

Consolidated Financial Statements of

**BRITISH COLUMBIA FERRY SERVICES INC.**

Years ended March 31, 2005 and 2004



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## **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, 2005 and 2004 and the consolidated statements of earnings 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, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Victoria, Canada

May 13, 2005

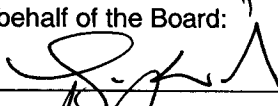
# BRITISH COLUMBIA FERRY SERVICES INC.


Consolidated Balance Sheets  
(expressed in thousands)

	As at March 31,	
	2005	2004
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 41,524	\$ 17,939
Restricted short term investments (note 6c)	15,054	-
Accounts receivable	6,147	5,857
Prepaid expenses	5,095	5,717
Inventories	21,699	23,570
	<u>89,519</u>	<u>53,083</u>
Capital assets (note 2)	630,291	551,474
Deferred financing costs	7,987	1,190
Deferred fuel costs (note 3)	8,000	-
Long-term land lease (note 4)	27,585	24,040
	<u>\$ 763,382</u>	<u>\$ 629,787</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 49,552	\$ 37,262
Interest payable on long-term debt	12,251	61
Accrued employee costs	39,371	36,276
Deferred revenue	13,756	13,003
Current portion of accrued employee future benefits	631	2,415
Current portion of obligation under capital lease	26	-
	<u>115,587</u>	<u>89,017</u>
Accrued employee future benefits (note 5)	16,849	15,644
Long-term debt (note 6)	499,581	427,701
Obligations under capital lease (note 7)	164	-
	<u>632,181</u>	<u>532,362</u>
Shareholders' equity:		
Share capital (note 8)	75,478	75,478
Retained earnings	55,723	21,947
	<u>131,201</u>	<u>97,425</u>
Commitments (notes 2 and 12)		
Contingent liabilities (note 16)		
Subsequent event (note 17)		
	<u>\$ 763,382</u>	<u>\$ 629,787</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

  
\_\_\_\_\_  
Director

  
\_\_\_\_\_  
Director

# BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Earnings and Retained Earnings  
(expressed in thousands)

	Years ended March 31,	
	2005	2004
Revenue:		
Tariffs	\$ 345,851	\$ 323,023
Ferry service fees (note 10)	106,971	105,806
Federal-Provincial Subsidy Agreement (note 11)	24,343	23,975
Retail	67,776	63,206
Other income	19,514	17,721
	<u>564,455</u>	<u>533,731</u>
Expenses:		
Operations	294,035	286,048
Maintenance	86,746	86,136
Administration	44,511	38,862
Cost of retail goods sold	26,513	23,298
Amortization	47,666	47,355
	<u>499,471</u>	<u>481,699</u>
Earnings from operations	64,984	52,032
(Loss) gain on foreign exchange	(61)	190
Interest expense	(24,480)	(22,672)
Loss on disposal and write-down of capital assets	(629)	(1,565)
Net earnings	<u>39,814</u>	<u>27,985</u>
Retained earnings (deficit), beginning of year	21,947	(40,630)
Transfer from contributed surplus (note 9)	-	40,630
Preferred share dividend (note 8)	(6,038)	(6,038)
Retained earnings, end of year	<u>\$ 55,723</u>	<u>\$ 21,947</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,	
	2005	2004
Cash provided by (used in):		
Operations:		
Net earnings	\$ 39,814	\$ 27,985
Items not involving cash:		
Amortization	47,666	47,355
Other non-cash charges	1,248	3,227
Fuel costs deferred	(8,000)	-
<u>Change in operating working capital</u>	<u>21,323</u>	<u>(9,092)</u>
	<u>102,051</u>	<u>69,475</u>
Financing:		
Proceeds from issuance of bonds	499,566	-
Proceeds from issuance of bridge financing	199,780	-
Repayment of bridge financing	(199,780)	-
(Repayment of) proceeds from long-term debenture	(427,701)	427,701
Establishment of debt service reserve	(14,988)	-
Deferred financing costs incurred	(7,152)	(1,190)
Dividends paid on preferred shares	(6,038)	(6,038)
Proceeds from issuance of share	-	1
Redemption of shares	-	(427,701)
Payment to the Province (note 9)	-	(17,213)
	<u>43,687</u>	<u>(24,440)</u>
Investing:		
Proceeds from disposal of assets	1,334	17,996
Purchase of capital assets	(119,855)	(59,649)
<u>Increase in lands under long-term lease</u>	<u>(3,632)</u>	<u>-</u>
	<u>(122,153)</u>	<u>(41,653)</u>
Increase in cash and cash equivalents	23,585	3,382
Cash and cash equivalents, beginning of year	17,939	14,557
<u>Cash and cash equivalents, end of year</u>	<u>\$ 41,524</u>	<u>\$ 17,939</u>

