analysis critical control point (HACCP) methodology which is a preventive approach to food safety. HACCP is an industry-wide effort approved by the scientific community, as well as by regulatory and industry practitioners.

We also adhere to a program of internal and external safety audits designed to verify our compliance with our safety management system. We also have a sound conventional insurance program designed to mitigate the financial impact of a major incident. However, there can be no guarantee that the insurance coverage will be sufficient to cover all such incidents.

REGULATIONS – ENVIRONMENTAL

Our operations are subject to Federal, Provincial and local environmental laws and regulations dealing with various operations, including solid and liquid waste management, air quality and oil spill response.

The provincial government has made a commitment to reduce greenhouse gas emissions (GHG) by 33% by the year 2020, based on emissions in 2007. While the reduction targets have not yet been set, the transportation industry has been identified as a sector that will have emission limits.

If we were to be involved in an environmental accident or be found in material violation of applicable law and regulations, we could be responsible for material clean-up costs, repair of property damage, and fines or other penalties.

Risk mitigation: We will continue to comply with environmental laws and regulations and actively search for ways to improve our environmental performance to help us become an industry leader in environmental management. We have training programs in place that include training our staff in first response to an oil spill.

We constantly look for ways to reduce fuel consumption and emissions on our vessels. We continue to use a lower sulphur diesel with a 5% biodiesel component on all of our vessels where the product is available and we currently meet the North American Emission Control Area standards for sulphur content that have been set for 2015. We have implemented a wide variety of fuel saving measures ranging from operating our vessels more efficiently to installing new, more fuel-efficient engines on some of our vessels and fuel monitoring systems on others and designing and building our new vessels to meet or exceed current environmental standards.

We have programs in place to protect the environment and reduce GHG. Besides using biodegradable hydraulic oils, we recycle beverage containers, cardboard, newsprint, plastics, wood, metal, spent fluorescent tubes, batteries, aerosol spray cans, and used cooking oil. We have also set up a composting program and currently divert 80 to 90 tonnes of compostable material annually on two of our three Major Routes. We continue to replace chemical products with more environmentally friendly solutions and have replaced gasoline powered terminal vehicles with electric vehicles and gasoline powered baggage vans with propane powered tugger units. We also reduce GHG levels by transferring vessels to shore-power while berthed overnight, promoting anti-idling and increasing waste diversion.

We have also been introducing new initiatives to further mitigate our environmental impact. A multi-year sewage and waste water treatment program to upgrade 27 vessels and eight terminals for treatment of sewage generated by the vessels is nearing completion. Wherever possible, the vessels convey sewage to a terminal through pump-ashore infrastructure. Where terminal facilities are not available, small vessels will be fitted with holding tanks, with truck pump-off. In all other cases, the vessels have been fitted with federally compliant marine sanitation devices. We have a treatment plant at one of our terminals while at the remaining seven sewage is collected and transferred to treatment plants operated by local governments. (See "Investing in our Capital Assets" above for more detail).

We believe that we maintain adequate environmental insurance; however, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

REGULATIONS – OTHER

Our operations are subject to a wide variety of national and local laws and regulations, all of which may change at any time.

There is the potential that the introduction of new safety or other regulations, including new taxes, or the interpretation of existing regulations, may impose a new, unexpected and significant cost burden and/or result in major disruptions to our operations.

Risk mitigation: We foster positive relationships with local officials and treat recommendations and advisories with respect and due consideration. Appeals are made to higher authorities as required.

We strive to lead the way in adopting new regulations. We were one of the first to adopt, prior to the mandatory compliance date, the provincial Public Health Act regulation which restricts trans-fat in all food service establishments.

We continue to seek reasonable and cost effective solutions for compliance with new regulations through our planning processes and asset renewal initiatives.

Commencing October 1, 2012, we once again will have the opportunity to apply to the Commissioner under Section 42 of the Act for an extraordinary price cap increase or other relief if the introduction of new safety or other regulations impose a new, unexpected and significant cost burden. (see "Corporate Structure – Economic Regulatory Environment" for more detail)

VESSEL REPAIR FACILITIES

We have a vessel repair facility in Richmond where we perform maintenance and refit work on our vessels; however, our facility does not have a dry-dock. There are only two shipyards with dry-docks in British Columbia that can accommodate large vessels. One of these shipyards dominates the vessel repair market, especially for large vessels.

Our vessel repair requirements are also changing. We expect to have fewer but larger refit projects over time, with most requiring dry-dock space. This strategy is expected to reduce mobilization and vessel re-deployment costs. At the same time, the overall demand for ship repair and ship building facilities is expected to increase with the federal ship procurement strategy. As a result, ship repair labour supply may become over-subscribed in the coming years.

The inability to acquire timely and cost effective ship repair services may cause operational disruption and may have an adverse effect on results of operations, cash flow and financial results.

Risk mitigation: We plan our vessel maintenance to minimize the number of out-of-service periods and to maximize the maintenance performed by our own staff. We have also established long-range maintenance plans for all vessels which enable us to plan and reserve space with ship repair facilities well in advance. Further, when regulations permit, in-water surveys are performed on vessels, potentially eliminating the requirement for dry-docking. Also, alternatives to using local facilities are being researched.

PERFORMANCE RISK

The occurrence of a major incident or mishap could result in default under the Contract unless such accident or mishap qualified as an event of force majeure.

The occurrence of a default under the Contract could have consequences, including an adjustment to ferry transportation fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.

Risk mitigation: We have an asset renewal program for our vessels and terminals, a major portion of which has already been completed. This program is revitalizing our fleet and upgrading our terminals to support our ongoing operations and maintain service reliability.

We regularly update our vessel maintenance schedules to ensure that we provide the core service levels required under the Contract.

We continuously monitor our operations from our 24-hour operations and security centre. This provides enhanced situational awareness and assessments to identify and prevent potential incidents and provides a coordinated response to any incident that may occur.

TAXES

We received an advance income tax ruling from Canada Revenue Agency (CRA) that, provided the facts and other statements set out therein are accurate, we are a "Tax Exempt Corporation" described in paragraph 149(1)(d.1) of the *Income Tax Act.* This ruling was subject to a proposed amendment to subsection 149(1.3) of the *Income Tax Act* announced by the Department of Finance on December 20, 2002. The essential elements of this amendment were included in Bill C-10, which was cancelled when Parliament was dissolved before the 2008 federal election and then subsequently included in the July 16, 2010 draft Income Tax Amendments Act, 2010, which had not been introduced into Parliament prior to Parliament being dissolved before the 2011 federal election. There is no reason to believe that the proposed amendment to subsection 149(1.3) will not be reintroduced. We have received a non-binding opinion from CRA that subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause us to cease to be a Tax Exempt Corporation. There can be no assurance that subsection 149(1.3) of the *Income Tax Act* will be amended as proposed, or that we are and will continue to be a Tax Exempt Corporation.

Risk mitigation: Commencing October 1, 2012 we once again will have the opportunity to apply to the Commissioner under Section 42 of the Act for an extraordinary price cap increase or other relief if the introduction of new regulations imposes a new, unexpected and significant cost burden.

TREATY NEGOTIATIONS: ABORIGINAL RIGHTS AND TITLE

Much of British Columbia, including areas where we have operations and real property interests, is subject to claims of aboriginal rights or title. Canadian courts have recognized that aboriginal peoples may enjoy constitutionally protected rights, whether or not recognized in a treaty, in respect of lands that were occupied by their ancestors. These rights vary from the right to use lands and waters to carry out traditional activities (for example, an aboriginal right to fish) to the right to exclusively occupy lands that are subject to aboriginal title. What kind of right might exist depends primarily upon the nature and extent of the prior aboriginal use and occupation at specific dates in British Columbia's history.

At present, many aboriginal groups, who claim that they have un-extinguished Aboriginal rights and title, are seeking recognition of those rights in modern treaties, or in government decision-making that may affect their traditional territories. Canadian courts have confirmed that provincial and federal governments have a duty to consult with and, if appropriate, accommodate aboriginal groups when they are proposing to make a decision that could potentially infringe upon asserted Aboriginal rights and title. Government approvals and licences, such as those required to operate existing terminal facilities or develop new ones, may trigger the government's duty to consult with any aboriginal groups whose claims of Aboriginal rights and title might be adversely affected by the granting of the licence or approval in question. Recent court decisions have clarified that the Crown does not have to accommodate Aboriginal groups for historic infringements, though historic infringements may be taken into consideration in addressing proposed new infringements.

Aboriginal groups who have entered into treaties may have a right to be consulted with respect to government actions that could adversely affect their treaty rights. Modern treaties may also require the Crown to consult with an Aboriginal group with respect to certain kinds of government action in certain geographic areas, depending on the terms of the treaty.

Risk mitigation: Under the master agreement, the Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to our possession of the ferry terminal properties leased under the Terminal Leases and will reimburse us for any damages we suffer as a result. The Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon an aboriginal group a proprietary or other interest in the ferry terminal properties should that right or interest interfere with our quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

Accounting Practices

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles.

Our significant accounting policies are contained in note 1 to our consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

We believe the following are the most critical accounting policies and estimates that we have used in the preparation of our financial statements:

WORKERS' COMPENSATION CLAIMS LIABILITY

Our financial statements include an estimate of residual liability for workers' compensation claims arising from the Workers' Compensation Board deposit class coverage system, in which our predecessor entity participated on or prior to March 31, 2003.

An actuarial valuation of the unfinalized claims remaining to be paid at March 31, 2011 that relate to incidents on or prior to March 31, 2003 was received in fiscal 2012 and the accrued benefit obligation estimated at $2.7 million. The residual liability balance ($1.7 million at March 31, 2011) was increased during fiscal 2012 by $1.0 million to adjust to this estimate. This residual liability is drawn down as claims are paid. The remaining balance at March 31, 2012 of $2.4 million is included in accrued employee future benefits in our financial statements.

PUBLIC SERVICE PENSION PLAN

Our employees are members of the Public Service Pension Plan (the Plan), a defined benefit and multi-employer pension plan. The Plan is exempt from the requirements under the provincial Pension Benefits Standards Act to use the "solvency" method in conjunction with the "going concern" method for valuation purposes. As such, the Plan is currently valued solely by the going concern method. The most recent valuation, as at March 31, 2011, indicated an unfunded liability of $275 million across the total Plan.

Effective April 1, 2012, the Public Service Pension Board of Trustees increased contribution rates to the basic account for plan members and employers from 7.78% to 8.18% of pensionable earnings each, primarily due to the change in the investment return and demographic assumptions. The contribution rates to the inflation adjustment account for members and employers changed from 1.50% and 2.50% to 1.25% and 2.75%, respectively.

RETIREMENT BONUS LIABILITY

We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2011, was obtained and the accrued benefit obligation estimated at $13.8 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2012, was $10.3 million ($10.2 million at March 31, 2011).

We have adopted the corridor method of recognizing actuarial gains and losses. Any gains and losses in excess of 10% of the obligation balance will be amortized over the average remaining service period of employees expected to receive benefits under this plan.

RATE REGULATION

We follow generally accepted accounting principles which, as we are a rate-regulated entity, may differ from those otherwise expected in non-rate-regulated businesses. These differences occur when the regulator issues orders and generally involve the timing of revenue and expense recognition. The principles we follow ensure that the actions of the regulator, which create assets and liabilities, have been reflected in the financial statements.

The accounting for these items is based on an expectation of the future actions of the regulator. As of March 31, 2012, we have three regulatory assets or liabilities:

- **Deferred fuel costs:** the difference between amounts allowed by the regulator in operating expense and those actually incurred with settlement expected through future tariffs, surcharges or rebates;

- **Performance term submission costs:** costs for incremental contracted services relating to our third performance term submission. Our regulator has approved recovery of these costs over the third performance term ending March 31, 2016.
- **Tariffs in excess of price caps:** the amount by which average annual tariffs collected at a specific date exceed established price caps set under the terms of the Act. The excess amounts collected will be returned to customers through future tariffs.

If the regulator's future actions are different from our expectations, the timing and amount of the settlement of regulatory assets and liabilities could be substantially different from that reflected in our financial statements.

Effective April 1, 2012, we will be reporting under International Financial Reporting Standards (IFRS) (see "Future Accounting Changes" below for more detail). As IFRS does not currently provide specific guidance with respect to accounting for rate-regulated activities, our regulatory assets and liabilities will not be reflected in our financial statements. However, we will disclose the impact of rate regulation on our financial position and results of operations in the notes to the financial statements and in the Management Discussion and Analysis. The change to IFRS will not alter the approach to price cap setting.

AMORTIZATION EXPENSE

Our capital assets, including assets under capital leases, are amortized on a straight-line basis at varying rates. Amortization rates require the use of estimates of the useful lives of the assets and of salvage value to be realized upon asset retirement.

We periodically review asset lives in conjunction with our longer term asset deployment, replacement and upgrade strategies. When we determine that asset lives do not reflect the expected remaining period of benefit, we make prospective changes to the remaining period over which they are amortized. There are a number of uncertainties inherent in estimating our asset lives and changes in these assumptions could result in material adjustments to our financial statements.

As disclosed in note 1 to our financial statements, we review and evaluate our long-lived assets for impairment when events or changes in circumstances indicate that the related amounts may not be recoverable.

HEDGING RELATIONSHIPS

We utilize derivative financial instruments to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. We do not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge, we determine whether or not to apply hedge accounting.

When applying hedge accounting, we document all relationships between hedging instruments and hedged items, as well as our risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. We also assess, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in the period in which they have been terminated or cease to be effective.

ASSET RETIREMENT OBLIGATIONS

When it can be reasonably determined, we recognize the fair value of a liability for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

Certain of our vessels contain undetermined amounts of asbestos. Under certain circumstances, we may be required to handle and dispose of the asbestos in a manner required by regulations. It is our intention to sell decommissioned vessels into world markets to buyers who will keep them in active service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood, or financial impact, if any, of this issue. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

ADOPTION OF NEW ACCOUNTING STANDARDS

No new accounting standards have been adopted for fiscal 2012.

FUTURE ACCOUNTING CHANGES

IFRS will be adopted by us in fiscal 2013. The following is a discussion of accounting changes that will impact us:

Our changeover date for conversion to IFRS was originally April 1, 2011. In October 2010, the Canadian Accounting Standards Board (AcSB) amended Part 1 of the CICA Handbook – Accounting (Handbook) to permit qualifying entities with rate-regulated activities to defer the adoption of IFRSs by one year to no later than annual periods beginning on or after January 1, 2012. We elected this option which deferred our changeover date for conversion to IFRS to April 1, 2012. In March 2012, the AcSB announced its intention to extend the option for deferral of the mandatory IFRS changeover date for entities with qualifying rate-regulated activities by one more year to annual periods beginning on or after January 1, 2013. The Handbook was amended in May 2012 to permit this further deferral of IFRS adoption. We have chosen not to defer the adoption of IFRS for this additional one year period. Accordingly, our changeover date for conversion to IFRS will remain as April 1, 2012.

We commenced our IFRS transition project in 2007, establishing a formal project governance structure with regular reporting. We also engaged a quality assurance advisor to assist in the project.

Our IFRS transition project consists of three phases:

1. Scoping and diagnostic phase which involved project planning and resourcing, high level impact assessment of differences between current Canadian GAAP and IFRS, and priority setting;
2. Analysis and development phase which involved detailed analysis and evaluation of options and alternative methodologies available under IFRS, and the financial impact of these options; and
3. Implementation and review phase which involves implementing and approving changes to accounting policies, information systems, business processes and training, and developing IFRS-compliant financial statements.

We are currently in the final stages of the implementation and review phase.

The following table includes elements of our IFRS transition plan and an assessment of progress towards achieving the key milestones.

