

Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Years ended March 31, 2010 and 2009



KPMG LLP
Chartered Accountants
St. Andrew's Square II
800 - 730 View Street
Victoria BC V8W 3Y7

Telephone (250) 480-3500
Fax (250) 480-3539
Internet www.kpmg.ca

AUDITORS' REPORT

To the Shareholders of British Columbia Ferry Services Inc.

We have audited the consolidated balance sheets of British Columbia Ferry Services Inc. as at March 31, 2010 and 2009 and the consolidated statements of earnings, comprehensive income and retained earnings and cash flows for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style.

Chartered Accountants

Victoria, Canada

May 12, 2010

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	As at March 31,	
	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 10,608	\$ 12,402
Restricted cash equivalents and short-term investments (note 2(e))	37,240	37,240
Other short-term investments	7,678	153
Accounts receivable (note 4(a))	17,707	13,181
Prepaid expenses	6,813	8,132
Inventories	18,040	16,835
Regulatory assets (note 6)	4,775	4,775
	102,861	92,718
Property, plant and equipment (note 7)	1,644,069	1,683,576
Intangible assets (note 8)	26,406	19,866
Assets held for sale (note 9)	200	435
Regulatory assets (note 6)	-	11,687
Long-term land lease (note 10)	33,437	33,896
	\$ 1,806,973	\$ 1,842,178
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 38,884	\$ 41,825
Short-term debt (note 2(d))	-	17,956
Interest payable on long-term debt	18,319	18,395
Accrued employee costs	48,644	51,923
Deferred revenue	16,023	15,409
Derivative liabilities (note 4 (c))	-	923
Regulatory liabilities (note 6)	-	2,858
Current portion of long-term debt (note 2)	9,000	9,000
Current portion of accrued employee future benefits (note 11)	800	800
Current portion of obligations under capital lease (note 12)	398	541
	132,068	159,630
Accrued employee future benefits (note 11)	11,130	12,047
Regulatory liabilities (note 6)	4,325	-
Long-term debt (note 2)	1,348,183	1,356,239
Obligations under capital lease (note 12)	139	537
Other long-term liabilities	172	153
	1,496,017	1,528,606
Shareholders' equity:		
Share capital (note 13)	75,478	75,478
Retained earnings	235,478	238,094
	310,956	313,572
Commitments (notes 7 and 18)		
Contingent liabilities (notes 1(t) and 20)		
Subsequent event (note 22)		
	\$ 1,806,973	\$ 1,842,178

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Donald P. Hayes"

Director

"Brian G. Kenning"

Director

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Earnings, Comprehensive Income and Retained Earnings
(expressed in thousands)

	Years ended March 31,	
	2010	2009
Revenue:		
Tariffs (note 14)	\$ 450,508	\$ 429,063
Ferry service fees (note 15)	149,507	124,485
Federal-Provincial Subsidy Agreement (note 16)	26,924	26,294
Retail	80,809	78,060
Other income	24,557	23,898
	<u>732,305</u>	<u>681,800</u>
Expenses:		
Operations	398,792	387,782
Maintenance	85,579	77,124
Administration	30,330	37,220
Cost of retail goods sold	30,127	28,929
Amortization	115,175	93,088
	<u>660,003</u>	<u>624,143</u>
Earnings from operations	72,302	57,657
Gain on foreign exchange	144	244
Interest expense (note 17)	(67,638)	(50,111)
(Loss) gain on disposal and impairment of capital assets (notes 7 and 9)	(1,386)	1,239
Net earnings	<u>3,422</u>	<u>9,029</u>
Other comprehensive income (note 1(v))	-	-
Net earnings and comprehensive income	<u>3,422</u>	<u>9,029</u>
Retained earnings, beginning of year	238,094	235,103
Preferred share dividend (note 13)	(6,038)	(6,038)
Retained earnings, end of year	<u>\$ 235,478</u>	<u>\$ 238,094</u>

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Cash Flows
(expressed in thousands)