Supplemental cash flow information (note 15)

See accompanying notes to consolidated financial statements.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

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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 British Columbia Ferry Authority, a corporation without share capital, and it is regulated by the British Columbia Ferry Commissioner to ensure that rates are fair and reasonable and to monitor service levels.

Prior to conversion, the Company operated under the name British Columbia Ferry Corporation and was incorporated under the *Ferry Corporation Act* on June 30, 1976. The Minister of Finance held the shares of British Columbia Ferry Corporation as representative of Her Majesty the Queen in Right of the Province of British Columbia.

To facilitate and effect the conversion, a number of transactions were completed on or around April 1, 2003. These include:

- Land and terminals sold to, and then leased from, the British Columbia Transportation Finance Authority;
- Debt issued in favour of the Province of British Columbia (the "Province");
- Reorganization of share capital;
- Redemption of common shares previously held by the Province;
- Issuance of common share to British Columbia Ferry Authority; and
- Issuance of preferred shares to the Province.

## 1. Significant accounting policies:

### (a) Basis of presentation:

The consolidated financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Deas Pacific Marine Inc. ("DPMI"), Catamaran Ferries International Inc. ("CFI"), Pacific Marine Leasing Inc. ("PMLI"), and BCF Captive Insurance Company Ltd. ("BCF Captive"). All inter-company balances and transactions have been eliminated on consolidation. To date, PMLI has been inactive. BCF Captive was incorporated in March 2005, and commenced operations April 1, 2005.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 1. Significant accounting policies (continued):

### (b) Regulation:

The Company is regulated by the British Columbia Ferry Commissioner (the "Commissioner") to ensure that tariffs are fair and reasonable and to monitor service levels. Under the terms of the *Coastal Ferry Act* (the "Act"), the tariffs the Company charges its customers are subject to price caps. Annual increases in price caps have been set for the first five year term through March 31, 2008. The Commissioner will establish the price caps to apply for each subsequent term.

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 assets and liabilities in the financial statements.

### (c) Cash and cash equivalents:

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

### (d) Short-term investments:

Short-term investments are valued at the lower of cost or market value and consist of treasury bills with original maturity dates greater than three months.

### (e) Inventories:

Inventories, which consist of materials and supplies, catering stores and fuel, are valued at the lower of weighted-average cost and current replacement cost.

### (f) Capital assets:

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 the estimated useful lives of the assets at the following rates:

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

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# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 1. Significant accounting policies (continued):

### (g) 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.

### (h) Revenue recognition:

Tariff revenue is recognized when transportation is provided. The value of pre-sold vouchers is included in the balance sheets as deferred revenue.

### (i) Pension and other employee future benefit plans:

Defined contribution plan accounting is applied to the Company's multiemployer defined benefit pension and long-term disability plans for which the Company has insufficient 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. The average remaining service period of the active employees covered by the other (non-pension) retirement benefits plan is 7.5 years.

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.



# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 1. Significant accounting policies (continued):

### (j) 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 resale, the economic life of capital assets and the corresponding period of amortization, the recoverability of capital assets, the valuation of employee future benefits, and provisions for contingencies. Actual results could differ from these estimates.