Financial statement preparation

KEY ACTIVITIES

- Identify differences in Canadian GAAP/IFRS accounting policies
- Select ongoing IFRS policies
- Develop financial statement format
- Select IFRS 1 exemptions for transition
- Quantify effects of change at April 1, 2011 (for opening IFRS financial position)

MILESTONES

- Senior management review of policy decisions and illustrative IFRS financial statements and disclosures by June 30, 2011
- Audit & Finance Committee approval of policy decisions and IFRS financial statement format, in principle, by September 30, 2011
- IFRS 1 exemptions finalized and quantified by September 30, 2011
- Policies and procedures in place by March 31, 2012

STATUS

- Scoping and diagnostic phase completed in fiscal 2009, with high-level review of the major differences between Canadian GAAP and IFRS
- Highest areas of impact identified, review prioritized, and in-depth analysis complete
- Accounting policy alternatives analyzed and recommendations made for key accounting policy decisions
- IFRS 1 exemptions reviewed and analyzed
- Senior management review of policy decisions complete
- Preparation and review of illustrative financial statements and note disclosures complete
- IFRS 1 exemptions finalized and quantified
- Policies and procedures complete
- Preparation of fiscal 2012 comparatives complete
- Preparation of first interim financial statements under IFRS, including first-time adoption reconciliations required under IFRS 1, in progress

Information technology infrastructure

KEY ACTIVITIES

- Confirm system upgrades required for IFRS reporting
- Review/revise data gathering processes
- Review/revise budgeting and forecasting processes

MILESTONES

- System configuration changes complete by March 31, 2010
- System reporting changes required to accommodate both current Canadian GAAP and IFRS complete by August 31, 2010
- Changes to budgeting and forecasting processes complete by June 30, 2011

STATUS

- Detailed reporting requirements to accommodate the transition to IFRS identified and documented
- Overall system approach selected
- System configuration to accommodate both current Canadian GAAP and IFRS complete
- System changes to accommodate reporting requirements complete
- Review to determine effects on the project of the two one-year deferrals of changeover date complete
- Review to determine recording and reporting impacts of the absence of a standard on rate regulation complete
- Changes required to budgeting and forecasting processes complete

Training, education & communication

KEY ACTIVITIES

- Determine required level of IFRS expertise within all areas of the company
- Ensure appropriate training of key members within Finance
- Provide appropriate education and communication to affected departments
- Provide department specific training on revised policies and procedures
- Provide timely communication to both internal and external stakeholders on impacts of the transition to IFRS

MILESTONES

- Topic-specific training for IFRS working committee complete prior to March 31, 2010
- Department-specific training completed by March 31, 2012
- Impacts of transition to IFRS communicated to external stakeholders by March 31, 2012

STATUS

- Core IFRS project team members completed topic-specific training, and successfully completed the "IFRS Award Program, Certificate Level"
- Interdepartmental workshops provided on specific topics, including property, plant and equipment; IFRS 1; and the IFRS Framework
- Throughout the project, communications with key stakeholders, including direct communication with the Commissioner, our Agent Bank, rating agencies, our Board of Directors, and with investors indirectly through our website
- Interdepartmental training on specific topics complete
- Impacts of transition communicated in December 31, 2011 and March 31, 2012 Management's Discussion & Analysis (MD&A)

Control environment

KEY ACTIVITIES

- Accounting policy determination, documentation and implementation
- MD&A ongoing communications

MILESTONES

- All internal control process descriptions updated by March 31, 2012
- Publish quantitative effects of conversion on April 1, 2011 opening balance sheet in December 31, 2011 MD&A

STATUS

- Analysis of control issues complete
- Review and update of process descriptions complete
- Policies and procedures complete
- April 1, 2011 opening IFRS statement of financial position published in the MD&A for both December 31, 2011 and March 31, 2012 (included below at the end of this discussion of Future Accounting Changes)

Business policy assessment

KEY ACTIVITIES

- Financial covenants assessment
- Compensation arrangements assessment
- Customer and supplier contract evaluation

MILESTONES

- Potential impact on compensation arrangements determined by December 31, 2011
- Impact on customer/supplier contracts determined by December 31, 2011
- Impact on financial covenants quantified by March 31, 2012

STATUS

- All relevant GAAP-dependent covenants and contracts have been identified
- Analysis to determine effects of IFRS on existing covenants and contracts is complete
- Impact on compensation arrangements analyzed

FIRST-TIME ADOPTION OF IFRS

All elections and exemptions under IFRS 1 have been reviewed and the choices we have made on transition have resulted in a net increase of $8.6 million in retained earnings. The elections and exemptions that apply to us upon adoption are summarized as follows:

- ***Employee Benefits:*** There is a choice to either recognize all cumulative actuarial gains and losses of defined benefit plans through opening retained earnings or recalculate the actuarial gains and losses under IFRS from the inception of the defined benefit plans. We have elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2011. The actuarial loss recognized in opening retained earnings was $3.6 million.

- ***Property, plant and equipment and Intangible assets:*** There is a choice of valuation of property, plant and equipment and intangible assets at April 1, 2011, either to:

  - retrospectively apply IFRS to the valuation of the assets; or
  - to revalue items, on an asset by asset basis, at fair value and use that fair value as deemed cost; or
  - use previous GAAP carrying amounts at transition as the deemed cost for assets used in rate-regulated operations as detailed in the amendment to IFRS 1 published May 6, 2010.

  We have elected to use previous GAAP carrying amounts at transition as the deemed cost for all intangible assets and the majority of our property, plant and equipment with the exception of land. We have elected to revalue land at fair value at April 1, 2011. This revaluation has resulted in an increase in land value of $12.2 million.

AREAS OF SIGNIFICANCE

A summary of the areas with the highest impact on our financial position and results of operations is as follows:

- ***Rate-regulated operations:*** IFRS does not currently provide specific guidance with respect to accounting for rate-regulated activities. It is our expectation that issues regarding rate-regulated activities will remain unresolved for some time and that we will not be reporting our regulatory assets or liabilities on the IFRS Statement of Financial Position.

  Impact on transition: Balances at March 31, 2011 of $3.7 million of current regulatory assets and $1.6 million of long-term regulatory liabilities were derecognized on our transition date of April 1, 2011 with a net reduction in retained earnings of $2.1 million.

  Expected future impact: As future balances of our regulatory accounts are uncertain, we cannot reasonably estimate and conclude the impact on our future financial position and results of operations with respect to accounting for rate-regulated activities.

- ***Property, plant and equipment:***

  1. ***Inspections and major overhauls:*** The capitalization of inspections and major overhauls of our vessels is a significant change affecting us. A process to track these items has been finalized and necessary system configuration changes completed. We have defined, identified, and quantified inspection and major overhaul items for each class of vessel for reclassification at transition date and internal reporting solutions have been completed.

     This change has the potential to cause significant fluctuations in earnings over the reporting periods due to the level of inspections and major overhauls in any one period and the number of periods over which each will be amortized. Over the five years ending March 31, 2016, we estimate the net impact of this change to range from a decrease in annual net earnings of $1 million to an increase in annual net earnings of $14 million.

  2. ***Valuation subsequent to transition:*** We have a choice under IFRS to value our property, plant and equipment using either a historical cost model or a revaluation model. We have decided to use a historical cost model for all property, plant and equipment with the exception of land. We will use a revaluation model for our land assets. (See First-time adoption of IFRS above for the impact on transition).

  3. ***Other rate-regulated impacts:*** As a rate-regulated entity and prior to transitioning to IFRS, we capitalized some costs such as feasibility, research and training that directly related to a specific asset. Under IFRS these costs will no longer be capitalized. Over the five years ending March 31, 2016, we estimate the net impact to be a decrease in earnings of up to $2 million annually.

The following is our April 1, 2011 opening IFRS Statement of Financial Position, including a reconciliation to our audited March 31, 2011 consolidated balance sheet prepared under current Canadian GAAP. This reconciliation distinguishes between existing GAAP/IFRS differences that are "adjustments" and those that are "reclassifications". Differences identified as adjustments increase or lower retained earnings whereas reclassifications have no retained earnings impact:

(thousands of Canadian dollars)	March 31, 2011 Canadian GAAP Balances	IFRS Adjustments	IFRS Reclassifications	April 1, 2011 Opening IFRS Balances
Assets				
Current assets				
Cash and cash equivalents	$ 33,335	$	$	$ 33,335
Restricted short-term investments	37,040			37,040
Other short-term investments	64,074			64,074
Accounts receivable	20,619			20,619
Prepaid expenses	5,648			5,648
Inventories	19,957			19,957
Regulatory assets	3,703	(3,703)		
	184,376	(3,703)	–	180,673
Non-current assets				
Long-term loan receivable	24,247			24,247
Long-term land lease	32,979			32,979
Property, plant & equipment	1,581,007	12,187		1,593,194
Intangible assets	34,929			34,929
	1,673,162	12,187	–	1,685,349
Total assets	$ 1,857,538	$ 8,484	$ –	$ 1,866,022
Liabilities				
Current liabilities				
Accounts payable and accrued liabilities	$ 51,249	$	$ (1,377)	$ 49,872
Short-term debt	3,949			3,949
Interest payable on long-term debt	18,261			18,261
Accured employee costs	48,194		(48,194)	
Deferred revenue	15,596			15,596
Derivative liabilities	23			23
Current portion of long-term debt	22,125			22,125
Current portion of accrued employee future benefits	1,200			1,200
Current portion of obligation under capital lease	1,040			1,040
Provisions			49,571	49,571
	161,637	–	–	161,637
Non-current liabilities				
Accrued employee future benefits	10,907	3,552		14,459
Regulatory liabilities	1,558	(1,558)		–
Long-term debt	1,327,014			1,327,014
Obligations under capital lease	47,723			47,723
	1,387,202	1,994	–	1,389,196
Total liabilities	1,548,839	1,994	–	1,550,833
Equity				
Share capital	75,478			75,478
Retained earnings	233,221	6,490		239,711
Total equity before reserves	308,699	6,490	–	315,189
Reserves				
	308,699	6,490	–	315,189
Total liabilities and equity	$ 1,857,538	$ 8,484	$ –	$ 1,866,022

Impact on opening retained earnings ($ thousands)	
Land revaluation	12,187
De-recognition of regulatory assets and liabilities	(2,145)
Cumulative actuarial loss on defined benefit plans	(3,552)
Increase in opening retained earnings	6,490

Corporate Structure and Governance

National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the "Instrument") and a related National Policy 58-201 *Corporate Governance Guidelines* (the "Guidelines") issued by the Canadian Securities Administrators require reporting issuers to disclose annually their approach to corporate governance with reference to specific matters. See Schedule A for the disclosure in accordance with this Instrument.

Forward Looking Statements

This management's discussion and analysis contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, fluctuating financial markets, demographics, tax changes, and the requirements of the Contract.

Forward looking statements included in this document include statements with respect to: economic conditions, traffic levels, and fuel prices; a net loss in fiscal 2013, a return to profitability in fiscal 2014, and our expectations of the impact of our cost containment program; our ability to maintain our credit ratings; our short-term and long-range business plans, capital expenditure levels, asset renewal programs for vessels and terminals, our cable ferry initiative, and our LNG plans; our expectations regarding vacation package sales, growth in drop trailer traffic, lack of need to access capital markets for at least the next two years, and how our operational cash requirements will be met; the additional payments to be received from the Province over the following four fiscal years, the Province's role regarding service levels and a long-term vision, the Commissioner's price cap review proceedings for the balance of the performance term, and the continuation of the deferred fuel cost accounts; and the impacts of Bill 14, Bill 20, Bill 47, and IFRS. In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this management's discussion and analysis are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this management's discussion and analysis, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances except as may be required by applicable law.

Schedule A

CORPORATE STRUCTURE AND GOVERNANCE

BOARD OF DIRECTORS

British Columbia Ferry Services Inc. ("BCFS" or the "Company") is subject to the *Business Corporations Act – British Columbia and the Coastal Ferry Act – British Columbia* (CFA). The board of directors (board) of BCFS is appointed by the Company's sole voting shareholder, B.C. Ferry Authority ("BCFA" or the "Authority").

During the fiscal year ended March 31, 2012, the board was composed of the following directors:

Chair: Donald P. Hayes

Members: Elizabeth J. Harrison (Vice Chair), Holly A. Haston-Grant,Brian G. Kenning, Gordon R. Larkin, Maureen V. Macarenko, P. Geoffrey Plant, Wayne H. Stoilen and Graham M. Wilson

Effective April 1, 2012, Elizabeth J. Harrison ceased to be a director.

The directors are stewards of BCFS and set the strategic direction of the Company. The board exercises its stewardship responsibilities by overseeing the conduct of the business, supervising management, which is responsible for the day-to-day conduct of the business, and endeavouring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

The board governance manual articulates the governance framework under which the board fulfills its stewardship responsibilities. The manual assembles in one document the essential elements for providing an appropriate level of governance for the organization. It includes, among other things, terms of reference for the board, chair, directors, committees, and committee chairs, and serves as a practical guide for the board and management in fulfilling their respective duties and responsibilities. The governance manual is a product and responsibility of the board.

The board is committed to the principles of independence and accountability. The board has adopted policies and practices that ensure it has the capacity, independent of management, to fulfill the board's responsibilities, make objective assessments of management, and assess the merits of management initiatives. The Governance & Nominating Committee has an ongoing responsibility to ensure that the governance structures and processes continue to enable the board to function independently.

The board and management recognize that there is a regular need for the board to meet without management in attendance. It is general practice to conduct a portion of every board and committee meeting with no members of management in attendance.

The board and its committees each have the authority to retain any outside advisor, at the Company's expense, that it determines to be necessary to permit it to carry out its duties.

The recruitment of directors is undertaken with the objective of ensuring the board is composed of a majority of strong, qualified, independent directors. The board supports the concept that the board chair should be an independent director.

The board has adopted a definition of an independent director for members of the Audit & Finance Committee consistent with the definition of independence in Multilateral Instrument 52-110. This definition, with some modification that is consistent with Multilateral Instrument 52-110, also applies to determining the independence of other members of the board.

The board is responsible for determining whether directors are independent pursuant to the definition of independence adopted by the board. To do this, the board requires members to disclose their relationships with the Company and its subsidiaries. These disclosures are reviewed by the corporate secretary, the chair of the Governance & Nominating Committee, and the chair of the board. Any director who is deemed independent, and whose circumstances change such that he or she might be considered to no longer be an independent director, is required to promptly advise the board of the change in circumstances. Directors are required annually to attest to their independence in writing.

All of the directors of the Company in the fiscal year were determined by the board to be independent pursuant to the definition of independence adopted by the board.

DIRECTORSHIPS

The following were directors of a reporting issuer (or the equivalent) in Canada or a foreign jurisdiction, other than BCFS:

Donald P. Hayes:	Director, Prima Colombia Hardwood Inc.
Brian G. Kenning:	Director, MacDonald Dettwiler & Associates Inc. Director, Royal Oak Ventures
P. Geoffrey Plant:	Director, Catalyst Paper Corporation
Graham M. Wilson:	Director, ITRON Inc. Director, Naikun Wind Energy Group Inc. Director, Hardwoods Distribution Inc.

ORIENTATION AND CONTINUING EDUCATION

The Company has a variety of orientation and education programs in place for directors. These programs are aimed at increasing the directors' familiarity with the operation of the Company and its governance practices.

All new directors are provided with the opportunity to participate in an orientation program. The orientation program is tailored to the individual director's needs and areas of interest. The program generally involves a half to full day session, usually held prior to a new director attending his/her first BCFS board meeting, during which the new director is briefed by members of senior management, and receives written information about the business and operations of BCFS and board governance practices, including the duties and obligations of directors. The board governance manual is made available to all directors. This manual provides a comprehensive overview of the roles and responsibilities of the board, its committees, and the contributions expected by each director.