	Years ended March 31,	
	2010	2009
Cash provided by (used in):		
Operations:		
Net earnings	\$ 3,422	\$ 9,029
Items not involving cash:		
Amortization	115,175	93,088
Other non-cash charges	1,854	(289)
Long-term regulatory costs deferred	10,314	(6,039)
Change in non-cash operating working capital (note 21)	(9,468)	(6,783)
	<u>121,297</u>	<u>89,006</u>
Financing:		
Dividends paid on preferred shares	(6,038)	(6,038)
Proceeds from issuance of bonds and other long-term debt	-	338,000
Debt service reserves	-	(8,170)
Repayment of long-term debt	(9,000)	-
(Repayment of) proceeds from short-term loans	(17,956)	17,956
Repayment of capital lease obligations	(541)	(775)
Deferred financing costs incurred	-	(1,704)
	<u>(33,535)</u>	<u>339,269</u>
Investing:		
Proceeds from disposal of property, plant and equipment	2,135	1,697
Purchase of property, plant and equipment and intangible assets	(84,166)	(530,713)
Increase in lands under long-term lease	-	(5,083)
(Purchase of) proceeds from other short-term investments	(7,525)	1,897
	<u>(89,556)</u>	<u>(532,202)</u>
(Decrease) in cash and cash equivalents	(1,794)	(103,927)
Cash and cash equivalents, beginning of year	12,402	116,329
Cash and cash equivalents, end of year	<u>\$ 10,608</u>	<u>\$ 12,402</u>

Supplemental cash flow information (note 21)

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements
Years ended March 31, 2010 and 2009
(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.

1. Significant accounting policies:

(a) Basis of presentation:

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of the Company and its wholly owned subsidiaries, Pacific Marine Leasing Inc. ("PML"), BCF Captive Insurance Company Ltd. ("BCF Captive"), Pacific Marine Ventures Inc. ("PMV"), and BCF Global Services Inc. ("Global"). All inter-company balances and transactions have been eliminated on consolidation.

(b) Adoption of new accounting standards:

Goodwill and Intangible Assets:

Effective April 1, 2009, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064 "*Goodwill and Intangible Assets*" which replaces Sections 3062 and 3450. This section establishes standards for the recognition, measurement and disclosure of goodwill and other intangible assets and requires retrospective application. As a result, the Company has reclassified the net book value of certain computer software and license costs. As at March 31, 2009, the net book value of intangible assets was increased by \$19.9 million and the net book value of property, plant and equipment was reduced by \$19.9 million. Other than these reclassifications and the disclosures included in note 8, there has been no significant impact on the Company's consolidated financial statements from the adoption of this section.

Rate-regulated operations:

Effective for the Company April 1, 2009, the CICA removed a temporary exemption in Section 1100, "*Generally Accepted Accounting Principles*", of the CICA Handbook. This exemption had provided relief to those entities subject to rate regulation from the requirement to apply the Section to the recognition and measurement of assets and liabilities arising from rate regulation by permitting them to be recognized and measured on a basis other than in accordance with the primary sources of Canadian GAAP.

The assets and liabilities arising from rate-regulation as described in Note 6 do not have specific guidance under a primary source of Canadian GAAP. In such instances and when developing accounting policies, the Company may consult other sources including pronouncements issued by bodies authorized to issue accounting standards in other jurisdictions. The Company has determined that its regulatory assets and liabilities qualify for

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Notes to Consolidated Financial Statements
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(columnar dollars expressed in thousands)

1. Significant accounting policies (continued):

(b) Adoption of new accounting standards (continued):

Rate-regulated operations (continued):

recognition under Canadian GAAP consistent with US Financial Accounting Standard Board's Accounting Standards Codification Topic 980 "Regulated Operations". Therefore, there was no effect on the Company's consolidated financial statements as a result of the removal of the temporary exemption in Section 1100.

Financial instruments:

In June 2009, the CICA issued amendments to Section 3862, "*Financial Instruments - Disclosures*", of the CICA Handbook. The amendments require additional disclosure about the fair value measurement of financial instruments and enhanced liquidity risk disclosures. These disclosures have been included in notes 1(h) and 3.

(c) Future accounting changes:

International Financial Reporting Standards ("IFRS"):

The Company's transition date for the conversion to IFRS will be April 1, 2011, and will require the restatement for comparative purposes of amounts reported by the Company for the year ending March 31, 2011. While the Company is continuing to assess the adoption of IFRS, the financial reporting impact of the transition cannot be reasonably estimated at this time.

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 International Accounting Standards Board ("IASB") initiatives with the potential to impact rate-regulated accounting under IFRS.