### (k) 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. Commencing calendar year 2004, the Company pays property taxes at assessed values. In calendar years prior to 2004, grants in lieu of property taxes were paid to municipalities within which the Company operated.

Effective April 2, 2003, the Company became subject to GST. The provision of vehicle and passenger ferry services is an exempt supply under the *Excise Tax Act*.

### (l) 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 year in which they arise.

### (m) Deferred financing costs:

Legal and financing costs incurred are capitalized and amortized on a straight-line basis over the life of the financing.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 1. Significant accounting policies (continued):

### (n) 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.

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 deferred and recognized in income in the period in which the underlying hedged transaction is recognized.

### (o) Asset retirement obligations:

The Company recognizes a liability at its fair value for any legal obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is required to be 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.

### (p) Comparative figures:

Certain comparative figures have been reclassified to conform to the presentation adopted for the current period.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

## 2. Capital assets:

March 31, 2005	Cost	Accumulated amortization	Net book value
Ships owned	\$ 758,130	\$ 458,115	\$ 300,015
Ships under capital lease	50,426	32,845	17,581
Berths, buildings and equipment	86,342	54,286	32,056
Berths, buildings and equipment under capital lease	417,096	209,503	207,593
Land	1,107	-	1,107
Construction-in-progress	71,939	-	71,939
	<b>\$ 1,385,040</b>	<b>\$ 754,749</b>	<b>\$ 630,291</b>

March 31, 2004	Cost	Accumulated amortization	Net book value
Ships owned	\$ 708,087	\$ 440,203	\$ 267,884
Ships under capital lease	50,377	30,892	19,485
Berths, buildings and equipment	73,152	48,066	25,086
Berths, buildings and equipment under capital lease	404,397	202,104	202,293
Land	1,107	-	1,107
Construction-in-progress	35,619	-	35,619
	<b>\$ 1,272,739</b>	<b>\$ 721,265</b>	<b>\$ 551,474</b>

For the year ended March 31, 2005 capitalized financing costs during construction amounted to \$1.5 million (March 31, 2004 - \$0.6 million).

Included in ships under capital lease are the Queen of Surrey and the Queen of Oak Bay. It is anticipated that the title will pass, without additional payments, for the Queen of Surrey and the Queen of Oak Bay on January 1, 2006 and January 1, 2007 respectively.

In addition to the construction-in-progress referenced above, contractual commitments at March 31, 2005 for capital assets to be constructed totaled \$339.4 million (March 31, 2004 - \$28.4 million). Included in the contractual commitments as at March 31, 2005 is \$307.4 million committed for design and construction of three "Super C" Class vessels. Delivery of the three vessels is scheduled to occur during the period from late 2007 to mid 2008.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

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### 3. Deferred fuel costs:

The Commissioner has authorized the Company to maintain deferral accounts to mitigate the effect on its earnings of unpredictable and uncontrollable price volatility in world fuel oil markets. The Commissioner has established set prices for each of the years until March 31, 2008. Differences between the set prices and the actual prices of fuel oil are recorded in the deferral accounts. These deferral accounts will be maintained until March 31, 2008, at which time the Commissioner will decide on their continuation.

Any balance in the deferral accounts will be taken into account by the Commissioner in setting future price cap increases. It is expected that all deferred fuel costs will be recovered through tariffs as approved by the Commissioner.

### 4. 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.

During the current year, the Company entered into an agreement with BCTFA in which the Company would make improvements to the highways approaching Horseshoe Bay and Swartz Bay terminals in exchange for increased lands under the existing land lease. As at March 31, 2005, the Horseshoe Bay improvements were complete and the Swartz Bay improvements were in progress. Long-term land lease has been increased by \$3.3 million and by \$0.6 million in regard to the Horseshoe Bay and Swartz Bay improvements, respectively. The increases to long-term land lease will be amortized over the remaining lease period, commencing the month following completion of improvements.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 5. 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. The most recent actuarial evaluation has determined that the Plan is in a surplus position.