The board recognizes the importance of ongoing director education and the need for each director to take personal responsibility for this process. To facilitate ongoing education, presentations are made to directors from time to time on matters of particular importance or emerging significance to the Company. As well, attendance by directors at seminars, courses or conferences of relevance to their position as directors of the Company may be arranged. Visits by directors to BCFS facilities and operations are also encouraged and serve to further enhance the directors' ongoing knowledge and understanding of the Company.

Responsibility for ensuring that orientation and ongoing education are provided to directors rests with the chair of the board. The Governance & Nominating Committee has responsibility for reviewing the orientation and education programs to ensure they are effective and meet the needs of directors.

ETHICAL BUSINESS CONDUCT

The board approved and adopted a Code of Business Conduct and Ethics (code) in November 2004; the code was subsequently reviewed and amended by the board in November 2009. Notice of adoption, and subsequent amendment of the code as Company policy, was communicated to the Company's personnel by intra-Company information bulletin and BCFS' newsletter for personnel. In addition, the code has been posted on the Company's intranet website for Company personnel, and on the Company's internet site. The code was filed on SEDAR on March 1, 2006; the amended code was filed on November 24, 2009. The board has also adopted a Corporate Disclosure and Securities Trading Policy, which is also posted on the Company's intranet and internet sites.

As part of the Company's disclosure controls process, in conjunction with quarter-end financial reporting, appropriate managers are required to make representations regarding compliance with the code and the Corporate Disclosure and Securities Trading Policy.

As part of the communication process for the reporting of questionable accounting and auditing matters, a secure telephone line and a secure e-mail address, each monitored by the executive director of internal audit, as well as a secure e-mail address monitored by the chair of the Audit & Finance Committee of the board, have been established and this has been communicated to Company personnel by intra-Company information bulletin and BCFS' newsletter for personnel. The contact particulars are also posted with the code on the Company's intranet site.

The board, through the Audit & Finance Committee, monitors compliance with the code through review of compliance reports received quarterly from management, the external auditors, and the internal auditors.

Directors and officers review the code, and acknowledge their support and understanding of the policy by signing an annual disclosure statement.

The code requires that directors and officers disclose potential conflicts of interest at the time of their appointment and immediately upon a situation of a conflict of interest or potential conflict of interest arising. Such disclosures are communicated to and reviewed by the corporate secretary, the chair of the Governance & Nominating Committee, and the chair of the board.

NOMINATION OF DIRECTORS

The CFA requires that when electing directors to the board of BCFS, BCFA must select individuals in such a way as to ensure that, as a group, the directors of BCFS are qualified candidates, who hold all of the skills and all of the experience needed to oversee the operation of BCFS in an efficient and cost effective manner. On the recommendation of the BCFS board, the board of BCFA approves a profile setting out the skills, experience and expertise that should be represented on the BCFS board (skills profile). The board of BCFS nominates qualified candidates for election as directors and recommends to BCFA the size of the BCFS board.

The Governance & Nominating Committee has responsibility for the director nomination process. The committee is composed entirely of directors who are independent, pursuant to the definition of independence adopted by the board of BCFS, and operates under terms of reference adopted by the board.

The skills, experience, and expertise of the incumbents and any retiring directors of BCFS are reviewed by the Governance & Nominating Committee in the context of the skills profile approved by the BCFA board, and the ongoing governance needs of BCFS. Any gaps are identified. Potential conflicts of interest and other extenuating circumstances are also identified.

The Governance & Nominating Committee makes recommendations to the BCFS board on suitable candidates for appointment to the BCFS board. These recommendations take into consideration the talents of the existing BCFS Board and those of the nominees, taking the skills profile established for the BCFS Board, including knowledge of or presence in the communities served by BCFS, into account.

The BCFS board makes its decision on prospective directors and forwards its recommendations to the BCFA board. The BCFA board then determines the directors of BCFS and causes BCFA, as the sole holder of the single issued voting share of BCFS, to elect such individuals to the board of BCFS.

MANAGEMENT'S DISCUSSION & ANALYSIS

EXECUTIVE COMPENSATION

The Human Resources & Compensation Committee is responsible for reviewing and making recommendations to the BCFS board on executive compensation.

EXECUTIVE COMPENSATION PLAN

The CFA requires that the compensation of certain executive officers of BCFS be set and administered within a remuneration limit prescribed by an executive compensation plan. BCFA is responsible under the CFA for approving an executive compensation plan and any amendments to such plan.

In the fiscal year, upon the recommendation of the BCFS board, BCFA approved an executive compensation plan with an effective date of October 1, 2011. The plan describes the philosophy for BCFS executive compensation and the maximum remuneration that individuals whose compensation is governed by such plan can receive in any fiscal year. The remuneration limits set out in the executive compensation plan were established with the assistance of an independent third-party compensation expert and with reference to the CFA, which requires that the remuneration under an executive compensation plan be consistent with the remuneration provided to individuals who, in organizations in Canada that are of a similar size and scope to BCFS, perform similar services or hold similar positions to that member of executive of BCFS, and not be greater than the remuneration that provincial public sector employers in British Columbia provide to individuals who, in those organizations, perform similar services or hold similar positions to that member of executive of BCFS.

Consistent with the CFA and *Miscellaneous Statutes Amendment Act No. 3 - 2010* (Bill 20), the approved executive compensation plan presently governs the remuneration the Company may provide to its current President & CEO, but not the remuneration of any other current executive officer so long as that individual remains in his current position.

EXECUTIVE COMPENSATION PROCESS

On an annual basis, the board, led by the Human Resources & Compensation Committee sets the performance requirements for the President & CEO and evaluates his performance against those requirements. Incentive pay for the President & CEO, which has a maximum target, is determined based on the evaluation results, and the available room under the total remuneration limit set for the position in the executive compensation plan. With the assistance of the independent, third-party compensation expert, the Human Resources & Compensation Committee periodically reviews the remuneration limit set in the executive compensation plan in conjunction with market data from appropriate comparator organizations, and provides advice to the board on possible changes to the plan for recommendation to BCFA. Changes in the President & CEO's remuneration, if any, are made in consideration of his performance, leadership skills, retention risk, and value to achieving corporate strategy, and in accordance with the executive compensation plan approved by BCFA.

The board, led by the Human Resources & Compensation Committee and on the recommendation of the President & CEO, sets the performance requirements of the other executive officers and evaluates each such executive annually with respect to the achievement of results, leadership skills, retention risk, and value to achieving corporate strategy. The evaluation results are used to determine their incentive pay, which has maximum targets. Changes, if any, to the compensation of these executive officers are made in consideration of the individual's performance and, in conjunction with market compensation data obtained by the independent third-party compensation expert.

On an annual basis, the President & CEO formally assesses the development of each of the other executive officers. The President & CEO uses these assessments to design and update succession plans for all senior executive positions, including the position of President & CEO. These plans are reviewed by the Human Resources & Compensation Committee on an annual basis. With respect to all executive officers, succession planning is an important issue that receives ongoing and regular attention by the board and the President & CEO of the Company.

DIRECTOR COMPENSATION

The CFA requires that the compensation of directors of BCFS be set and administered within a remuneration limit prescribed by a directors' compensation plan. The BCFA is responsible under the CFA for approving a directors' compensation plan and any amendments to such plan. The remuneration provided under such a plan must be consistent with the remuneration that organizations in Canada that are of a similar size and scope to BCFS provide to their Directors, and not be greater than the remuneration that provincial public sector organizations in British Columbia provide to their directors.

In the fiscal year ended March 31, 2011, upon the recommendation of the BCFS board, BCFA approved a directors' compensation plan with an effective date of October 1, 2010. The plan was developed with the assistance of an independent third-party compensation expert and describes the philosophy for BCFS director compensation and the remuneration that can be provided to BCFS directors. Remuneration for directors of BCFS was amended and set by the Authority effective October 1, 2010, in accordance with the approved BCFS directors' compensation plan.

The Governance & Nominating Committee reviews director compensation regularly and provides advice to the board on any amendments to the directors' compensation plan to be recommended to BCFA.

PROTOCOL AGREEMENT

The Authority and BCFS have entered into a protocol agreement which clarifies and confirms their respective roles and responsibilities in relation to the authority of BCFA as shareholder of BCFS and the matters set forth in the CFA respecting the appointment and remuneration of BCFS directors and the remuneration of certain executive officers of BCFS.

BOARD COMMITTEES

The board has developed guidelines for the establishment and operation of committees of the board. Each committee operates according to a specific mandate approved by the board. The Committee structure is set out below. The board chair is an ex-officio (non-voting) member of each of the Committees.

AUDIT & FINANCE COMMITTEE:
Members during the fiscal year ended March 31, 2012:

Chair:	Brian G. Kenning
Members:	Elizabeth J. Harrison, P. Geoffrey Plant and Graham M. Wilson

Effective April 1, 2012, Elizabeth J. Harrison ceased to be a director and a member of the Committee.

The Audit & Finance Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities. The committee has the mandate to:

- review the financial reports and other financial information provided by the Company to its security holders;
- review the annual operating and capital budgets, modifications thereto, and details of any proposed financing;
- monitor the integrity of the financial reporting process and the system of internal controls that the board and management have established;
- monitor the management of the principal risks that could impact the financial reporting of the Company, and the Company's compliance with legal and regulatory requirements as they relate to the Company's financial statements;
- review and approve the audit plan, process, results, and performance of the Company's external auditors and the internal audit department (the internal auditor) while providing an open avenue of communication between the board, management, external auditors, and the internal auditor; and
- assess the qualifications and independence of the external auditors, and recommend to the board the nominations of the external auditors and the compensation to be paid to the external auditors.

The committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the external auditors as well as anyone in the organization. The committee has the authority to retain special legal, accounting, and other advisors or experts it deems necessary in the performance of its duties.

Each of the members of the committee has been determined by the board to be independent, that is, without any direct or indirect relationship with the company that could reasonably interfere with the exercise of the member's independent judgment.

All members of the committee are financially literate within the meaning of Multilateral Instrument 52-110, that is, each has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements.

Since April 2, 2003, all recommendations of the committee to nominate or compensate an external auditor have been adopted by the board.

The aggregate fees billed by the Company's external auditor in each of the last two fiscal years were:

Year ended March 31 ($ thousands)	2012	2011
External Auditor billings		
Audit and audit related	**157.8**	196.3
Tax services	**2.2**	2.6
IFRS advisory services	**19.7**	8.7
Forensic data analytics	**4.5**	–
	184.2	207.6

Pursuant to its terms of reference, the committee must pre-approve retaining the external auditors for any non-audit service to be provided to the Company or its subsidiaries, provided that no approval shall be provided for any service that is prohibited under the rules of the Canadian Public Accountability Board or the Public Company Accounting Oversight Board, or the Independence Standards of the Canadian Institute of Chartered Accountants.

Before retaining the external auditors for any non-audit service, the committee must consider the compatibility of the service with the external auditors' independence. The committee may pre-approve retaining of the external auditors for the engagement of any non-audit services by establishing policies and procedures to be followed prior to the appointment of the external auditors for the provision of such services. To date, no such policies and procedures have been established. In addition, the committee may delegate to one or more members the authority to pre-approve retaining of the external auditors for any non-audit services to the extent permitted by applicable law.

SAFETY, HEALTH, ENVIRONMENT & SECURITY COMMITTEE:
Members during the fiscal year ended March 31, 2012:

Chair:	Wayne H. Stoilen
Members:	Holly A. Haston-Grant, Gordon R. Larkin and Maureen V. Macarenko

The Safety, Health, Environment & Security Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities. The committee has the mandate to:

- exercise due diligence over the safety, health, environmental, and security operations of the Company;
- develop, review, and make recommendations, as required, on matters related to the Company's safety, health, environmental, and security policies and practices; and
- monitor compliance with government regulations and with the Company's commitment to excellence on these issues.

GOVERNANCE & NOMINATING COMMITTEE:
Members during the fiscal year ended March 31, 2012:

Chair:	Elizabeth J. Harrison
Members:	Gordon R. Larkin, P. Geoffrey Plant and Wayne H. Stoilen

Effective April 1, 2012, Elizabeth J. Harrison ceased to be a director and chair of the committee.

The Governance & Nominating Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities with respect to ensuring that the corporate governance system of BCFS is effective. The committee has the mandate to:

- review, assess, and make recommendations regarding the effectiveness of the policies and practices of the board;
- ensure the board's continuing ability to fulfill its legislative mandate;
- implement effective due diligence over the operations of the Company;
- make recommendations on the skills, experience and expertise that board members collectively and individually should have in order to oversee the operation of BCFS in an efficient and cost effective manner;
- establish and implement effective processes for identifying and recommending suitable candidates for appointment as directors of BCFS; and
- make recommendations on the remuneration of directors of BCFS.

HUMAN RESOURCES & COMPENSATION COMMITTEE:
Members during the fiscal year ended March 31, 2012:

Chair:	Graham M. Wilson
Members:	Holly A. Haston-Grant, Brian G. Kenning and Maureen V. Macarenko

The Human Resources & Compensation Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities regarding the human resources and compensation strategies and policies of BCFS. The committee has the mandate to:

- regularly review, at a strategic level, the approach taken to manage the Company's human resources, including the recruitment, retention, motivation, and engagement of employees in the interests and success of the Company;
- regularly review the succession and development plans for the President & CEO and executive management; and
- review and recommend to the board a total compensation philosophy for the President & CEO and executive management that, subject to the CFA, attracts and retains executives, links total compensation to financial performance, and the attainment of strategic, operational, and financial performance, provides competitive total compensation opportunities at a reasonable cost, while enhancing the ability to fulfill the Company's overall strategies and objectives.

ASSESSMENTS

As part of its dedication to best governance practices, the board is committed to regular assessments of the effectiveness of the board, the board chair, committees, committee chairs, and individual directors.

The Governance & Nominating Committee annually reviews and makes recommendations to the board on the method and content for annual evaluations. The board has in the past engaged an independent governance consultant to coordinate the evaluation. The board also regularly assesses the performance of individual directors. This occurs through discussions between the individual directors and the board chair.

The evaluation of the board's performance in the fiscal year ended March 31, 2012, was led by the board chair. It involved the completion by directors of a written questionnaire and individual discussions between each director and the board chair on matters related to board effectiveness. The process also included a self assessment by directors of their skills and experience in relation to the skills profile established for the board. The board will implement any recommendations arising from the assessment in the upcoming year.

MANAGEMENT'S REPORT

BC Ferries management is responsible for presentation and preparation of the annual consolidated financial statements, management's discussion and analysis ("MD&A") and all other information in this annual report.

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements and information in the MD&A necessarily include amounts based on management's informed judgements and best estimates. The financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable and accurate financial statements, management has established systems of internal control that are designed to provide reasonable assurance that assets are safeguarded from loss and that reliable financial records are maintained. These systems are monitored by management and by internal auditors. In addition, the internal auditors perform appropriate tests and related audit procedures.

The consolidated financial statements have been examined by KPMG LLP, independent chartered accountants. The external auditors' responsibility is to express a professional opinion on the fairness of management's consolidated financial statements. The auditors' report outlines the scope of their examination and sets forth their opinion.

The Board of Directors, through its Audit & Finance Committee, oversees management's responsibilities for financial reporting and internal control. The Audit & Finance Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit & Finance Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance.

MIKE CORRIGAN
President & Chief Executive Officer

ROBERT P. CLARKE
Executive Vice-President & Chief Financial Officer

Victoria, Canada
June 15, 2012

To the Shareholders of British Columbia Ferry Services Inc.

We have audited the accompanying consolidated financial statements of British Columbia Ferry Services Inc., which comprise the consolidated balance sheets as at March 31, 2012 and March 31, 2011 and the consolidated statements of (loss) earnings, comprehensive income and retained earnings and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of 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 an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of British Columbia Ferry Services Inc. as at March 31, 2012 and March 31, 2011, and its results of operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

CHARTERED ACCOUNTANTS

Victoria, Canada
June 15, 2012

CONSOLIDATED FINANCIAL STATEMENTS

British Columbia Ferry Services Inc.