On July 23, 2009, the IASB issued an exposure draft ("ED") addressing rate-regulated activities. The ED proposes new standards which define regulatory assets and regulatory liabilities, sets out criteria for their recognition, specifies how they should be measured and requires disclosures about their financial effect. The Company reviewed the ED and responded to the IASB requesting clarification of scope as defined in the ED. More than 150 comment letters with significantly differing comments and views were received by the IASB.

At its February 2010 meeting, the IASB began discussions on the responses to the ED. They also discussed the logistical considerations impacting the rate-regulated activities project and reviewed the potential paths forward including a project timetable prepared by its staff. The IASB did not make any tentative decisions on specific aspects of the project, except to tentatively finalize an amendment to IFRS 1 to provide transition relief for first-time adopters. This amendment was issued in May 2010 and is currently being assessed by the Company. The IASB directed the staff to continue its research and analysis on this project and to focus on the key issue of whether regulatory assets and liabilities exist in accordance with the current Framework for the Preparation and Presentation of Financial Statements and whether they are consistent with other current IFRS standards.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements

Years ended March 31, 2010 and 2009

(columnar dollars expressed in thousands)

1. Significant accounting policies (continued):

(c) Future accounting changes (continued):

International Financial Reporting Standards ("IFRS") (continued):

The IASB plans to continue its deliberation of this project at a future meeting and expects to issue a new standard by the end of June 2011.

The continued uncertainty regarding IFRS treatment of regulatory assets and liabilities has resulted in an inability to reasonably estimate and conclude the impact of IFRS on the Company's future financial position and results of operations with respect to differences, if any, in accounting for rate-regulated activities.

(d) 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.

(e) Cash and cash equivalents:

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

(f) Short-term investments:

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

(g) 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.

(h) 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

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements
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1. Significant accounting policies (continued):

(h) Financial instruments (continued):

financial instruments are measured at fair value and all gains and losses are included in net income 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. 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 value 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 (i.e. as prices) or indirectly (i.e. 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).

(i) Embedded derivatives:

As at March 31, 2010, 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.

(j) 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

BRITISH COLUMBIA FERRY SERVICES INC.

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1. Significant accounting policies (continued):

- (j) Hedging relationships (continued):
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.
- (k) 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 at the following rates:

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

- (l) Intangible assets:
The costs of acquired computer software and licenses as well as internally developed computer software and website are capitalized. These intangible assets are valued at their acquisition cost plus direct overhead and financing costs, less amortization. Intangible assets are amortized on a straight-line basis over their estimated useful lives of 3 to 5 years.
- (m) 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 market value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.
- (n) 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.
- (o) 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.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements
Years ended March 31, 2010 and 2009
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1. Significant accounting policies (continued):

(o) Pension and other employee future benefit plans (continued):

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. The average remaining service period of the active employees covered by the other (non-pension) retirement benefits plan was 7.1 years as at March 31, 2007, the date of the most recent actuarial valuation.

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.

(p) 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.

(q) 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 purposes.

(r) 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

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements
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(columnar dollars expressed in thousands)

1. Significant accounting policies (continued):

- (r) Foreign currency transactions (continued):
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.
- (s) Debt transaction costs:
Legal and financing costs incurred for long-term debt arranged for 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.
- (t) 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.
- (u) 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.
- (v) Comprehensive income:
The Company has not recognized any adjustments through other comprehensive income for the years ended March 31, 2010 and 2009.
- (w) Comparative figures:
Certain comparative figures have been reclassified to conform to the presentation adopted for the current period.

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2. Loans:

Long-term debt:	As at March 31,	
	2010	2009
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%)	75,000	82,500
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)	15,000	7,500
12 Year Loan, maturing June 2020 (b)		
Tranche A (effective interest rate 5.18%)	76,875	84,375
Tranche B (floating interest rate of CAD LIBOR plus 30 bps)	13,125	5,625
2.95% Loan, maturing January 2021 (effective interest rate 3.08%) (c)	99,000	108,000
	1,369,000	1,378,000
Less: Deferred financing costs and unamortized bond discounts	(11,817)	(12,761)
Current portion	(9,000)	(9,000)
	\$ 1,348,183	\$ 1,356,239

Principal repayments due in the next five years are:

Year ended	
2011	\$ 9,000
2012	22,125
2013	24,000
2014	164,000
2015	274,000
Thereafter	875,875
	\$ 1,369,000

BRITISH COLUMBIA FERRY SERVICES INC.