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 multiemployer 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, 2005, consisting of cash contributed by the Company to its multiemployer 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 \$16.6 million (2004: \$19.0 million).

# BRITISH COLUMBIA FERRY SERVICES INC.

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

## 5. Accrued employee future benefits (continued):

### (c) Defined benefit plans

All of the Company's defined benefit plans, except its multiemployer plans, are currently unfunded. The most recent actuarial valuation of the retirement bonus and death benefit plans is as at March 31, 2005, with the next valuation expected as of March 31, 2008. The most recent actuarial valuations of the WCB obligation and the Sick Bank obligation are as at December 31, 2002 and March 31, 2001, respectively. The next valuations for the WCB and Sick Bank obligations are expected during the fiscal year ended March 31, 2006.

Accrued benefit obligations	Other benefit plans	
	2005	2004
Balance, beginning of year	\$ 18,059	\$ 21,293
Current service cost	556	544
Interest cost	853	919
Benefits paid	(1,841)	(4,645)
Actuarial (gains) losses	649	(52)
<b>Balance, end of year</b>	<b>18,276</b>	<b>18,059</b>

Reconciliation of funded status of the benefit plans to the amounts recorded in the financial statements	Other benefit plans	
	2005	2004
Fair value of plan assets	\$ -	\$ -
Accrued benefit obligation	18,276	18,059
<b>Funded status of plans – deficit</b>	<b>\$ (18,276)</b>	<b>\$ (18,059)</b>
Unamortized net actuarial loss	796	-
<b>Accrued benefit liability</b>	<b>\$ (17,480)</b>	<b>\$ (18,059)</b>
Current portion of accrued employee future benefits	631	2,415
<b>Accrued employee future benefits</b>	<b>(16,849)</b>	<b>(15,644)</b>

# BRITISH COLUMBIA FERRY SERVICES INC.

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

## 5. Accrued employee future benefits (continued):

Elements of defined benefit costs recognized in the year	Other benefit plans	
	2005	2004
Current service cost, net of employee contributions	\$ 556	\$ 544
Interest cost	853	919
Actuarial (gains) losses	649	(52)
Elements of employee future benefits costs before adjustments to recognize the long-term nature of employee future benefit costs	\$ 2,058	\$ 1,411
Difference between actuarial (gain) loss recognized for year and actual actuarial (gain) loss on accrued benefit obligation for year	(796)	-
<b>Defined benefit costs recognized</b>	<b>1,262</b>	<b>1,411</b>

Significant assumptions	Other benefit plans	
	2005	2004
The significant assumptions used are as follows (weighted average):		
Accrued benefit obligation as of March 31:		
Discount rate	4.6%	4.9%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	92.0%	95.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
Benefit cost for years ended March 31:		
Discount rate	5.0%	4.9%
Rate of compensation increase	2.0%	2.0%
Annual employee retention rate	95.0%	95.0%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%

### (d) Multiemployer plans

The total cost recognized for the Company's multiemployer plans is as follows:

	2005	2004
Public Service Pension Plan contributions (i)	\$ 12,682	\$ 12,515
Long-term disability plan contributions	2,086	1,864
Long-term disability plan amortization of surplus (ii)	64	64
	<b>\$ 14,832</b>	<b>\$ 14,443</b>

# BRITISH COLUMBIA FERRY SERVICES INC.

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

## 5. Accrued employee future benefits (continued):

- i) Employer contribution rates increased effective April 1, 2004 by 0.25% to help strengthen the Plan's Inflation Adjustment Account, which funds discretionary cost of living increases. The most recent valuation for funding purposes, prepared as at March 31, 2002, determined a surplus for Basic Account pension benefits. The next valuation will be as at March 31, 2005, and it is not yet known when this valuation will be available to the Company.
- ii) Contribution rates are actuarially determined every three years as a percentage of covered payroll. The most recent valuation, as at March 31, 2002, determined a fund surplus, which is being amortized over a period of ten years, via a reduction in the contribution rate. The next valuation will be as at March 31, 2005 and is expected June, 2006.