CONSOLIDATED BALANCE SHEETS (EXPRESSED IN THOUSANDS)

As at March 31	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 7,700	$ 33,335
Restricted short-term investments (note 2(e))	35,705	37,040
Other short-term investments	26,880	64,074
Accounts receivable (notes 4(a) and 13)	42,341	20,619
Prepaid expenses	6,725	5,648
Inventories	22,017	19,957
Regulatory assets (note 6)	–	3,703
	141,368	184,376
Property, plant and equipment (note 7)	1,577,709	1,581,007
Intangible assets (note 8)	41,913	34,929
Long-term regulatory assets (note 6)	1,501	–
Long-term loan receivable (note 11)	24,515	24,247
Long-term land lease (note 9)	32,521	32,979
	$ 1,819,527	$ 1,857,538
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 51,985	$ 51,249
Short-term debt (note 2(d))	17,737	3,949
Interest payable on long-term debt	18,249	18,261
Accrued employee costs	49,204	48,194
Deferred revenue	13,784	15,596
Derivative liabilities (note 4(c))	12	23
Regulatory liabilities (note 6)	2,379	–
Current portion of long-term debt (note 2)	9,000	22,125
Current portion of accrued employee future benefits (note 10)	1,600	1,200
Current portion of obligations under capital lease (note 11)	974	1,040
	164,924	161,637
Accrued employee future benefits (note 10)	11,171	10,907
Long-term regulatory liabilities (note 6)	–	1,558
Long-term debt (note 2)	1,285,232	1,327,014
Obligations under capital lease (note 11)	47,013	47,723
	1,508,340	1,548,839
Shareholders' equity:		
Share capital (note 12)	75,478	75,478
Contributed surplus (note 13)	25,000	–
Retained earnings	210,709	233,221
	311,187	308,699
Commitments (notes 7 and 17)		
Contingent liabilities (notes 1(s) and 19)		
	$ 1,819,527	$ 1,857,538

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Donald P. Hayes, Director   Brian G. Kenning, Director

CONSOLIDATED STATEMENTS OF (LOSS) EARNINGS, COMPREHENSIVE INCOME AND RETAINED EARNINGS

(EXPRESSED IN THOUSANDS)

Years ended March 31	2012	2011
Revenue:		
Tariffs	$ 457,003	$ 458,049
Ferry service fees (note 14)	154,959	151,023
Federal-Provincial Subsidy Agreement (note 15)	27,487	26,924
Retail	76,522	78,920
Other income	22,206	24,354
	738,177	739,270
Expenses:		
Operations	413,259	411,116
Maintenance	86,313	85,717
Administration	30,974	31,169
Cost of retail goods sold	29,132	29,659
Amortization	122,973	114,486
	682,651	672,147
Earnings from operations	55,526	67,123
Gain on foreign exchange	233	173
Interest expense (note 16)	(71,902)	(72,173)
(Loss) gain on disposal and impairment of capital assets (note 7)	(331)	8,658
Net (loss) earnings	(16,474)	3,781
Other comprehensive income (note 1(u))	–	–
Net (loss) earnings and comprehensive income	(16,474)	3,781
Retained earnings, beginning of year	233,221	235,478
Preferred share dividend (note 12)	(6,038)	(6,038)
Retained earnings, end of year	$ 210,709	$ 233,221

See accompanying notes to consolidated financial statements.

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CASH FLOWS (EXPRESSED IN THOUSANDS)

Years ended March 31	2012	2011
Cash provided by (used in):		
Operations:		
Net (loss) earnings	$ (16,474)	$ 3,781
Items not involving cash:		
Amortization	122,973	114,486
Other non-cash items	(2,665)	(6,659)
Long-term regulatory costs deferred	(3,059)	(7,543)
Change in non-cash operating working capital (note 20)	(318)	1,459
	100,457	105,524
Financing:		
Dividends paid on preferred shares	(6,038)	(6,038)
Repayment of long-term debt	(55,875)	(9,000)
Proceeds from (repayment of) short-term loans	13,788	3,949
Repayment of capital lease obligations	(1,042)	(1,021)
	(49,167)	(12,110)
Investing:		
Proceeds from disposal of property, plant and equipment	118	11,181
Purchase of property, plant and equipment and intangible assets	(115,304)	(120,874)
Recovery of import duties and related taxes (note 7)	–	119,449
Reduction of restricted short-term investments	1,335	200
Advancement of long-term loan	(268)	(24,247)
Proceeds from (purchase of) short-term investments	37,194	(56,396)
	(76,925)	(70,687)
(Decrease) increase in cash and cash equivalents	(25,635)	22,727
Cash and cash equivalents, beginning of year	33,335	10,608
Cash and cash equivalents, end of year	$ 7,700	$ 33,335

Supplemental cash flow information (note 20).

See accompanying notes to consolidated financial statements.

YEARS ENDED MARCH 31, 2012 AND 2011
(columnar dollars expressed in thousands)

British Columbia Ferry Services Inc. (the “Company”) was incorporated under the *Company Act* (British Columbia) by way of conversion on April 2, 2003, and now validly exists under the *Business Corporations Act* (British Columbia). The Company’s primary business activity is the provision of coastal ferry services in British Columbia.

The Company is subject to the *Coastal Ferry Act* (the “Act”), which came into force on April 1, 2003. Its common share is held by the B.C. Ferry Authority (the “Authority”), a corporation without share capital, and it is regulated by the British Columbia Ferries Commissioner (the “Commissioner”) to ensure that rates are fair and reasonable and to monitor service levels.

On June 24, 2010, the Province enacted the *Miscellaneous Statutes Amendment Act (No.3), 2010*, (Bill 20), amending several statutes, including the Act. The amendments include changes to the governance and regulatory framework within which the Company operates.

Among other things, the Bill 20 amendments to the Act changed the mandate of the Authority to include: responsibility for the compensation plans of the Company’s directors and certain executive officers; a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of the Company; and subjected the records of the Company and the Authority to the *Freedom of Information and Protection of Privacy Act.* The amendments to the regulatory framework expanded the responsibilities of the Commissioner to include: consideration of the interests of ferry users, regulation of reservation fees, and regulation of ferry transportation services where the Commissioner determines the Company has an unfair competitive advantage.

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of presentation:

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Company and its wholly owned subsidiaries. All inter-company balances and transactions have been eliminated on consolidation.

(b) Future accounting changes:

International Financial Reporting Standards (“IFRS”):

The Company’s changeover date for the conversion to IFRS was originally April 1, 2011. In October, 2010, the Canadian Accounting Standards Board (“AcSB”) amended Part 1 of the CICA Handbook – Accounting (“Handbook”) to permit qualifying entities with rate-regulated activities to defer the adoption of IFRSs by one year to no later than annual periods beginning on or after January 1, 2012. The Company elected this option which deferred the changeover date for conversion to IFRS to April 1, 2012. In March 2012, the AcSB announced its intention to extend the option for deferral of the mandatory IFRS changeover date for entities with qualifying rate-regulated activities by one more year to annual periods beginning on or after January 1, 2013. The Handbook was amended in May 2012 to permit this further deferral of IFRS adoption. The Company has chosen not to defer the adoption of IFRS for this additional one year period. Accordingly, the Company’s changeover date for conversion to IFRS will remain April 1, 2012.

Transition to IFRS will require the restatement for comparative purposes of amounts reported by the Company for the year prior to changeover date. The Company expects that all standards that will be in effect for the changeover year have already been issued by the International Accounting Standards Board (“IASB”). However, the Company is continuing to monitor the IASB and the AcSB as well as the Canadian Securities Administrators for any developments which may affect the timing, nature or disclosure relating to our adoption of IFRS.

The areas that have the highest potential to significantly impact the Company are rate-regulated operations; property plant and equipment; intangible assets and asset impairment; and initial adoption of IFRS under the provisions of IFRS 1 *“First-Time Adoption of IFRS”*. The Company is monitoring any IASB initiatives with the potential to impact rate-regulated accounting under IFRS.

The IASB published an amendment to IFRS 1 on May 6, 2010 which provides an exemption for property, plant and equipment and intangible assets used in operations subject to rate regulation. A first-time adopter may elect to use, on an item by item basis, the previous GAAP carrying amount of such items as deemed cost at the date of transition to IFRS. The Company has assessed the impact of the options available as a result of this IFRS 1 amendment and has decided to adopt the exemption for all its intangible assets and the majority of its items of property, plant and equipment. The Company has chosen the revaluation method for its land assets which will result in a $12.2 million increase in the value of these assets at its transition date of April 1, 2011.

IFRS 1 *"First-Time Adoption of IFRS"* allows a choice to either recognize all cumulative actuarial gains and losses of defined benefit plans through opening retained earnings or recalculate the actuarial gains and losses under IFRS from the inception of the defined benefit plans. The Company has elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2011. The actuarial loss to be recognized in opening retained earnings is $3.6 million.

In September 2010, the IASB staff released Agenda Paper 12 on rate-regulated activities. In the staff's opinion, while the impact of regulators may have an economic impact on entities subject to rate-regulation:

- Regulatory assets do not meet the definition of a financial asset nor the definition of an intangible asset as specified in IAS 38; and
- Regulatory liabilities do not meet the definition of a financial liability nor the definition of a provision as specified in IAS 37.

The IASB closed its project on rate-regulated activities. However, the IASB has commenced consulting constituents to seek input on their strategic direction and preparation in setting work plans over the next three years. It has also provided constituents with suggestions for items to add to their agenda, including rate-regulated activities. The Company has provided a response in support of reinstating a project on rate-regulated activities.

The Company expects that issues regarding rate-regulated activities will remain unresolved for some time and that regulatory assets or liabilities will not be reported on the IFRS Statement of Financial Position. Accordingly, current regulatory assets of $3.7 million and long-term regulatory liabilities of $1.6 million will be derecognized on the Company's transition date of April 1, 2011 with a net reduction in retained earnings of $2.1 million. The details of regulatory assets and liabilities will be disclosed in the notes to the IFRS financial statements commencing with the interim period ending June 30, 2012. As future balances of its regulatory accounts are unknown, the Company cannot reasonably estimate and conclude the impact on future financial position and results of operations with respect to accounting for rate-regulated activities.

(c) Regulation:
The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. In order to recognize the economic effects of regulation, the timing of recognition of certain revenues and expenses may differ from that otherwise expected under generally accepted accounting principles. These timing differences give rise to regulatory assets and regulatory liabilities in the financial statements.

The Company follows Accounting Guideline 19 "*Disclosures by Entities Subject to Rate Regulation"* (AcG-19) of the CICA Handbook which establishes guidelines on certain aspects of the disclosure and presentation of information in the financial statements of entities subject to rate regulation. AcG-19 requires the disclosure of general information regarding the nature and economic effects of rate regulation, as well as additional information on how rate regulation has affected the financial statements (note 6). The guideline does not address recognition and measurement issues associated with the accounting for rate-regulated operations.

(d) Cash and cash equivalents:
Cash and cash equivalents are comprised of cash and investments that are highly liquid in nature and have original maturity dates of three months or less.

(e) Short-term investments:
Short-term investments consist of financial instruments with original maturity dates greater than three months and less than a year.

(f) Inventories:
Inventories, which consist of materials and supplies, catering stores, and fuel are valued at the lower of weighted-average cost and net realizable value.

(g) Financial instruments:
The Company establishes the classification of financial instruments at their initial recognition. Financial assets are classified as held-for-trading, available for sale, held-to-maturity, or loans and receivables. Financial liabilities are classified as held-for-trading or other liabilities.

All financial instruments, including derivatives, are included on the consolidated balance sheet and are initially measured at fair value. Subsequent measurement and recognition of changes in fair value of financial instruments depends on their initial classification. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net earnings in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet at which time the cumulative gain or loss previously reported in other comprehensive income is recognized in net earnings except for permanent impairment losses which are recognized in net earnings as incurred. Loans and receivables, investments held-to-maturity and other financial liabilities are initially measured at fair value and are subsequently measured at amortized cost. Derivative instruments are recorded as either assets or liabilities measured at their fair values unless exempted from derivative treatment as a normal purchase and sale.

In estimating fair value, the Company uses quoted market prices when available. Models incorporating observable market data along with transaction specific factors are also used in estimating fair value. Financial assets and liabilities are classified in the fair value hierarchy according to the lowest level of observability of inputs that are significant to the fair value measurement. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect placement within the following fair value hierarchy levels:

- **level 1** – quoted prices in active markets for identical assets or liabilities,
- **level 2** – techniques (other than quoted prices included in level 1) that are observable for the asset or liability, either directly (as prices), or indirectly (as derived from prices), and
- **level 3** – techniques which use inputs which have a significant effect on recorded fair values for the asset or liability that are not based on observable market data (unobservable inputs).

(h) Embedded derivatives:

As at March 31, 2012, the Company has no embedded derivatives that meet the requirements of Section 3855 which would require that they be separated from host contracts and valued separately at fair value.

(i) Hedging relationships:

Derivative financial instruments are utilized by the Company to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. The Company does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the Company determines whether it will or will not apply hedge accounting.

When applying hedge accounting, the Company documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also assesses, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in the period in which they have been terminated or cease to be effective.

(j) Property, plant and equipment:

The costs of major replacements, additions, extensions and improvements, including direct overhead and financing costs during construction, are capitalized. The costs of maintenance, repairs, refit and minor renewals or replacements are expensed as incurred.

Capital assets, including assets under capital leases, are amortized on a straight-line basis over their estimated useful lives as follows:

Asset class	Estimated useful life
Ship hulls	40 years
Ship propulsion and utility systems	20 to 30 years
Marine structures	20 to 40 years
Buildings	20 to 40 years
Equipment and other	3 to 20 years

(k) Intangible assets:

The costs of acquired computer software, licenses and rights of use as well as internally developed computer software and websites are capitalized. These intangible assets are valued at their acquisition cost plus direct overhead and financing costs, less amortization. Computer software, licenses, and websites are amortized on a straight-line basis over their estimated useful lives of 3 to 7 years. Rights of use intangible assets are amortized on a straight-line basis over their estimated useful lives of 20 to 30 years.

(l) Impairment of long-lived assets:

The Company reviews capital assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such capital assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(m) Revenue recognition:
Tariff revenue is recognized when transportation is provided. The value of pre-sold fare media is included in the balance sheets as deferred revenue. Ferry service fees are recorded when service is provided.

(n) Pension and other employee future benefit plans:
Defined contribution plan accounting is applied to the Company's multi-employer defined benefit pension and long-term disability plans. These multi-employer plans are administered by external parties and the Company does not have sufficient information to apply defined benefit plan accounting. The actuarial determination of the accrued benefit obligations for retirement benefits other than pension uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors).

For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.

Actuarial gains (losses) arise from the difference between actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligation. For the Company's retirement bonus and death benefit plans, the excess of the net accumulated actuarial gain (loss) over 10 percent of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees.

Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

(o) Use of estimates:
The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the valuation of assets held for sale, the economic life of capital assets and the corresponding periods of amortization, the recoverability of capital assets, the valuation of employee future benefits, and provisions for contingencies. Actual results could differ from these estimates.

(p) Taxes:
The Company is a "Tax Exempt Corporation" as described in the *Income Tax Act* and as such is exempt from federal and provincial income taxes.

The provision of vehicle and passenger ferry services is an exempt supply under the *Excise Tax Act* for GST/HST purposes.