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2. Loans (continued):

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 defer the principal payments for the first three years to a second tranche on which interest only (at floating rates) is paid quarterly and the principal is paid at the end of the term. These floating rates can change from time to time, depending upon Standard & Poor's rating of the Company.

(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.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to Consolidated Financial Statements

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(columnar dollars expressed in thousands)

2. Loans (continued):

(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, matures May 12, 2013. Draws on this facility totalled \$nil as at March 31, 2010 (2009: \$18.0 million), and are shown as short-term debt at their discounted value. Interest expensed during the year ended March 31, 2010, was \$0.1 million (2009: \$0.5 million). In addition, letters of credit outstanding against this facility at March 31, 2010, totalled \$0.3 million (2009: \$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 4.98% and 2.95% loans equal to the first six months of debt service.

As at March 31, 2010, debt service reserves of \$37.2 million were held in short-term investments and have been classified as restricted cash equivalents and short-term investments on the balance sheet (2009: \$37.2 million held in cash and cash equivalents).

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3. Financial instruments:

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

	As at March 31, 2010		As at March 31, 2009	
	Carrying Value	Approx Fair Value	Carrying Value	Approx Fair Value
Available for sale ¹				
Cash	\$ 1,617	\$ 1,617	\$ 3,910	\$ 3,910
Held for trading ²				
Other cash equivalents	8,991	8,991	6,494	6,494
Restricted short-term investments	37,240	37,240	-	-
Derivative assets	-	-	-	-
Derivative liabilities	-	-	923	923
Held-to-maturity ³				
Investments with maturities < 3 months	-	-	1,998	1,998
Restricted cash equivalents	-	-	37,240	37,240
Other short-term investments	7,678	7,678	153	153
Loans and receivables ³				
Accounts receivable	17,707	17,707	13,181	13,181
Other financial liabilities ³				
Accounts payable and accrued liabilities	38,884	38,884	41,825	41,825
Short-term debt	-	-	17,956	17,956
Interest payable on long-term debt	18,319	18,319	18,395	18,395
Accrued employee costs	48,644	48,644	51,923	51,923
Long-term debt, including current portion ^{4, 5}	1,357,183	1,458,074	1,365,239	1,344,065
Other long-term liabilities	172	172	153	153

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 amortized fair value except as noted.

⁴ Carrying value is measured at amortized cost using the effective interest rate method.

⁵ 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, 2010, or by using available quoted market prices.

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3. Financial instruments (continued):

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.

At March 31, 2010, 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, 2010, 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" at March 31, 2010 and 2009.

(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.

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4. Financial risk management (continued):

(a) Credit risk (continued):

Accounts receivable by source are as follows:

	March 31, 2010	
Trade customers and miscellaneous	39.4%	\$ 6,978
Federal and Provincial governments	59.4%	10,510
Counter-parties	1.2%	219
Total	100.0%	\$ 17,707

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. At March 31, 2010, 93% of trade receivables are current. At March 31, 2010, the provision for impairment of credit losses was \$0.1 million (2009: \$0.3 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 credit-approval practices, 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.

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4. Financial risk management (continued):

(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, 2010, the Company's credit ratings were as follows:

	DBRS	Standard & Poor's
British Columbia Ferry Services Inc.:		
Senior secured long-term debt	A (March 31, 2009: A low)	A+ (March 31, 2009: A-)

The following is an analysis of the contractual maturities of the Company's financial liabilities as at March 31, 2010.

Financial liabilities	< 1year	2-3 years	4-5 years	> 5years	Total
Accounts payable and accrued liabilities	\$ 38,884	\$ -	\$ -	\$ -	\$ 38,884
Interest payable on long-term debt	18,319	-	-	-	18,319
Accrued employee costs	48,644	-	-	-	48,644
Obligations under capital lease, including current portion	398	139	-	-	537
Long-term debt, including current portion (excluding deferred costs) ¹	9,000	46,125	438,000	875,875	1,369,000
Other long-term liabilities	-	172	-	-	172
	\$ 115,245	\$ 46,436	\$ 438,000	\$ 875,875	\$ 1,475,556

¹ Carrying value at March 31, 2010, is net of unamortized deferred financing costs of \$11.8 million.