## 6. Long-term debt:

	As at March 31,	
	2005	2004
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (a)	\$ 250,000	\$ -
Unamortized discount	(121)	-
	<u>249,879</u>	<u>-</u>
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (a)	\$ 250,000	\$ -
Unamortized discount	(298)	-
	<u>249,702</u>	<u>-</u>
Debenture held by the Province of British Columbia	-	427,701
	<u>\$ 499,581</u>	<u>\$ 427,701</u>

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*. Currently, the Company has issued two bonds series and entered into a credit facility. The master trust indenture requires the Company to maintain a debt service reserve.



# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 6. Long-term debt (continued):

### (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. Interest on the Series 04-1 bonds is payable semi-annually on May 27 and November 27 of each year until maturity. Interest on the Series 04-4 bonds is payable semi-annually on April 13 and October 13 of each year until maturity.

### (b) Credit facility:

The Company entered into a credit facility with a syndicate of Canadian banks, secured by pledged bonds. The credit facility makes available to the Company a 364 day revolving operating facility with a one year term-out in an amount up to \$77.5 million, currently undrawn; and a three year revolving extendible facility in an amount up to \$77.5 million, currently undrawn.

During the first quarter, the company fully drew upon a \$200 million two year non-revolving bridge term facility. The amount has been fully repaid during the third quarter, and is no longer available under the credit facility.

### (c) Debt service reserve:

The company is required to maintain a debt service reserve for the Series 04-1 and 04-4 bonds and all amounts drawn under the credit facility equal to not less than six months forecasted debt service, to be increased under certain conditions. A debt service reserve of \$7.2 million and \$7.8 million on the Series' 04-1 and 04-4 bonds, respectively, is currently invested in short-term investments.

## 7. Obligations under capital lease:

During the year, the Company entered into a lease agreement for a training facility. The initial lease period is for a term of ten years, expiring April, 2015. The Company may, at its option, extend the lease term for up to two periods of five years each. Use of the facility by other organizations is controlled by the Company during the lease period. A discount rate of 6.25% has been used to determine the present value of the obligation under capital lease.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

## 7. Obligations under capital lease (continued):

Future minimum lease payments:

Year ended	
2006	\$ 66
2007	66
2008	66
2009	66
2010	66
Thereafter	217
Executory costs and imputed interest included in payments	(357)
	190
Current portion of capital lease liability	(26)
	\$ 164

## 8. 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.

Prior to April 2, 2003, authorized share capital consisted of 1,000,000 unclassified common shares without par value with a maximum consideration of one hundred million dollars.

### (b) Issued and outstanding:

	As at March 31,			
	2005		2004	
	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

# BRITISH COLUMBIA FERRY SERVICES INC.

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

## 8. Share capital (continued):

On April 2, 2003, the Company amended its memorandum of incorporation to revise the number and classes of authorized shares, redeemed 100% of its then outstanding common shares, and issued one new Class B common share and 75,477 new Class C preferred shares.

### (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.

## 9. Contributed surplus:

	As at March 31,	
	2005	2004
Balance, beginning of year	\$ -	\$ 536,957
Share redemption value in excess of paid up capital	-	(496,327)
Elimination of deficit	-	(40,630)
Balance, end of year	\$ -	\$ -

Contributed surplus arose from the difference between the recorded value of certain assets received from the Province in prior years and their cost to the Company and from debt transferred to the Province. The carrying amount was reduced as at March 31, 2000 by the elimination of the accumulated deficit of the Company to reflect the financial restructuring at that time.

The carrying amount was further reduced as at March 31, 2003, upon direction of the Province as the sole shareholder at the time, to pay the Province the proceeds less commission from the auction of the assets held for resale of \$17.2 million.