(q) Foreign currency transactions:
The Company's normal operating currency is the Canadian dollar. Monetary assets and liabilities denominated in foreign currency are translated to Canadian dollars at the rate of exchange prevailing at the balance sheet date. Revenues and expenses are translated at rates in effect at the time of the transaction. Foreign exchange gains and losses are recognized in the statement of earnings during the period in which they arise.

(r) Debt transaction costs:
Legal and financing costs incurred for arranging long-term debt are capitalized. Once the debt is issued these costs are reclassified from deferred costs to long-term debt which is measured using the effective interest rate method.

(s) Asset retirement obligations:
In the period when it can be reasonably determined, the Company recognizes a liability at its fair value for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

It is possible that the Company's estimates of its ultimate asset retirement obligations could change as a result of changes in regulations, changes in the extent of environmental remediation required, changes in the means of reclamation or changes in cost estimates. Changes in estimates are accounted for prospectively from the period the estimate is revised.

The Company's long-lived assets include certain vessels which contain undetermined amounts of asbestos. Under certain circumstances the Company may be required to handle and dispose of the asbestos in a manner required by regulations. It is the Company's intention to sell decommissioned vessels into world markets for continued use in providing commercial ferry service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood or financial impact, if any, of this issue.

(t) Interest rate support:
The Company receives interest rate support from the Government of Canada for eligible new Canadian built vessels or major refurbishment of vessels. Amounts receivable in regard to capitalized interest are recognized as a reduction of capitalized interest upon completion of the project. Amounts receivable in regard to post-completion debt service costs are recognized as a reduction to interest expense.

(u) Comprehensive income:
The Company has not recognized any adjustments through other comprehensive income for the years ended March 31, 2012 and 2011.

(v) Comparative figures:
Certain comparative figures have been reclassified to conform to the presentation adopted for the current period.

2. LOANS:

As at March 31	2012	2011
Long-term debt:		
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate 5.92%) (a)	$ 250,000	$ 250,000
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate 6.41%) (a)	250,000	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate 5.06%) (a)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate 5.62%) (a)	200,000	200,000
6.21% Senior Secured Bonds, Series 08-2, due December 2013 (effective interest rate 6.33%) (a)	140,000	140,000
12 Year Loan, maturing March 2020 (b)		
Tranche A (effective interest rate 5.17%)	60,000	67,500
Tranche B (floating interest rate of 1.48% at March 31, 2012)	5,625	22,500
12 Year Loan, maturing June 2020 (b)		
Tranche A (effective interest rate 5.18%)	61,875	69,375
Tranche B (floating interest rate of 1.47% at March 31, 2012)	5,625	20,625
2.95% Loan, maturing January 2021 (effective interest rate 3.08%) (c)	81,000	90,000
	1,304,125	1,360,000
Less: Deferred financing costs and unamortized bond discounts	(9,893)	(10,861)
Current portion	(9,000)	(22,125)
	$ 1,285,232	$ 1,327,014

Principal repayments due in the next five fiscal years are:

Year ended		
2013	$	9,000
2014		149,000
2015		270,250
2016		24,000
2017		24,000
Thereafter		827,875
	$	1,304,125

In May 2004, the Company entered into a master trust indenture which established common security and a set of common covenants for the benefit of all lenders under the Company's financing plan. The financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings, ranking pari passu.

The Company has issued five bond series of obligation bonds under the master trust indenture and entered into a credit facility agreement. In addition, the Company has entered into loan agreements which provided $288 million to partially finance the Company's purchase of two Super 'C' class vessels and one northern vessel. These funds were released to coincide with the conditional acceptance of the vessels in February 2008, May 2008 and January 2009.

(a) Bonds:
Bonds are issued under supplemental indentures either as obligation bonds or as pledged bonds. The bonds are secured by a registered first mortgage and charge over vessels, an unregistered first mortgage and charge over ferry terminal leases, and by a general security agreement on property and contracts. The bonds are redeemable in whole or in part at the option of the Company. The following table shows the semi-annual interest payment dates for the obligation bonds each year through to maturity.

Bonds	Interest payment dates	
Series 04-1	May 27	November 27
Series 04-4	April 13	October 13
Series 07-1	March 20	September 20
Series 08-1	January 11	July 11
Series 08-2	December 19	June 19

(b) 12 Year Loans:
Proceeds of $90.0 million were received in each of February 2008 and May 2008 for the partial financing of the purchase of the *Coastal Inspiration* and the *Coastal Celebration* to coincide with conditional acceptance of these vessels from the shipyard. Quarterly payments are due in March, June, September and December each year of the term of the loans.

These loan agreements deferred the principal payments for the first three years to a second tranche (Tranche B) on which interest only is paid in periods ranging from one to six months at the option of the Company, with the principal balance due when the loan matures. The interest rates on Tranche B are reset at floating rates of CAD LIBOR plus 30 bps, which will vary depending on the interest payment period. During the quarter ended September 30, 2011, the Company entered into amendments to the two loan agreements. These amendments allowed for the continuance of Tranche B for three years provided that the outstanding balance of Tranche B was fully prepaid. The Company fully prepaid the outstanding Tranche B balances of both loans ($22.5 million each); consequently, the Tranche A principal payments will be financed by draws under Tranche B for the next three years.

(c) 2.95% Loan:
Proceeds of $108.0 million were received in January 2009 and applied toward the purchase of the *Northern Expedition* to coincide with conditional acceptance from the shipyard. Equal semi-annual principal payments plus interest are due in January and July each year of the 12 year term of the loan.

(d) Credit facility:
The Company has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of $155.0 million, was amended on April 20, 2012 to extend the maturity date from May 2013 to April 2017. Draws on this facility totalled $17.7 million as at March 31, 2012 (2011: $3.9 million), and are shown as short-term debt. The average interest rate on these borrowings was 1.9% at March 31, 2012. Interest expensed during the year ended March 31, 2012, was less than $0.1 million (2011: less than $0.1 million). In addition, letters of credit outstanding against this facility at March 31, 2012 were $0.1 million (2011: $0.2 million).

(e) Debt service reserves:
The Company is required to maintain debt service reserves for the Series 04-1, 04-4, 07-1, 08-1 and 08-2 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 12 year loans and the 2.95%

loans equal to not less than six months forecasted debt service, to be increased under certain conditions. As permitted under the terms of the 12 year loans and the 2.95% loan, during the year ended March 31, 2012, the Company withdrew $1.3 million from the debt service reserves representing six months interest on the principal paid to date on these loans (2011: $0.2 million).

As at March 31, 2012, debt service reserves of $35.7 million were held in short-term investments and have been classified as restricted short-term investments on the balance sheet (2011: $37.0 million).

3. FINANCIAL INSTRUMENTS:

The carrying and fair values of the Company's financial instruments are as follows:

	2012		2011	
As at March 31	**Carrying Value**	**Approx Fair Value**	Carrying Value	Approx Fair Value
Available for sale [1]				
Cash	**$ 4,034**	**$ 4,034**	$ 1,648	$ 1,648
Held-for-trading [2]				
Other cash equivalents	**1,457**	**1,457**	137	137
Restricted short-term investments	**–**	**–**	37,040	37,040
Derivative liabilities	**12**	**12**	23	23
Held-to-maturity [3]				
Investments with maturities < 3 months	**2,209**	**2,209**	31,550	31,550
Restricted short-term investments	**35,705**	**35,705**	–	–
Other short-term investments	**26,880**	**26,880**	64,074	64,074
Loans and receivables [3]				
Accounts receivable	**42,341**	**42,341**	20,619	20,619
Loan receivable [4]	**24,515**	**24,515**	24,247	24,247
Other financial liabilities [3]				
Accounts payable and accrued liabilities	**51,985**	**51,985**	51,249	51,249
Short-term debt	**17,737**	**17,737**	3,949	3,949
Interest payable on long-term debt	**18,249**	**18,249**	18,261	18,261
Accrued employee costs	**49,204**	**49,204**	48,194	48,194
Long-term debt, including current portion [5, 6]	**1,294,232**	**1,491,008**	1,349,139	1,463,954

1 Measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Due to the nature of this financial instrument, carrying value approximates fair value.

2 Measured at fair value with all gains and losses included in net earnings in the period in which they arise. Fair values for the derivative liabilities have been estimated using period-end market rates. These fair values approximate the amount that the Company would pay to settle the contract at March 31.

3 Measured at amortized cost. Due to the nature of these financial instruments and/or short-term maturity of these financial instruments, carrying value approximates fair value except as noted.

4 Measured at amortized cost. Carrying value approximates fair value as the rate of return is variable and is expected to return a market rate of interest.

5 Carrying value is measured at amortized cost using the effective interest rate method.

6 Fair value is calculated by discounting the future cash flows of each debt issue at the estimated yield to maturity for the same or similar issues at March 31, 2012, or by using available quoted market prices.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where the market prices are not available, fair values are estimated using discounted cash flow analysis based on the Company's current borrowing rate for similar borrowing arrangements.

As at March 31, 2012, all available for sale and held-for-trading financial instruments are classified as level 1 in the fair value hierarchy with quoted prices in active markets.

During the year ended March 31, 2012, no profits resulting from the use of valuation techniques used to measure level 2 or 3 instruments in the fair value hierarchy (i.e. those with no active market price) have been recognized.

The Company may use derivative instruments to hedge its exposure to fluctuations in fuel prices and foreign currency exchange rates. The fair value of commodity derivatives reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that the Company would receive or pay should the derivative contracts be terminated at the stated dates. Any gains or losses related to fuel commodity swaps are charged to the Company's deferred fuel cost accounts.

4. FINANCIAL RISK MANAGEMENT:

Exposure to credit risk, liquidity risk, and market risk arises in the normal course of the Company's business. The Company manages market risk arising from the volatility in foreign currency, interest rate, and fuel price exposures in part through the use of derivative financial instruments including forward contracts, swaps and options. The Company does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the Company determines whether it will or will not apply hedge accounting. No hedges have been designated under Section 3865 – "*Hedges*" as at March 31, 2012 and 2011.

(a) Credit risk:

Credit risk is the risk that a third party to a financial instrument might fail to meet its obligations under the terms of the financial instrument. For cash and cash equivalents, short-term investments, and accounts receivable the Company's credit risk is limited to the carrying value on the balance sheet. Management does not believe that the Company is subject to any significant concentration of credit risk.

The Company limits its exposure to credit risk on cash and cash equivalents and short-term investments by investing in liquid securities with high credit quality counter parties, placing limits on tenor of investment instruments and instituting maximum investment values per counter party.

Accounts receivable by source are as follows:

March 31, 2012

Trade customers and miscellaneous	**18.2%**	**$ 7,692**
Federal and Provincial governments	**81.8%**	**34,649**
Total	**100.0%**	**$ 42,341**

Accounts receivable from trade customers are primarily due from commercial customers and transportation operators. Credit risk is reduced by a large and diversified customer base and is managed through the review of third party credit reports on customers both before extending credit and during the business relationship. The Company manages its exposure to credit risk associated with all customers through the monitoring of aging of receivables, by collecting deposits from and adjusting credit terms for higher risk customers and customers who are not on a pre-authorized payment plan. Amounts due from tickets sold to passengers through the use of major credit cards are settled shortly after sale and are classified as cash and cash equivalents on the balance sheet.

Accounts receivable from trade customers are generally due in 30 days. As at March 31, 2012, 99% of trade receivables are current. As at March 31, 2012, the provision for credit losses was $0.1 million (2011: $0.1 million) and reflects management's estimate of uncollectible receivables from trade customers based on past experience and analysis of customer accounts.

Amounts due from the Government of Canada and the Province of British Columbia (the "Province") are considered low credit risk.

The Company is exposed to credit risk in the event that a counter party in a derivative contract defaults on its obligation, including fuel commodity swaps and foreign exchange forward contracts. The Company manages the credit exposure related to financial instruments by dealing with high credit quality institutions, in accordance with established investment parameters, and by an ongoing review of its exposure to counter parties. Counter party credit rating and exposures are monitored by management on an ongoing basis, and are subject to approved credit limits. The counter parties with which the Company has significant derivative transactions must be rated single A or higher. The Company does not expect any counter parties to default on their obligations.

(b) Liquidity risk:

Liquidity risk is the risk that an entity will not be able to meet its obligations associated with its financial liabilities. The Company's financial position could be adversely affected if it fails to arrange sufficient and cost effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. The ability to arrange sufficient and cost effective financing is subject to numerous factors, including the results of operations and financial position of the Company, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

The Company manages liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of debt service reserves (note 2). The Company targets a strong investment grade credit rating to maintain capital market access at reasonable interest rates. As at March 31, 2012 and March 31, 2011, the Company's credit ratings were as follows:

	DBRS	Standard & Poor's
British Columbia Ferry Services Inc.:		
Senior secured long-term debt	A	A+

The following is an analysis of the contractual maturities of the Company's financial liabilities as at March 31, 2012:

Financial liabilities	< 1 year	2-3 years	4-5 years	> 5 years	Total
Accounts payable and accrued liabilities	$ 51,985	$ –	$ –	$ –	$ 51,985
Short-term debt	17,737	–	–	–	17,737
Interest payable on long-term debt	18,249	–	–	–	18,249
Accrued employee costs	49,204	–	–	–	49,204
Obligations under capital lease, including current portion	974	2,071	2,746	42,196	47,987
Long-term debt, including current portion (excluding deferred costs) [1]	9,000	419,250	48,000	827,875	1,304,125
	$ 147,149	$ 421,321	$ 50,746	$ 870,071	$ 1,489,287

1 Carrying value at March 31, 2012, excludes unamortized deferred financing costs of $9.9 million.

(c) Market risk:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates, foreign currency prices or fuel prices.

Interest rate risk:

The Company is exposed to interest rate risk associated with short-term borrowings and floating rate debt. As at March 31, 2012, the Company's cash equivalents and short-term investments include fixed rate instruments with maturities of 185 days or less. Accordingly, the Company has exposure to interest rate movement that occurs beyond the term of the maturity of the fixed rate investments. The Company's credit facility and the second tranche of each of the two 12 year loans are at variable rates and are subject to interest rate risk. To manage this risk, the Company maintains between 70% and 100% of its debt portfolio in fixed rate debt, in aggregate. Additionally, the Company may enter into interest rate agreements to manage its exposure on debt instruments. As at March 31, 2012, the Company has no interest rate agreements in place to offset interest rate risk and had approximately two per cent of total debt in variable rate instruments. A 50 basis point change in interest rates would not have had a significant effect on earnings for the twelve months ended March 31, 2012.

Foreign currency price risk:

The Company is exposed to risk from foreign currency prices on financial instruments, such as accounts payable and future purchase commitments denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, the Company reviews foreign currency denominated commitments and hedges through derivative instruments as necessary. As at March 31, 2012, the Company has foreign currency forward contracts of $1.5 million (2011: $1.2 million). A 10 per cent change in foreign exchange rates would not have had a significant effect on earnings for the twelve months ended March 31, 2012.

Fuel price risk:
The Company is exposed to risks associated with changes in the market price of marine diesel fuel. The Company may manage its exposure to fuel price volatility by entering into hedging instruments with certain financial intermediaries in order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs. Pursuant to the Company's Financial Risk Management Policy, the term of the contracts is not to extend beyond three years. This policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; 90% of anticipated monthly fuel consumption for the 12 month period thereafter and to 85% of anticipated monthly fuel consumption for the remaining 12 month period.

The Company is also allowed by regulatory order to use deferred fuel cost accounts to mitigate the impact of changes in fuel price on its earnings. Any differences between the per litre cost of fuel purchased and consumed (including hedge gains or losses) and the per litre cost of fuel included in the determination of price caps for the second performance term (note 6) are:

i) for those routes comprising the Northern Route Group;

   a. one-half of the first 5 cents per litre of difference is recorded in expense for the period with the remaining one-half of the first 5 cents per litre of difference recorded in deferral accounts for recovery or settlement through future tariffs to customers (note 6(a)), and

   b. any difference beyond 5 cents per litre is recorded in accounts receivable or payable for subsequent recovery from or payment to the Province, and

ii) for all other routes;

   a. one-half of the first 5 cents per litre of difference is recorded in expense for the period with all remaining differences per litre recorded in deferral accounts for recovery or settlement through future tariffs to customers (note 6(a)).