BRITISH COLUMBIA FERRY SERVICES INC.

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4. Financial risk management (continued):

(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. 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 4.98% long-term 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, 2010, 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, 2010.

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, 2010, the Company has no foreign currency forward contracts (2009: nil). 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, 2010.

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 swap agreements with certain financial intermediaries in order to 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 Commodity Risk Management Policy, the term of the contracts is not to extend beyond March 31, 2012. This policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period to March 31, 2011, and to a maximum of 90% of anticipated monthly fuel consumption for the 12 month period thereafter to March 31, 2012.

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

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4. Financial risk management (continued):

(c) Market risk (continued):

Fuel price risk (continued):

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, 2010, the amounts payable to the Province in relation to fuel cost differences totalled \$1.3 million (2009: \$2.4 million recoverable 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:

	March 31, 2010		March 31, 2009	
	\$	%	\$	%
Aggregate borrowings ¹	1,524,537	83.04	1,534,078	83.01
Shareholders' equity ²	311,281	16.96	313,876	16.99
Total capital	1,835,818	100.00	1,847,954	100.00

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

² Excludes undesignated subsidiaries, PMV and Global.

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 per cent of the Company's total capital, while guarantees and

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5. Capital management (continued):

investments are restricted at 75 per cent. 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, 2010 and 2009.

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 Commissioner has set price caps for the four year term through March 31, 2012 (the "second performance term"), and will establish the price caps to apply for each subsequent term.

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, 2010, would have been \$13.2 million higher (2009: \$21.5 million lower) as detailed below:

	As at March 31,	
	2010	2009
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)	(11,321)	8,733
Performance term submission costs (b)	84	-
Hedge gains (losses) – vessel construction contracts (c)	-	16,833
Tariffs in excess of price cap (d)	2,858	700
Total (decrease) increase in net earnings	\$ (13,154)	\$ 21,491

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6. Financial statement effect of rate regulation (continued):

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,	
	2010	2009
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	(9,550)	(4,775)
	9,551	14,326
Current portion (asset)	(4,775)	(4,775)
Long-term portion of first performance term accounts	4,776	9,551
Second performance term accounts:		
Deferred fuel costs (a)		
Balance – beginning of year	1,213	(4,826)
Fuel costs deferred (including realized hedge gains and losses)	(16,082)	26,761
Rebates granted	6,298	494
Surcharges collected	-	(17,025)
Fuel price risk payments to (recoveries from) the Province (note 4 (c))	1,273	(2,429)
Other payments from the Province	(1,620)	(1,684)
Interest payable	(267)	(78)
Balance – end of year	(9,185)	1,213
Unrealized fuel hedge losses (gains) (a)	-	923
Performance term submission costs (b)	84	-
Long-term portion of second performance term accounts	(9,101)	2,136
Total long-term regulatory (liabilities) assets	\$ (4,325)	\$ 11,687
Regulatory liabilities - current		
Tariffs in excess of price cap (d) - current	\$ -	\$ 2,858

(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.

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6. Financial statement effect of rate regulation (continued):

(a) Deferred fuel costs (continued):

The Commissioner has 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 it is expected that recovery will occur over this four year period. Accordingly, this \$18.5 million will be 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, forms the opening balances of the fuel cost deferral accounts for the second performance term.

During the year ended March 31, 2010, the Province agreed to pay \$1.6 million, to be applied against the balance of deferred fuel costs (2009: \$1.7 million).

During the year ended March 31, 2010, the Company recognized \$4.6 million in amortization expense for deferred fuel costs (2009: \$4.6 million).

It is expected that the recovery or settlement period of balances in the second performance term deferred fuel cost accounts will be the remaining period of the term ending March 31, 2012.

Unrealized hedge gains or losses result from the use of forward contracts to fix the price of future fuel purchases and are valued on a mark-to-market basis as at the balance sheet date. Section 3855 "*Financial Instruments – Recognition and Measurement*" requires that these financial instruments be valued at fair value and recognized in the consolidated financial statements.