On April 2, 2003, the Company redeemed 100% of its outstanding shares at a value of \$503.2 million. The amount in excess of paid up capital, \$496.3 million, was charged to contributed surplus. Contributed surplus was then reduced to zero by the elimination of the accumulated deficit.

## 10. Ferry service fees:

The Company has 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 initial term provides for an annual fee of approximately \$107 million.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 11. Federal-Provincial Subsidy Agreement:

The Company receives revenue provided to the Province of British Columbia 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.

## 12. Strategic relationship agreement:

In April 2003, the Company formed a five-year strategic relationship agreement with IBM Canada Ltd. to lease computer hardware and software, as well as to implement business and technology solutions for the Company. During the year, part of the agreement was extended for one year.

Commitments made by the Company under this agreement are estimated as follows:

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Year ended	
2006	\$ 7,924
2007	6,748
2008	6,524
2009	1,514
	<hr/>
	\$ 22,710

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## 13. Risk management:

### (a) Fuel management:

The Company may manage its exposure to vessel 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. When fuel hedging instruments are used, it is solely for the purpose of reducing fuel price risk, not for generating trading profits. Gains and losses resulting from the contracts are recognized as a component of fuel costs. As at March 31, 2005, the Company has no outstanding fuel hedges (see also note 3).

# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 13. Risk management (continued):

### (b) Credit and interest rate risk:

Management does not believe that the Company is subject to any significant concentration of credit risk. Most of the Company's receivables result from tickets sold to passengers through the use of major credit cards. These receivables are short-term, generally being settled shortly after sale. The Company manages the credit exposure related to financial instruments by selecting credit-worthy counter-parties and by limiting its exposure to a single counter-party.

The Company may enter into interest rate agreements to manage its exposure on debt instruments. As at March 31, 2005, the Company has no active interest rate agreements.

### (c) Foreign exchange risk:

The Company may enter into foreign exchange forward contracts to manage its exposure on future purchase commitments. As at March 31, 2005, the Company has entered into foreign exchange forward contracts valued at Cdn \$449.9 million, for the committed cost, including customs and duty, of three new "Super C" Class vessels that are payable in Euros (March 31, 2004: nil).

### (d) Fair value of financial instruments:

The fair values of cash and cash equivalents, short term investments, accounts receivable, accounts payable and accrued liabilities, and interest payable on long-term debt approximate their carrying amounts due to their short term to maturity.

## 14. Related party transactions:

In accordance with the *Coastal Ferry Act*, the Company processes transactions on behalf of its parent, British Columbia Ferry Authority ("BCFA"), without charge. During the year ended March 31, 2005, the Company paid management fees of \$31,796 to BCFA (March 31, 2004: \$24,651).

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

Prior to April 2, 2003, the Company's common shares were held by the Minister of Finance as representative of Her Majesty the Queen in Right of the Province of British Columbia.

The Company engages in transactions with provincial government agencies, departments and Crown corporations, notably British Columbia Hydro and Power Authority, British Columbia Buildings Corporation and Information Technology Services Division of the Ministry of Finance and Corporate Relations, on normal commercial terms. Prior to April 2, 2003, these entities were related parties.

# BRITISH COLUMBIA FERRY SERVICES INC.

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

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## 15. Supplemental cash flow information:

	Years ended March 31,	
	2005	2004
Cash paid during the year for interest	\$ 12,828	\$ 22,420
Non-cash transactions:		
Issuance of preferred shares	-	75,477
Disposal of terminals, net book value	-	230,232
Terminal structures capital lease, net prepaid	-	205,888
Terminal land operating lease, net prepaid	-	24,344

## 16. 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.

## 17. Subsequent event:

On April 1, 2005, BCF Captive commenced operations. BCF Captive has been licensed to operate as a captive insurance company by the Financial Institutions Commission of British Columbia. The Company provided \$5 million initial capital to BCF Captive in April 2005.