As a result of the use of deferred fuel cost accounts, the maximum effect on earnings from a change in fuel prices would be approximately $3.0 million.

During the year ended March 31, 2012, the amounts receivable from the Province in relation to fuel cost differences totalled $1.8 million (2011: $0.2 million receivable from the Province).

5. CAPITAL MANAGEMENT:

The Company's principal business of ferry transportation requires ongoing access to capital in order to fund operations, satisfy outstanding long-term debt obligations and fulfill future capital asset acquisition obligations. In order to ensure capital market access is maintained, the Company targets maintaining strong investment grade credit ratings (note 4(b)).

The capital structure of the Company is presented in the following table:

	2012		2011	
As at March 31	**$**	**%**	**$**	**%**
Aggregate borrowings [1]	**1,507,112**	**82.89**	1,563,763	83.50
Shareholders' equity [2]	**311,187**	**17.11**	309,020	16.50
Total capital	**1,818,299**	**100.00**	1,872,783	100.00

1 Includes long-term debt, including current portion, credit facility (drawn and undrawn) and short-term borrowings.

2 Shareholders' equity at March 31, 2011 excluded undesignated subsidiaries Pacific Marine Ventures Inc. and BCF Global Services Inc. both of which were designated during the year ended March 31, 2012.

The Company has covenants restricting the issuance of additional debt, distributions to shareholders, and guarantees and investments. Incurrence of additional debt and distributions are restricted when aggregate borrowings exceed 85% of the Company's total capital while certain guarantees and certain investments may be restricted when aggregate borrowings exceed 75%.

Debt service coverage (earnings before interest, taxes, depreciation, amortization, and rent) must be at least 1.5 times the debt service cost and the Company is required to maintain debt service reserves (notes 2 and 4). In addition to these restrictions and requirements, there are other covenants contained in the Master Trust Indenture (May 2004) available at www.SEDAR.com. The Company was in compliance with all of its covenants throughout the years ended March 31, 2012 and 2011.

6. FINANCIAL STATEMENT EFFECT OF RATE REGULATION:

The Company is regulated by the Commissioner to ensure that tariffs are fair and reasonable and to monitor service levels. Under the terms of the Act, the tariffs the Company charges its customers are subject to price caps. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels.

The accounting for regulated operations of the Company differs from non-regulated businesses following GAAP. The Company records assets and liabilities that result from the regulated price cap setting process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because they are probable of future recovery in tariffs. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions. Management continually assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes and believes the existing regulatory assets are probable of recovery. This determination reflects the current regulatory climate and is subject to change in the future. If future recovery of costs ceases to be probable, asset write-offs would be required to be recognized in the current period earnings at that time.

If the Company was not a rate-regulated entity and did not record regulatory assets and liabilities, net earnings for the year ended March 31, 2012, would have been $3.1 million higher (2011: $1.7 million lower) as detailed below:

Year ended March 31		2012		2011
Impact of regulatory accounts on net earnings				
FIRST PERFORMANCE TERM ACCOUNTS:				
Deferred fuel costs (a)	$	(4,625)	$	(4,625)
Performance term submission costs (b)		(150)		(150)
SECOND PERFORMANCE TERM ACCOUNTS:				
Deferred fuel costs (a)		3,046		7,393
Performance term submission costs (b)		95		148
Tariffs in excess of price cap (c)		(1,389)		(1,072)
Total (decrease) increase in net earnings resulting from regulatory accounts	$	(3,023)	$	1,694
Unamortized training costs (note 8)		(99)		48
Total (decrease) increase in net earnings	$	(3,122)	$	1,742

Accounting for the impacts of rate regulation has resulted in recording the following regulatory assets and liabilities in the consolidated balance sheets:

As at March 31	2012	2011
Regulatory accounts		
FIRST PERFORMANCE TERM ACCOUNTS:		
Balance at March 31, 2008:		
Deferred fuel costs (a)	**$ 18,501**	$ 18,501
Performance term submission costs (b)	**600**	600
	19,101	19,101
Accumulated amortization	**(19,101)**	(14,326)
Total of first performance term accounts	**–**	4,775
SECOND PERFORMANCE TERM ACCOUNTS:		
Deferred fuel costs (a)		
Balance – beginning of year	**(1,790)**	(9,185)
Fuel costs deferred (including realized hedge gains and losses)	**19,486**	849
(Surcharges collected) rebates granted	**(13,098)**	8,593
Fuel price risk (recoveries from) payments to the Province (note 4 (c))	**(1,799)**	(196)
Other payments from the Province	**(1,503)**	(1,556)
Interest payable	**(40)**	(295)
Balance – end of year	**1,256**	(1,790)
Tariffs in excess of price cap (c)	**(2,461)**	(1,072)
Performance term submission costs (b)	**327**	232
Total of second performance term accounts	**(878)**	(2,630)
Total regulatory (liabilities) assets	**(878)**	2,145
Current regulatory (liabilities) assets	**(2,379)**	3,703
Total long-term regulatory assets (liabilities)	**$ 1,501**	$ (1,558)

(a) Deferred fuel costs:

As prescribed by regulatory order, the Company defers differences between actual fuel costs and approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for settlement in future tariffs. Also prescribed by regulatory order, the Company collects fuel surcharges or provides fuel rebates from time to time which are applied against deferred fuel cost account balances and has included interest in the amount to be recovered from or returned to customers.

The Commissioner considered $18.5 million of unrecovered deferred fuel costs in the determination of the price caps set for the second performance term beginning April 1, 2008, and recovery occurred over this four year period. Accordingly, this $18.5 million was amortized to expense on a straight-line basis over the term. The difference between the balances in the deferred fuel cost accounts at March 31, 2008 and this $18.5 million, a $6.6 million credit, formed the opening balances of the fuel cost deferral accounts for the second performance term. It is expected that the fuel cost deferral accounts will continue and the balance of $1.3 million in these accounts at March 31, 2012 will be recovered during the third performance term, which commences April 1, 2012.

During the year ended March 31, 2012, the Province agreed to pay $1.5 million, to be applied against the balance of deferred fuel costs (2011: $1.6 million).

During the year ended March 31, 2012, the Company recognized $4.6 million in amortization expense for deferred fuel costs (2011: $4.6 million).

(b) Performance term submission costs:
The Commissioner has authorized the Company to defer costs of representation associated with the second and third performance terms. The Commissioner has considered, or will consider, these costs in the determination of the price caps set for the four years beginning April 1, 2008, and for the four years beginning April 1, 2012. The Commissioner has not included an allowance for a return on investment for the second or third performance term submission costs. The recovery periods are the four year period of the second performance term, commencing April 1, 2008 and the four year period of the third performance term, commencing April 1, 2012.

(c) Tariffs in excess of price cap:
The Act contains provisions which ensure that if tariffs charged by the Company exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At March 31, 2012, tariffs charged to customers on the Major Route Group exceeded the price cap by $2.5 million (2011: $1.1 million).

7. PROPERTY, PLANT AND EQUIPMENT:

March 31, 2012	**Cost**	**Accumulated amortization**	**Net book value**
Vessels	**$ 1,736,977**	**$ 693,244**	**$ 1,043,733**
Berths, buildings and equipment	**101,451**	**56,736**	**44,715**
Berths, buildings and equipment under capital lease	**733,900**	**272,837**	**461,063**
Land	**1,385**	**–**	**1,385**
Land under capital lease	**5,177**	**–**	**5,177**
Construction-in-progress	**21,636**	**–**	**21,636**
	$ 2,600,526	**$ 1,022,817**	**$ 1,577,709**

March 31, 2011	Cost	Accumulated amortization	Net book value
Vessels	$ 1,698,151	$ 620,758	$ 1,077,393
Berths, buildings and equipment	91,932	49,260	42,672
Berths, buildings and equipment under capital lease	686,128	259,789	426,339
Land	914	–	914
Land under capital lease	5,177	–	5,177
Construction-in-progress	28,512	–	28,512
	$ 2,510,814	$ 929,807	$ 1,581,007

During the year ended March 31, 2011, the Company received $119.4 million of duty remission, including related GST from the Government of Canada, relating to the purchase of four vessels built in Germany. This amount was recorded as a reduction of the cost of these assets.

During the year ended March 31, 2011, the Company disposed of its former head office building located at 1112 Fort Street, Victoria for $11.0 million, resulting in a gain on sale of $9.3 million.

Capitalized financing costs during construction for property, plant and equipment for the year ended March 31, 2012, totalled $1.5 million (2011: $2.5 million). Amortization expense for assets under capital lease for the year ended March 31, 2012, totalled $23.2 million (2011: $20.2 million).

In addition to the construction-in-progress referenced above, the contractual commitments as at March 31, 2012 for capital assets to be constructed, totalled $13.1 million (2011: $48.7 million).

The Government of Canada, through the Infrastructure Stimulus Program, has agreed to provide funding to help offset the costs of sewage and waste water treatment and other major projects at certain of our terminals. The Company received a total of $8.7 million under this program. During the year ended March 31, 2012, $2.6 million (2011: $6.1 million) of this amount has been recorded as a reduction of the cost of property, plant and equipment.

During the year ended March 31, 2012, the Company received $0.7 million (2011: $0.8 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated amortization of $13.6 million and $2.2 million respectively, as at March 31, 2012.

8. INTANGIBLE ASSETS

March 31, 2012	**Cost**	**Accumulated amortization**	**Net book value**
Acquired software, licenses and rights	**$ 33,947**	**$ 15,181**	**$ 18,766**
Internally developed software and websites	**23,822**	**15,268**	**8,554**
Work in progress	**14,593**	**–**	**14,593**
	$ 72,362	**$ 30,449**	**$ 41,913**

March 31, 2011	Cost	Accumulated amortization	Net book value
Acquired software, licenses and rights	$ 36,476	$ 19,767	$ 16,709
Internally developed software and websites	23,920	15,652	8,268
Work in progress	9,952	–	9,952
	$ 70,348	$ 35,419	$ 34,929

There was no impairment of intangible assets during the year ended March 31, 2012 or the year ended March 31, 2011.

Capitalized financing costs during construction for intangible assets for the year ended March 31, 2012 totalled $0.5 million (March 31, 2011 $0.4 million).

Included in the cost of intangible assets as at March 31, 2012, is $0.7 million of unamortized training costs (2011: $0.8 million). If the Company was not a regulated entity, these training costs would be expensed in the period incurred.

During the year ended March 31, 2012, intangible assets totalling $12.8 million (2011: $11.8 million) were acquired and $0.5 million (2011: $2.1 million) were internally developed. During this same period intangible assets with a cost and accumulated amortization of $11.2 million were retired (2011: $1.6 million). Amortization expense for the year ended March 31, 2012 totalled $6.3 million (2011: $5.3 million).

9. LONG-TERM LAND LEASE:

On April 1, 2003, the Company's land and structures comprising its terminals were transferred by the Company to the BC Transportation Financing Authority ("BCTFA"), a British Columbia Crown Corporation and related party at the time of the transaction. In exchange, the Company received recognition of a prepayment for leases of the transferred terminal structures and land. The structures, having lives of less than the lease term, are considered a capital lease and as such have been capitalized and included with capital assets and are amortized in accordance with the Company's amortization policy.

The land, having an indefinite useful life, is considered an operating lease. The prepayment of the land lease has been deferred and will be amortized on a straight-line basis over eighty years, being the initial sixty year lease period plus an additional twenty year bargain renewal option. The transaction is reflected at the book values of the transferred terminal structures and land.

Since April 1, 2003, the Company has entered into various agreements with BCTFA to add lands to the existing terminal leases. During the years ended March 31, 2012 and March 31, 2011, no new land costs were added to the terminal leases.

10 ACCRUED EMPLOYEE FUTURE BENEFITS:

(a) Description of benefit plans:

The Company and its employees contribute to the Public Service Pension Plan (the "Plan"). The Pension Corporation of the Province of British Columbia administers the Plan, including the payment of retirement and post-employment benefits on behalf of employers. The Plan is a multi-employer defined benefit pension plan. Under joint trusteeship, which became effective January 1, 2001, the risk and reward associated with the Plan's unfunded liability or surplus is shared between the employers and the plan members and will be reflected in their future contributions.

In addition, eligible employees are entitled to other retirement and future benefits as provided for under the collective agreement and terms of employment. A retirement bonus and a death benefit, both unfunded defined benefit plans and both administered by the Company, are based on years of service and final average salary. A funded long-term disability multi-employer plan provides disability income benefits after employment, but before retirement.

The Company also administers an unfunded accumulated sick leave bank ("Sick Bank obligation") consisting of unused sick time credits earned prior to the discontinuation of the sick leave accumulation benefit in 1979. Accumulated sick leave may be drawn down at 100% or paid out at 50%. Benefits are paid out at current salary rates. No new credits are accumulated to this bank.

The Company's employees may also receive compensation benefits arising from claims prior to March 31, 2003, administered by the Workers' Compensation Board ("WCB obligation"). Prior to March 31, 2003, the Company participated in the Workers' Compensation Board deposit class coverage system. Subsequent to March 31, 2003, the Company has been covered under the Workers' Compensation Board rate system. The change to the rate system resulted in a residual liability from the deposit class system that has been valued by actuarial assumptions as appropriate for a closed plan. Currently this obligation is unfunded.

(b) Total cash payments:

Total cash payments for employee future benefits for the year ended March 31, 2012, consisting of cash contributed by the Company to its multi-employer defined benefit plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to a third party administrator of an unfunded plan, was $26.5 million (2011: $25.8 million).

(c) Defined benefit plans:

All of the Company's defined benefit plans, except its multi-employer plans, are currently unfunded. The most recent actuarial valuation of the retirement bonus and death benefit plans is as at March 31, 2011. A plan amendment at December 31, 2007 restricts exempt employees from joining the retirement bonus and death benefit plans. This has resulted in a negative past service cost which is being amortized over the average remaining service period of the active employee group covered by the plans commencing January 1, 2008. As part of an implementation plan to assist with the transition of certain shipboard management to excluded positions, a further plan amendment was made during the year ended March 31, 2011. This amendment allows bargaining unit employees transferring to excluded positions to continue to be eligible for the retirement bonus, provided the transfer happens on or before December 31, 2013. The most recent actuarial valuations of the WCB obligation and the Sick Bank obligation are as at March 31, 2011 and March 31, 2001, respectively.