(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 performance term submission costs. The recovery periods will be 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) Hedge gains or losses – vessel construction contracts:

The Company defers gains or losses on financial derivative instruments which have been entered into to manage market risk against fluctuations in the Canadian dollar equivalent of vessel construction contracts denominated in foreign currencies. The intent and effect of these transactions is to provide greater certainty of the cost of the related new vessel acquisitions. The total cost of these assets, including hedge gains or losses, has been determined by the Commissioner to be reasonable and will be taken into account in the determination of price caps set for the periods following the entry of these assets into service. It is expected that the settlement or recovery period of hedge gains or losses is five to forty years. The Company did not have any such hedge gains or losses related to vessel construction contracts during the twelve months ended March 31, 2010

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6. Financial statement effect of rate regulation (continued):

(d) 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, 2010, tariffs charged to customers on all route groups were below established price caps. At March 31, 2009, tariffs charged to customers on the Major Route Group exceeded the price cap by \$2.9 million.

7. Property, plant and equipment:

March 31, 2010	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	\$ 1,772,870	\$ 554,304	\$ 1,218,566
Berths, buildings and equipment	91,957	51,722	40,235
Berths, buildings and equipment under capital lease	598,154	256,822	341,332
Land	1,406	-	1,406
Construction-in-progress	42,530	-	42,530
	\$ 2,506,917	\$ 862,848	\$ 1,644,069

March 31, 2009	Cost	Accumulated amortization	Net book value
Property, plant and equipment			
Vessels	\$ 1,568,702	\$ 533,714	\$ 1,034,988
Berths, buildings and equipment	76,962	50,081	26,881
Berths, buildings and equipment under capital lease	586,149	240,967	345,182
Land	1,406	-	1,406
Construction-in-progress	275,119	-	275,119
	\$ 2,508,338	\$ 824,762	\$ 1,683,576

Capitalized financing costs during construction for property, plant and equipment and intangible assets for the year ended March 31, 2010, totalled \$2.8 million (2009: \$14.3 million). Amortization expense for assets under capital lease for the year ended March 31, 2010, totalled \$18.3 million (2009: \$16.2 million).

In addition to the construction-in-progress referenced above, the contractual commitments at March 31, 2010 for capital assets to be constructed, totalled \$25.6 million (2009: \$11.9 million).

During the year ended March 31, 2010, the Company disposed of a surplus parcel of land adjacent to its ship repair facility in Richmond, B.C. and a gain of \$1.8 million was recognized.

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7. Property, plant and equipment (continued):

The Government of Canada, through the Marine Security Contribution Program, has agreed to provide funding to help offset the costs of improving security at certain of our terminals. The Company expects to receive a total of \$9.1 million under this program. This amount has been recorded as a reduction of property, plant and equipment during the year ended March 31, 2010 (2009: nil).

During the year ended March 31, 2010, the Company received \$0.9 million (2009: \$0.7 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated amortization of \$13.5 million and \$1.3 million respectively, as at March 31, 2010.

8. Intangible assets:

March 31, 2010	Cost	Accumulated amortization	Net book value
Intangible assets subject to amortization			
Acquired software and licenses	\$ 28,812	\$ 16,810	\$ 12,002
Internally developed software and website	22,531	14,831	7,700
Work in progress	6,704	-	6,704
	\$ 58,047	\$ 31,641	\$ 26,406

March 31, 2009	Cost	Accumulated amortization	Net book value
Intangible assets subject to amortization			
Acquired software and licenses	\$ 28,949	\$ 23,562	\$ 5,387
Internally developed software and website	20,864	12,768	8,096
Work in progress	6,383	-	6,383
	\$ 56,196	\$ 36,330	\$ 19,866

There was no impairment of intangible assets during the year ended March 31, 2010, or the year ended March 31, 2009.

Included in the cost of intangible assets as at March 31, 2010, is \$0.7 million of unamortized training costs (2009: \$0.7 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, 2010, intangible assets totalling \$10.2 million (2009: \$4.3 million) were acquired and \$2.4 million (2009: \$6.2 million) were internally developed. During this same period intangible assets with a cost and accumulated amortization of \$11.0 million were retired (2009: \$nil). Amortization expense for the year ended March 31, 2010 totalled \$6.3 million (2009: \$5.8 million).