Other benefit plans	2012	2011
ACCRUED BENEFIT OBLIGATIONS		
Balance, beginning of year	**$ 13,162**	$ 13,221
Current service cost	**557**	530
Interest cost	**804**	827
Benefits paid	**(1,871)**	(1,466)
Actuarial losses (gains)	**958**	50
Balance, end of year	**$ 13,610**	$ 13,162

Other benefit plans	2012	2011
RECONCILIATION OF FUNDED STATUS OF THE BENEFIT PLANS TO THE AMOUNTS RECORDED IN THE FINANCIAL STATEMENTS		
Fair value of plan assets	$ –	$ –
Accrued benefit obligation	13,610	13,162
Funded status of plans – deficit	(13,610)	(13,162)
Unamortized net actuarial loss	1,417	1,835
Unamortized plan amendment – past service cost	(578)	(780)
Accrued benefit liability	(12,771)	(12,107)
Current portion of accrued employee future benefits	1,600	1,200
Accrued employee future benefits	$ (11,171)	$ (10,907)

Other benefit plans	2012	2011
ELEMENTS OF DEFINED BENEFIT COSTS RECOGNIZED IN THE YEAR		
Current service cost	$ 557	$ 530
Interest cost	804	827
Actuarial losses	1,378	488
Plan amendments	(202)	(202)
Defined benefit costs recognized	$ 2,537	$ 1,643

Significant assumptions

The significant assumptions used are as follows (weighted average):

	2012	2011
ACCRUED BENEFIT OBLIGATION AS OF MARCH 31:		
Discount rate	5.0%	5.7%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	94.6%	94.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
BENEFIT COST FOR YEARS ENDED MARCH 31:		
Discount rate	5.0%	5.7%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	94.6%	94.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
Average remaining service period of active employees (years)	7.0	6.8

(d) Multi-employer plans:
The total cost recognized for the Company's multi-employer plans is as follows:

	2012	2011
Public Service Pension Plan contributions (i)	$ 19,656	$ 19,230
Long-term disability plan contributions	4,952	5,068
Long-term disability plan amortization of surplus (ii)	64	64
	$ 24,672	$ 24,362

i) The March 31, 2011 actuarial valuation report for the Public Service Pension Plan was received by the Public Service Pension Board of Trustees on December 6, 2011. This report indicated that the pension fund has a deficit of $275 million. Under the terms of the plan's joint trust agreement, plan members and employers share in any increase or decrease in contribution rates. Effective April 1, 2012 the plan trustees increased the member and employer contribution rates to the basic account from 7.78% to 8.18% of pensionable earnings. This increase is primarily due to changes in the investment return and demographic assumptions. The contribution rates to the inflation adjustment account decreased for members from 1.50% to 1.25% and increased for employers from 2.5% to 2.75%, effective April 1, 2012. The next valuation, expected to be received during the fiscal year ended March 31, 2015, will be as at March 31, 2014.

ii) Contribution rates for the long-term disability plan are actuarially determined every three years as a percentage of covered payroll. The most recent valuation, as at March 31, 2011, determined an overall fund surplus. The newly established funding policy calls for amortization of individual participating employer deficits and surpluses over 5 years and a 110% funding target for each participant in 5 years. As a result the employer contribution rate was increased from 3.09% to 3.5% of covered payroll effective April 1, 2012. The next scheduled valuation, expected to be received during the fiscal year ended March 31, 2015, will be as at March 31, 2014.

11. HEAD OFFICE PROPERTY AND OTHER CAPITAL LEASES:

During the year ended March 31, 2011, agreements which constitute a capital lease for space in a new downtown Victoria, BC head office building took effect following the completion of construction of the new building. The initial term of the new building lease is for fifteen years, with four renewal options of five years each. The lease agreement includes payment of building operating costs and property taxes based on the Company's proportion of total rentable area. In addition, the Company has entered into lease agreements with terms of three or four years for computer equipment and for a ten year term for a training facility. During the year ended March 31, 2012, the Company did not add any leased computer equipment to property, plant and equipment (2011: $nil).

Loan and purchase option:

During the year ended March 31, 2012, the Company's wholly-owned subsidiary, Pacific Marine Leasing Inc., advanced $0.3 million (2011: $24.2 million) to the developer of the new head office property to finalize the loan amount at $24.5 million. The term of the loan is fifteen years, secured by a second mortgage of the property. The loan agreement provides for interest equal to one-half of the net cash flow from the property, subject to minimum and maximum percentage rates of interest. Over the term of the loan, interest is expected to approximate the market rate when the loan was made. Incidental to the loan, the Company was granted an option to purchase up to fifty percent of the owner's equity interest in the new building at a price of $24.5 million. The purchase option expires at the end of the loan term.

Future minimum lease payments and obligations under the head office and other capital leases are as follows:

	Head office lease				Other leases		
Year ended March 31	Minimum lease payments	Executory costs	Imputed Interest (5.04%)	Obligation	Minimum lease payments	Executory costs and Imputed interest	Total Obligations
2013	$ 4,996	$ 1,709	$ 2,325	$ 962	$ 77	65	974
2014	5,030	1,743	2,277	1,010	18	18	1,010
2015	5,064	1,777	2,226	1,061	–	–	1,061
2016	5,249	1,813	2,172	1,264	–	–	1,264
2017	5,435	1,850	2,103	1,482	–	–	1,482
Thereafter	49,839	17,874	14,284	17,681	–	–	17,681
Purchase option	24,515	–	–	24,515	–	–	24,515
Total	$ 100,128	$ 26,766	$ 25,387	$ 47,975	$ 95	$ 83	$ 47,987
Current portion				(962)			(974)
				$ 47,013			$ 47,013

12. SHARE CAPITAL:

(a) Authorized:

1,000,000 Class A voting common shares, without par value

1 Class B voting common share, without par value

80,000 Class C non-voting, 8% cumulative preferred shares, with a par value of $1,000 per share, convertible to Class A shares upon the sale of the outstanding Class B share by the initial shareholder. Special rights attached to the Class C shares restrict the Company's ability to issue shares and to declare dividends.

(b) Issued and outstanding:

As at March 31	2012 Number of shares	2012 Amount $	2011 Number of shares	2011 Amount $
Class B, common	**1**	**$ 1**	1	$ 1
Class C, preferred	**75,477**	**75,477**	75,477	75,477
		$ 75,478		$ 75,478

(c) Dividends:

Dividends on the Class C cumulative preferred shares, if declared, are payable annually on March 31 of each year. All dividend entitlements to date have been paid.

13. CONTRIBUTED SURPLUS:

On March 30, 2012, the Province confirmed that it had approved a contribution to the equity of the Company in the amount of $25 million payable as at March 31, 2012. This amount has been included in accounts receivable at March 31, 2012 and was received on April 20, 2012.

14. FERRY SERVICE FEES:

The Company entered into an agreement with the Province commencing April 1, 2003 to provide ferry services that would not be commercially viable under the current regulated tariff structure. In exchange for fees, the Company provides agreed ferry service levels on specified routes and administers certain social policy initiatives on behalf of the Province. The agreement is for a period of sixty years, the details of which are renegotiated after a first term of five years and each four year term thereafter. The agreement was amended on June 30, 2007 and March 31, 2008 to, among other things, establish the ferry service levels and the fees for the provision of such service for the second performance term ending March 31, 2012.

15. FEDERAL-PROVINCIAL SUBSIDY AGREEMENT:

The Company receives revenue provided to the Province from the Government of Canada pursuant to a contract between the federal and provincial governments for the provision of ferry, coastal freight and passenger services in the waters of British Columbia. The annual payment increases with the Vancouver Consumer Price Index.

16. INTEREST RATE SUPPORT:

During the year ended March 31, 2012, the Government of Canada agreed to provide $1.6 million in the form of interest rate support to the Company for major refurbishment of one vessel (2011: $1.0 million for major refurbishment of one vessel). During the year ended March 31, 2012, $1.5 million of these amounts have been recorded as a reduction of interest expense (2011: $0.5 million) and $0.2 million as a reduction of capitalized interest (2011: $0.1 million).

The Company has no requirement to repay these funds, other than as a result of an event of default under the agreement with the Government of Canada.

17. OTHER COMMITMENTS:

The Company has entered into operating leases for certain building spaces, land and equipment. Lease payments charged to expense during the year ended March 31, 2012 were $1.0 million (2011: $1.5 million).

Future minimum lease payments are as follows:

Year ended	
2013	$ 851
2014	486
2015	279
2016	45
	$ 1,661

18. RELATED PARTY TRANSACTIONS:

In accordance with the Act, the Company is responsible for paying any expenses that are incurred by the Authority without charge. During the year ended March 31, 2012, the Company paid $181,363 (2011: $71,361) of such expenses.

The Province owns the Company's 75,477 non voting preferred shares but has no voting interest in either the Company or the Authority.

19. CONTINGENT LIABILITIES:

The Company, in conducting its usual business activities, is involved in various legal proceedings and litigation, the outcome of which is indeterminable. It is the Company's policy to carry adequate insurance to minimize the financial risk associated with such matters. Management is of the opinion that the aggregate net liability, if any, of these proceedings and litigation would not be significant to the Company. Any additional future costs or recoveries which differ from the accrued amounts will be recognized in net earnings as determined.

20. SUPPLEMENTAL CASH FLOW INFORMATION:

Years ended March 31		2012		2011
(A) CHANGES IN NON-CASH OPERATING WORKING CAPITAL:				
Change in working capital				
Accounts receivable	$	(21,722)	$	(1,787)
Prepaid expenses		(1,077)		40
Inventories		(2,060)		(1,917)
Regulatory assets		3,703		1,072
Accounts payable and accrued liabilities		736		12,365
Interest payable on long-term debt		(12)		(58)
Accrued employee costs		1,010		(450)
Deferred revenue		(1,812)		(427)
Regulatory liabilities		2,379		–
Employee future benefits		400		400
Change in non-cash working capital		(18,455)		9,238
Change attributable to capital asset acquisitions		(6,863)		(7,779)
Change attributable to contributed surplus (note 13)		25,000		–
Change in non-cash operating working capital	$	(318)	$	1,459
(B) CASH PAID DURING THE YEAR FOR INTEREST	$	74,508	$	74,329
(C) NON-CASH TRANSACTIONS:				
Capital assets acquired under capital lease	$	268	$	49,247

21. SUBSEQUENT EVENT:

On May 31, 2012, the Province enacted the *Coastal Ferry Amendment Act, 2012* (Bill 47) amending the Act. The amendments include changes to the regulatory framework within which the Company operates. Among other things, the Bill 47 amendments to the Act expanded the authority and responsibilities of the Commissioner to include: approval of permanent changes to service levels, authority to order a temporary or permanent service reduction in certain circumstances, authority to require the Company to seek approval in advance of making certain capital expenditures, and the responsibility to set price caps sufficient to enable the Company to maintain access to borrowing rates that in the opinion of the Commissioner are reasonable.

When the Bill 47 amendments were initially introduced on May 9, 2012, the Province also announced that it would provide additional payments to the Company totalling $79.5 million. These payments are intended to reduce the pressure for future fare and price cap increases. The first payment of $25.0 million received April 20, 2012, was approved by the Province on March 30, 2012 as a contribution to the equity of the Company and was payable as at March 31, 2012. A further $54.5 million is expected to be received in annual payments of $21.5 million in the year ending March 31, 2013, $10.5 million in the year ending March 31, 2014, $11.0 million in the year ending March 31, 2015 and $11.5 million in the year ending March 31, 2016.

CORPORATE DIRECTORY

British Columbia Ferry Services Inc.

(April 1, 2011 – March 31, 2012)

BOARD OF DIRECTORS

Donald P. Hayes
Chair

Elizabeth J. Harrison*
Vice Chair

Holly A. Haston-Grant

Brian G. Kenning

Gordon R. Larkin

Maureen V. Macarenko

P. Geoffrey Plant, QC

Wayne H. Stoilen

Graham M. Wilson

* Effective April 1, 2012, Elizabeth J. Harrison ceased to be a director.

SENIOR OFFICERS OF THE COMPANY

Michael J. Corrigan
President & Chief Executive Officer (effective January 1, 2012)
Executive Vice President & Chief Operating Officer
(April 1, 2011 – December 31, 2011)

David L. Hahn (April 1, 2011 – December 31, 2011)
(Past) President & Chief Executive Officer

Robert P. Clarke
Executive Vice President & Chief Financial Officer

Glen N. Schwartz
Executive Vice President, Human Resources
& Corporate Development

OFFICERS OF THE COMPANY

Janet E. Carson
Vice President, Marketing & Travel Services

Mark F. Collins
Vice President, Engineering

L. Blaine Ellis
Vice President, Employee Relations

M. Alana Gallagher
Treasurer

Cynthia M. Lukaitis
Vice President & Corporate Secretary

Captain D.W. James Marshall
Vice President, Fleet Operations

Mark S. Stefanson
Vice President, Public Affairs

Corrine E. Storey
Vice President, Customer Services

Pierre Vorster
Vice President & Chief Information Officer

B.C. Ferry Authority

MESSAGE FROM THE CHAIR OF THE BOARD OF DIRECTORS

The Authority has adopted high standards of public and stakeholder accountability.

The B.C. Ferry Authority (the "Authority") has continued this past year to focus on implementing the changes to the governance structure of the Authority and its subsidiary, British Columbia Ferry Services Inc. ("BCFS"), arising from *Miscellaneous Statutes Amendment Act (No.3) – 2010* ("Bill 20").

Enacted in June 2010, Bill 20 amended several statutes, including the *Coastal Ferry Act*. Among other things, Bill 20 changed the mandate of the Authority to include responsibility for approving the compensation plans for the directors, as well as certain executive officers of BCFS.

This past year, in response to the requirements of Bill 20, the Authority established an executive compensation plan, which governs the remuneration BCFS may provide to its new President & CEO. This plan, together with the compensation plan for the directors of BCFS established by the Authority in the prior fiscal year, is available for public view on the Authority's website: www.bcferryauthority.com.

The close of this past year brought with it a change in the membership of the board of the Authority. On behalf of the board, I extend my thanks to outgoing director Tom Harris for his commitment and valuable service to the Authority. I also take pleasure in welcoming Randy Morriss to the Authority board and recognize the experience and expertise he will bring.

The Authority has adopted high standards of public and stakeholder accountability that require the Authority's financial and operating performance, the plans it has established in respect of BCFS director and executive compensation, as well as its processes for appointing directors of the Authority and BCFS, be open to public view.

The board looks forward to continuing to execute its mandate over the next year.

JANE L. PEVERETT,
Chair of the Board of Directors
B.C. Ferry Authority

The B.C. Ferry Authority (the "Authority" or "BCFA") is established and governed by the *Coastal Ferry Act* ("CFA"). The Authority is a corporation without share capital which owns the single issued voting share of the operating company, British Columbia Ferry Services Inc. (the "Company" or "BCFS"). The Province of British Columbia (the "Province") is the holder of all of the preferred shares of BCFS, and has no voting interest in either the Authority or BCFS.

The Authority's principal responsibilities are set out in the CFA as amended by the *Miscellaneous Statutes Amendment Act (No.3) – 2010* ("Bill 20") and are to appoint the directors of BCFS and to establish compensation plans for the directors and certain executive officers of BCFS.

In the fiscal year ended March 31, 2012, no appointments to the board of directors (the "board") of BCFS expired, and BCFA made no change in the composition of the BCFS board.

In accordance with the CFA, the Authority has established director and executive compensation plans for BCFS. These plans are available for public view on the Authority's website: www.bcferryauthority.com.

The compensation plan for the directors of BCFS was established in the fiscal year ended March 31, 2011, and remuneration for BCFS' directors was set by BCFA in accordance with that plan effective October 1, 2010. No amendments to the BCFS directors' compensation plan or to the remuneration of BCFS' directors were made by the Authority in the fiscal year ended March 31, 2012.

The Authority established a BCFS executive compensation plan in the fiscal year ended March 31, 2012. The plan is effective October 1, 2011 and, in accordance with the CFA and Bill 20, it presently governs the remuneration the Company may provide to its current President & CEO, but not the remuneration of any other executive officer of BCFS so long as that individual remains in his current position.

The Authority sets the remuneration for its directors in accordance with the provisions of the CFA. The current remuneration framework for BCFA's directors was set effective October 1, 2010 and has remained unchanged since that date.

The Authority and BCFS have entered into a protocol agreement which clarifies and confirms their respective roles and responsibilities in relation to the authority of BCFA as shareholder of BCFS and the matters respecting the appointment and remuneration of BCFS' directors, and the remuneration of the current President & CEO and future executive officers of BCFS.

The Authority has adopted high standards of public and stakeholder accountability that require the Authority's financial and operating performance, the plans it has established in respect of BCFS director and executive compensation, as well as its processes for appointing directors of the Authority and BCFS, be open to public view.

Appointment of BCFA Directors

The composition of the board of directors of the Authority is set out in the CFA and includes regional and stakeholder representation. Four directors are to be appointed by the board from nominees of four appointment areas, composed of coastal regional districts, and one director is to be appointed from the nominees of the BC Ferry & Marine Workers' Union, the trade union representing the employees of BCFS. The board is also to include two directors appointed by the Province and two additional directors appointed by the board from members of the community-at-large.

The terms of three directors expired March 31, 2012. To fill these positions, the board sought and received nominations during the fiscal year of qualified Authority candidates from the Northern Coastal & North Island and Central Vancouver Island & Northern Georgia Strait appointment areas. The nominees included the incumbent director from the Northern Coastal & North Island appointment area and he, together with a qualified nominee from the Central Vancouver Island & Northern Georgia Strait appointment area, was appointed to the board effective April 1, 2012. Also effective that date, the incumbent director from the community-at-large was re-appointed to the board. All three appointments are for terms ending March 31, 2015. At April 1, 2012, the board had two vacancies pending appointments by the Province.

In selecting individuals to serve as directors of the Authority, two primary objectives continued to guide the deliberations of the board. The first objective was to ensure that the composition of the board met the requirements of the CFA, and the second was to ensure that collectively the board included individuals with the skills and experience necessary to ensure the sound performance of the Authority and the effective interaction and operation of the board. The skills and experience profile adopted by the Authority guided the board in its appointment process during the fiscal year. The profile is attached as Schedule "A" to the general bylaws of the Authority.

General Bylaws

The general bylaws of the Authority are available for public view on the Authority's website. There were no amendments made to the general bylaws in the fiscal year.

Meetings

The board meets regularly to conduct its business. During the fiscal year, the board met on seven occasions. This included the annual general meeting of the Authority held in accordance with section 18 of the CFA. A summary of the outcomes of the meetings of the board is provided in Table 1.

TABLE 1
SUMMARY OF MEETING OUTCOMES [1]
Fiscal year ended March 31, 2012

DATE	TYPE	OUTCOMES
May 27, 2011	Board of Directors	• Financial statements of the Authority for the year ended March 31, 2011 approved. • Annual report for the year ended March 31, 2011 approved.
July 6, 2011	Board of Directors	• Director from the community-at-large re-appointed effective April 1, 2012 for a three year term ending March 31, 2015. • Board Chair re-elected effective April 1, 2012. • Revisions to the board governance manual approved. • Report on the Authority's compliance with the CFA for the year ended March 31, 2011 approved for submission to the British Columbia Ferries Commissioner. • Corporate Secretary authorized to execute the shareholder's unanimous consent resolutions pertaining to all of the business required to be transacted at the annual general meeting of BCFS.
August 24, 2011	Board of Directors	• International Financial Reporting Standards adopted effective April 1, 2012.
August 24, 2011	Annual General Meeting	• Annual general meeting of the Authority held.
November 4, 2011	Board of Directors	*No resolutions passed.*
November 28, 2011	Board of Directors	• BCFS executive compensation plan approved. • Amended Articles of BCFS conditionally approved.
March 28, 2012	Board of Directors	• Directors appointed from nominees of the Northern Coastal & North Island and Central Vancouver Island & Northern Georgia Strait appointment areas effective April 1, 2012 for three year terms ending March 31, 2015. • External auditor of the Authority reappointed for a period of up to three years commencing fiscal year 2012/13. • Fiscal year 2011/12 terms of engagement for the external auditor approved. • Fiscal year 2012/13 operating budget of the Authority approved. • Time and location of the next annual general meeting of the Authority confirmed.

NOTE: 1. Meeting outcomes are resolutions passed by the board.

Director Remuneration

Bill 20, enacted June 24, 2010, required that remuneration for directors appointed to BCFA after the date of first reading of Bill 20 be set in an amount and manner consistent with provincial public sector organizations. Existing directors were entitled under the provisions of Bill 20 to continue to receive their (higher) baseline remuneration until the completion of their term of office. However, the board broadened the application of the director remuneration provisions of Bill 20 to include existing as well as new directors of BCFA and, effective October 1, 2010, the remuneration for all BCFA directors was set in the amount and manner as outlined in Table 2. No changes were made to the framework for the remuneration of BCFA directors in the fiscal year.

TABLE 2

BCFA DIRECTOR REMUNERATION FRAMEWORK
Fiscal year ended March 31, 2012

ANNUAL RETAINERS	
Board Chair Retainer	$ 25,000
Board Member Retainers:	
Base Retainer (all directors excluding board Chair)	$ 6,250
Committee Chair Retainer [1]	$ 2,000
Committee Member Retainer [1]	$ 750
PER DIEM FEES	
Board Member Fees (all directors excluding board Chair)	Up to $1,200 per day
FERRY TRAVEL PASS	
Ferry pass for directors and eligible members of their respective immediate families, for complimentary vehicle and personal travel on BCFS' vessels.	

NOTE:
1 There currently are no committees of the board.

Directors of BCFA are also eligible for reimbursement of reasonable expenses incurred on board-related business.

The amount each director of BCFA received for remuneration and expenses in the fiscal year ended March 31, 2012 is set out in Table 3.

TABLE 3

BCFA DIRECTOR REMUNERATION & EXPENSES
Fiscal year ended March 31, 2012
($)

Director	Remuneration [1,2]	Expenses Reimbursed
Jane L. Peverett [3]	27,329	505
Bohdan I. Bodnar	17,364	Nil
Roderick D. Dewar	13,789	380
Thomas W. Harris	15,450	Nil
A. Daniel Miller	13,450	1,094
John Radosevic	14,242	371
Stephen E. Smith	13,488	2,388

NOTES:
1 Remuneration includes retainers, per diem fees and taxable income from the ferry travel pass program (see Note 2).
2 There is a ferry travel pass program for directors and their eligible family members which provides for complimentary travel on BCFS vessels. The program only applies while the director serves on the board. This program may generate a taxable benefit for the director.
3 Jane L. Peverett served as chair of the board of BCFA in the fiscal year.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors, B.C. Ferry Authority

We have audited the accompanying financial statements of B.C. Ferry Authority, which comprise the statement of financial position as at March 31, 2012 and the statements of operations and changes in net assets for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the 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 financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of B.C. Ferry Authority as at March 31, 2012, and its results of operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

CHARTERED ACCOUNTANTS

June 21, 2012
Victoria, Canada

Statement of Financial Position

(expressed in thousands)

As at March 31	2012	2011
Assets		
Investment in British Columbia Ferry Services Inc.	$ 235,710	$ 233,222
	$ 235,710	$ 233,222
Net Assets		
Invested in common share of British Columbia Ferry Services Inc.	$ 1	$ 1
Contributed surplus of British Columbia Ferry Services Inc.	25,000	–
Accumulated undistributed earnings of British Columbia Ferry Services Inc.	210,709	233,221
	$ 235,710	$ 233,222

See accompanying notes to financial statements.

On behalf of the Board:

Jane L. Peverett, Director

A. Daniel Miller, Director

Statement of Operations

(expressed in thousands)

As at March 31	2012	2011
Revenue:		
Distributable loss of British Columbia Ferry Services Inc. (note 2)	$ (22,512)	$ (2,257)
Expenses:		
Administration	181	71
Recovery from British Columbia Ferry Services Inc. (note 3)	(181)	(71)
	–	–
Net loss	$ (22,512)	$ (2,257)

See accompanying notes to financial statements.

Statement of Changes in Net Assets

(expressed in thousands)

	2012				2011
Years Ended March 31	Invested in BCFS	Undistributed Earnings of BCFS	Contributed Surplus of BCFS	Total	Total
Beginning of year	$ 1	$ 233,221	$ –	$ 233,222	$ 235,479
Contributed surplus (note 4)	–	–	25,000	25,000	–
Net loss	–	(22,512)	–	(22,512)	(2,257)
End of year	$ 1	$ 210,709	$ 25,000	$ 235,710	$ 233,222

See accompanying notes to financial statements.

B.C. Ferry Authority (the "Authority") was established by the *Coastal Ferry Act* (British Columbia) (the "Act") on April 1, 2003, as a corporation without share capital. The Act specifies that the Authority is governed by a board of nine directors. The terms of three director positions expire each fiscal year. The board of directors appoints replacements for outgoing directors for seven of the positions as follows:

- four appointed from nominees provided to the board by each of the four appointment areas consisting of those coastal regional districts that the Lieutenant Governor in Council for British Columbia may prescribe, with one director appointed from each area;
- one appointed from nominees provided by the trade union representing the employees of the British Columbia Ferry Services Inc. ("BCFS");
- two appointed from qualified individuals as defined in the Act.

The Lieutenant Governor in Council for British Columbia appoints the other two director positions from qualified individuals as terms expire. At March 31, 2012, these two positions are vacant.

The Authority's primary purpose is to hold the share of BCFS, a company incorporated under the *Company Act* (British Columbia) by way of conversion on April 2, 2003, and which now validly exists under the *Business Corporations Act* (British Columbia). BCFS's primary business is the provision of coastal ferry services in British Columbia. The Province of British Columbia (the "Province") contributed the initial capital to the Authority to fund the purchase of the BCFS common share. The Act provides that upon a sale of the common share of BCFS held by the Authority, the Province is to be repaid its initial contribution and the Authority is dissolved. The Act also provides that upon dissolution of the Authority, all remaining assets of the Authority, if any, vest in the Province.

On June 24, 2010, the Province enacted the *Miscellaneous Statutes Amendment Act (No.3), 2010*, (Bill 20), amending several statutes, including the Act. Among other things, the amendments changed the mandate of the Authority to include responsibility for the compensation plans of the directors and certain executive officers of BCFS and a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of BCFS. These amendments also require the British Columbia Ferries Commissioner to issue an opinion annually on the performance of the Authority in carrying out its legislated responsibilities.

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of presentation:

The financial statements are prepared in accordance with Canadian generally accepted accounting principles for not-for-profit entities. The Authority's investment in its wholly owned subsidiary, BCFS, is accounted for by the equity method. Under the equity method the original cost of the investment is adjusted for the Authority's share of post-acquisition earnings or losses, dividends and any other post-acquisition changes in the equity of BCFS.

(b) Revenue recognition:

The Authority follows the deferral method of accounting for contributions. The Authority does not expect to receive endowment contributions.

(c) Taxes:

The Authority and BCFS are exempt from federal and provincial income taxes.

(d) Statement of Cash Flows:

A statement of cash flows has not been included with these statements as it does not provide additional information.

(e) Future accounting changes:

The Authority's changeover date for the conversion to International Financial Reporting Standards ("IFRS") is April 1, 2012. The Authority has developed an implementation plan for the conversion and identified the key accounting policy differences. The Authority is in the process of assessing the impact of these differences on its financial statements. The areas that have the highest potential to impact the Authority include the requirement to prepare consolidated financial statements instead of using the equity method to account for its investment in BCFS. Other areas include rate regulated operations; property, plant and equipment; intangible assets and asset impairment; and initial adoption of IFRS under the provisions of IFRS 1 *"First-Time Adoption of IFRS"*. Transition to IFRS will require the restatement for comparative purposes of amounts reported for the year prior to the changeover date. Transition to IFRS will result in an increase in the equity of BCFS of $6.5 million at April 1, 2011.

(expressed in thousands)

2. DISTRIBUTABLE LOSS OF BRITISH COLUMBIA FERRY SERVICES INC.:

The distributable loss of BCFS consists of the current period net (loss) earnings, less any dividends paid in the current period and less a reserve for undeclared preferred share dividend, if any.

Years ended March 31	2012	2011
Net (loss) earnings and comprehensive income of BCFS	$ (16,474)	$ 3,781
Dividends paid on 8% cumulative preferred shares	(6,038)	(6,038)
	$ (22,512)	$ (2,257)

3. RECOVERY FROM BRITISH COLUMBIA FERRY SERVICES INC.:

The Act provides that BCFS is responsible for paying any expenses that are incurred by the Authority.

4. SUBSIDIARY SUPPLEMENTAL INFORMATION:

The consolidated financial position and operating results for BCFS and its wholly-owned subsidiaries are summarized below:

As at March 31	2012	2011
Assets:		
Current assets	$ 141,368	$ 184,376
Capital and other assets	1,678,159	1,673,162
	$ 1,819,527	$ 1,857,538
Liabilities:		
Current liabilities	$ 164,924	$ 161,637
Accrued employee future benefits	11,171	10,907
Long-term regulatory liabilities	–	1,558
Long-term debt and capital lease obligations	1,332,245	1,374,737
	1,508,340	1,548,839
Shareholders' equity:		
Common share held by the Authority	1	1
Preferred shares (a)	75,477	75,477
Contributed surplus (b)	25,000	–
Retained earnings	210,709	233,221
	311,187	308,699
	$ 1,819,527	$ 1,857,538

Years ended March 31	2012	2011
Revenue (including gains)	$ 738,410	$ 748,101
Expenses (including losses)	754,884	744,320
Net (loss) earnings and comprehensive income	$ (16,474)	$ 3,781
Cash flows from operating	$ 100,457	$ 105,524
Cash flows from financing	(49,167)	(12,110)
Cash flows from investing	(76,925)	(70,687)

(a) The outstanding non-voting, 8% cumulative preferred shares are held by the Province and are convertible to common shares upon a sale of the outstanding common share. Special rights attached to the preferred shares restrict BCFS's ability to issue share capital and to declare dividends.

(b) On March 30, 2012, the Province confirmed that it had approved a contribution to the equity of BCFS in the amount of $25 million, payable at March 31, 2012. This amount was included in the accounts receivable of BCFS at March 31, 2012 and the funds were received April 20, 2012.

CORPORATE DIRECTORY

B.C. Ferry Authority

BOARD OF DIRECTORS
(Effective April 1, 2012)

Jane L. Peverett
(Community-at-large)

Bohdan I. Bodnar
(Southern Mainland appointment area)

Roderick D. Dewar
(Southern Vancouver Island appointment area)

Randolph K. Morriss
(Central Vancouver Island & Northern Georgia Strait appointment area)

A. Daniel Miller
(Community-at-large)

John Radosevic
(Organized labour)

Stephen E. Smith
(Northern Coastal & North Island appointment area)

Vacant
(Province of British Columbia)

Vacant
(Province of British Columbia)

OFFICERS
(Effective April 1, 2012)

Jane L. Peverett
Chair

Cynthia M. Lukaitis
Vice President & Corporate Secretary

BOARD OF DIRECTORS
(April 1, 2011 – March 31, 2012)

Jane L. Peverett

Bohdan I. Bodnar

Roderick D. Dewar

Thomas W. Harris

A. Daniel Miller

John Radosevic

Stephen E. Smith

OFFICERS
(April 1, 2011 – March 31, 2012)

Jane L. Peverett
Chair

Cynthia M. Lukaitis
Vice President & Corporate Secretary

BRITISH COLUMBIA FERRY SERVICES INC.
500–1321 Blanshard Street, Victoria,
British Columbia V8W 0B7

www.bcferries.com
www.bcferryauthority.com

MIX
Paper from responsible sources
FSC® C014956

This annual report is printed on FSC® certified paper. The cover and first 10 text pages are made from 10% post-consumer recycled fibre; the last 84 text pages are made from 100% post-consumer recycled fibre. By choosing FSC® certified paper, BC Ferries is supporting responsible forest management.

zero 100% carbon neutral
by Hemlock Printers www.hemlock.com/zero

Environmental Benefits Statement

By using paper made with post-consumer recycled content, the following resources have been saved.

trees	water	energy	solid waste	greenhouse gases
9	14,731	3	111	391
fully grown	litres	million BTU	kilograms	kilograms

Environmental impact estimates were made using the Environmental Paper Network Calculator. For more information visit http://calculator.environmentalpaper.org