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9. Assets held for sale:

During the year ended March 31, 2010, in accordance with the Company's business plan to upgrade or replace aging assets, the *Queen of Prince Rupert* and the *Queen of Vancouver* were decommissioned. The *Queen of Prince Rupert* is held for sale as at March 31, 2010. This vessel and its related spare parts and inventories was written down by \$1.4 million to reflect estimated fair values less costs to sell. The *Queen of Vancouver* and the *Queen of Saanich* (decommissioned during the year ended March 31, 2009) were sold during the year ended March 31, 2010, resulting in a loss on disposal of \$1.5 million.

10. 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 year ended March 31, 2010, the cost of lands added to the terminal leases totalled \$nil (2009: \$5.1 million).

11. 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

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11. Accrued employee future benefits (continued):

(a) Description of benefit plans (continued):

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, 2010, 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 \$25.5 million (2009: \$23.4 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, 2007. 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. The most recent actuarial valuations of the WCB obligation and the Sick Bank obligation are as at March 31, 2006 and March 31, 2001, respectively.

Accrued benefit obligations	Other benefit plans	
	2010	2009
Balance, beginning of year	\$ 14,104	\$ 15,079
Current service cost	527	511
Interest cost	636	673
Benefits paid	(2,011)	(2,155)
Actuarial gains	(35)	(4)
Balance, end of year	\$ 13,221	\$ 14,104

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11. Accrued employee future benefits (continued):

(c) Defined benefit plans (continued):

Reconciliation of funded status of the benefit plans to the amounts recorded in the financial statements	Other benefit plans	
	2010	2009
Fair value of plan assets	\$ -	\$ -
Accrued benefit obligation	13,221	14,104
Funded status of plans – deficit	(13,221)	(14,104)
Unamortized net actuarial loss	2,273	2,443
Unamortized plan amendment – past service cost	(982)	(1,186)
Accrued benefit liability	(11,930)	(12,847)
Current portion of accrued employee future benefits	800	800
Accrued employee future benefits	\$ (11,130)	\$ (12,047)

Elements of defined benefit costs recognized in the year	Other benefit plans	
	2010	2009
Current service cost, net of employee contributions	527	511
Interest cost	636	673
Actuarial losses	135	202
Plan amendments	(204)	(204)
Defined benefit costs recognized	\$ 1,094	\$ 1,182

Significant assumptions

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

Accrued benefit obligation as of March 31:	2010	2009
Discount rate	5.1%	5.1%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	92.0%	92.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
Benefit cost for years ended March 31:		
Discount rate	5.1%	5.1%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	92.0%	92.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%

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11. Accrued employee future benefits (continued):

- (d) Multi-employer plans:

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

	2010	2009
Public Service Pension Plan contributions (i)	\$ 18,907	\$ 18,289
Long-term disability plan contributions	4,626	2,966
Long-term disability plan amortization of surplus (ii)	64	64
	<u>\$ 23,597</u>	<u>\$ 21,319</u>

- i) The March 31, 2008 actuarial valuation report for the Public Service Pension Plan was received by the Public Service Pension Board of Trustees on December 3, 2008. This report indicated that the pension fund has a surplus of \$487 million. Under the terms of the plan's joint trust agreement, plan members and employers share in any increase or decrease in contribution rates. The plan trustees have increased the member and employer contribution rates to the basic account from 7.63% to 7.78% of pensionable earnings effective April 1, 2009, primarily due to changes in the investment return and salary increase assumptions. The contribution rates to the inflation adjustment account remain unchanged for members and employers at 1.5% and 2.5% respectively. The next valuation will be as at March 31, 2011.
- 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, 2008, determined a fund deficit. To address this deficit the employer contribution rate was increased from 1.81% to 2.87% of covered payroll effective April 1, 2009, and further increased to 3.09% of covered payroll effective April 1, 2010. The next scheduled valuation will be as at March 31, 2011.

12. Obligations under capital lease:

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, 2010, the Company did not add any leased computer equipment to capital assets (2009: \$0.4 million).

Future minimum lease payments:

Year ended	
2011	\$ 449
2012	154
2013	12
2014	-
Executory costs and imputed interest included in payments (5.62% - 6.33%)	(78)
	<u>537</u>
Current portion of capital lease liability	<u>(398)</u>
	<u>\$ 139</u>

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12. Obligations under capital lease (continued):

For the year ended March 31, 2010, \$0.1 million of interest paid on capital leases is included in interest expense (2009: \$0.1 million).

13. 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,			
	2010		2009	
	Number of shares	Amount \$	Number of shares	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.

14. Fare reduction and service restoration agreement:

During the year ended March 31, 2009, the Company entered into an agreement with the Province under which the Province paid the Company \$1.2 million to reimburse the costs of providing certain sailings from mid-October 2008 through March 31, 2009. This \$1.2 million has been recorded as a reduction of operations expenses for the fiscal year ended March 31, 2009.

In addition, the Province paid the Company \$19.6 million to allow a 33 percent reduction on fares for all routes during the months of December 2008 and January 2009, and on the Prince Rupert to Skidegate route during February 2009. This \$19.6 million has been recorded as tariff revenue for the fiscal year ended March 31, 2009.

15. 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

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15. Ferry service fees (continued):

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.

16. 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.

17. Interest rate support:

During the year ended March 31, 2010, the Government of Canada agreed to provide \$1.6 million in the form of interest rate support to the Company for major refurbishment of two vessels (2009: \$10.7 million for major refurbishment of one vessel and construction of another). During the year ended March 31, 2010, \$4.7 million of these amounts have been recorded as a reduction of interest expense (2009: \$2.4 million) and \$0.6 million as a reduction of capitalized interest (2009: \$3.6 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.

18. Other commitments:

(a) Operating lease agreements:

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, 2010 were \$1.5 million (2009: \$1.2 million).

Future minimum lease payments, reflecting early termination of an existing office space lease as described in (b) below, are as follows:

Year ended		
2011	\$	1,326
2012		928
2013		730
2014		462
2015		258
	\$	3,704

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18. Other commitments (continued):

(b) Capital lease agreements:

During the year ended March 31, 2009, the Company signed agreements which constitute a capital lease for space in a new downtown Victoria, BC head office building. The lease is expected to take effect in September 2010 following the completion of construction of the new building and will result in the termination of an existing office space lease.

The initial term of the new building lease is for fifteen years, with four renewal options of five years each. The Company's wholly-owned subsidiary, Pacific Marine Leasing Inc., has agreed to advance up to \$25 million to the developer of the new head office property for a term of fifteen years, secured by a second mortgage of the property. 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 maximum price of \$25 million. The purchase option expires at the end of the loan term.

Additionally, the Company has agreed to sell the current head office building located at 1112 Fort Street, Victoria, BC for approximately \$11 million. Both the commencement of the new office lease and the sale of the existing head office building are subject to the construction of the new head office building being completed no later than May 31, 2011.

Future minimum lease payments are as follows:

Year ended	
2011	1,736
2012	2,976
2013	2,976
2014	2,976
2015	2,976
Thereafter	34,798
	\$ 48,438

19. 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, 2010, the Company paid \$1,130 (2009: \$1,789) 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.

20. 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 recorded as expenses or revenues as determined.

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21. Supplemental cash flow information:

	Years ended March 31,	
(a) Changes in non-cash operating working capital:	2010	2009
Change in working capital		
Accounts receivable	\$ (4,526)	\$ 1,282
Prepaid expenses	1,319	(847)
Inventories	(1,205)	220
Accounts payable and accrued liabilities	(2,941)	(49,438)
Interest payable on long-term debt	(76)	2,677
Accrued employee costs	(3,279)	(1,290)
Deferred revenue	614	301
Regulatory liabilities	(2,858)	(700)
Change in non-cash working capital	(12,952)	(47,795)
Change attributable to capital asset acquisitions	3,484	41,012
Change in non-cash operating working capital	\$ (9,468)	\$ (6,783)
(b) Cash paid during the year for interest	\$ 74,043	\$ 63,291
(c) Non-cash transactions:		
Capital assets acquired under capital lease	\$ -	\$ 444

22. Subsequent event:

On April 29, 2010, the Province introduced legislation, *Bill 20 – Miscellaneous Statutes Amendment Act (No.3), 2010*, to amend several statutes, including the Act. The proposed amendments include changes to the governance and regulatory framework within which the Company operates.

The proposed governance changes broaden the mandate of the Authority to include responsibility for the compensation plans of the Company's directors and certain executive officers and a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of the Company. The proposed amendments to the regulatory framework expand the responsibilities of the Commissioner to include consideration of the interests of ferry users and regulation of reservation fees. These amendments also require the Commissioner to determine whether the Company has an unfair competitive advantage in providing transportation services.