Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Years ended March 31, 2006 and 2005

KPMG

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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, 2006 and 2005 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, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Victoria, Canada

May 17, 2006

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Balance Sheets
(expressed in thousands)

	As at March 31, 2006	2005
Assets		
Current assets:		
Cash and cash equivalents	$ 2,291	$ 41,524
Short-term investments (note 2)	14,988	15,054
Accounts receivable	21,227	6,147
Prepaid expenses	6,702	5,095
Inventories	21,809	21,699
	67,017	89,519
Capital assets (note 3)	707,324	630,291
Deferred financing costs	8,183	7,987
Regulatory assets (note 4)	22,783	8,000
Long-term land lease (note 5)	28,370	27,585
	$ 833,677	$ 763,382
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 69,326	$ 49,552
Interest payable on long-term debt	12,251	12,251
Accrued employee costs	44,810	39,371
Deferred revenue	14,000	13,756
Regulatory liabilities (note 4)	958	-
Current portion of accrued employee future benefits	800	631
Current portion of obligation under capital lease	25	26
	142,170	115,587
Accrued employee future benefits (note 6)	16,737	16,849
Long-term debt (note 7)	499,604	499,581
Obligations under capital lease (note 8)	138	164
	658,649	632,181
Shareholders' equity:		
Share capital (note 9)	75,478	75,478
Retained earnings	99,550	55,723
	175,028	131,201
Commitments (notes 3 and 13)		
Contingent liabilities (note 17)		
Subsequent event (note 18)		
	$ 833,677	$ 763,382

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, 2006	2005
Revenue:		
Tariffs	$ 353,624	$ 345,851
Ferry service fees (note 10)	108,223	106,971
Federal-Provincial Subsidy Agreement (note 11)	24,890	24,343
Retail	68,749	67,776
Other income	23,676	19,514
	579,162	564,455
Expenses:		
Operations	291,771	294,035
Maintenance	81,081	86,746
Administration	51,181	44,511
Cost of retail goods sold	26,977	26,513
Amortization	53,106	47,666
	504,116	499,471
Earnings from operations	75,046	64,984
Gain (loss) on foreign exchange	249	(61)
Interest expense (note 12)	(25,128)	(24,480)
Loss on disposal and write-down of capital assets	(302)	(629)
Net earnings	49,865	39,814
Retained earnings, beginning of year	55,723	21,947
Preferred share dividend (note 9)	(6,038)	(6,038)
Retained earnings, end of year	$ 99,550	$ 55,723

See accompanying notes to consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Consolidated Statements of Cash Flows
(expressed in thousands)

	Years ended March 31, 2006	2005
Cash provided by (used in):		
Operations:		
Net earnings	$ 49,865	$ 39,814
Items not involving cash:		
Amortization	53,106	47,666
Other non-cash charges	1,191	1,248
Regulatory costs deferred	(14,783)	(8,000)
Change in operating working capital	8,970	21,323
	98,349	102,051
Financing:		
Dividends paid on preferred shares	(6,038)	(6,038)
Deferred financing costs incurred	(692)	(7,152)
Proceeds from issuance of bonds	-	499,566
Proceeds from issuance of bridge financing	-	199,780
Repayment of bridge financing	-	(199,780)
Repayment of long-term debenture	-	(427,701)
Establishment of debt service reserve	-	(14,988)
	(6,730)	43,687
Investing:		
Proceeds from disposal of assets	7	1,334
Purchase of capital assets	(129,712)	(119,855)
Increase in lands under long-term lease	(1,147)	(3,632)
	(130,852)	(122,153)
(Decrease) increase in cash and cash equivalents	(39,233)	23,585
Cash and cash equivalents, beginning of year	41,524	17,939
Cash and cash equivalents, end of year	$ 2,291	$ 41,524

Supplemental cash flow information (note 16)

See accompanying notes to consolidated financial statements.

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 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:

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. CFI was dissolved on April 1, 2006. To date, PMLI has been inactive. BCF Captive was incorporated in March 2005, and commenced operations April 1, 2005.

(b) 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 Accounting Standards Board issued Accounting Guideline 19 "Disclosures by Entities Subject to Rate Regulation" (AcG-19) of the CICA Handbook (Handbook) to establish 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. The guideline does not address recognition and measurement issues associated with the accounting for rate-regulated operations. The Company has adopted AcG-19 for the year ended March 31, 2006 (note 4).

(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.

1. Significant accounting policies (continued):

(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:

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

(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.

1. Significant accounting policies (continued):

(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. These multiemployer plans are administered by external parties and the Company does not have sufficient information to apply defined benefit plan accounting.

The actuarial determination of the accrued benefit obligations for retirement benefits other than pension uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors).

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

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

(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.

1. Significant accounting policies (continued):

(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.

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

(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.

(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. At the inception of each hedge the company determines whether it will or will not apply hedge accounting.

When applying hedge accounting, the Company documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also assesses, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items.

Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in income in the period in which they have been terminated or cease to be effective.

(columnar dollars expressed in thousands)

1. Significant accounting policies (continued):

(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) 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.

(q) Comparative figures:

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

2. Short-term investments:

	As at March 31, 2006	2005
Restricted funds:		
Debt service reserve, Series 04-1 bonds	$ 7,175	$ 7,175
Debt service reserve, Series 04-4 bonds	7,813	7,813
	14,988	14,988
Unrestricted funds:	-	66
Short-term investments	$ 14,988	$ 15,054

The company is required to maintain a debt service reserve for the Series 04-1 and 04-4 bonds equal to not less than six months forecasted debt service.

(columnar dollars expressed in thousands)

3. **Capital assets:**

March 31, 2006	Cost	Accumulated amortization	Net book value
Ships owned	$ 776,422	$ 464,073	$ 312,349
Ship under capital lease	60,421	19,026	41,395
Berths, buildings and equipment	95,646	61,080	34,566
Berths, buildings and equipment under capital lease	446,388	215,276	231,112
Land	1,107	-	1,107
Construction-in-progress	86,795	-	86,795
	$ 1,466,779	$ 759,455	$ 707,324

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
	$ 1,385,040	$ 754,749	$ 630,291

For the year ended March 31, 2006 capitalized financing costs during construction amounted to $2.7 million (2005: $1.5 million).

It is anticipated that the title of the ship under capital lease, the *Queen of Oak Bay*, will pass to the company, without additional payments, on January 1, 2007. The *Queen of Surrey* was included in the ships under capital lease category in the year ended March 31, 2005; title passed to the company on January 1, 2006 and the *Queen of Surrey* is now included in the ships owned category.

In addition to the construction-in-progress referenced above, contractual commitments at March 31, 2006 for capital assets to be constructed totaled $324.2 million (2005: $339.4 million). Included in the contractual commitments as at March 31, 2006 is $308.2 million (2005: $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.

(columnar dollars expressed in thousands)

4. 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. Annual increases in price caps have been set for the first five year term through March 31, 2008. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels. The Commissioner will establish the price caps to apply for each subsequent term.

The accounting for regulated operations of the Company may differ from non-regulated businesses following Canadian generally accepted accounting principles (GAAP). As a result, 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 tariffs. Management continually assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes and recent rate orders to other regulated entities. Management believes the existing regulatory assets are probable of recovery. This determination reflects the current political and 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 current period earnings.

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,	
Regulatory assets	2006	2005
Deferred fuel costs (a)	$ 22,715	$ 8,000
Performance term submission costs (b)	68	-
Total regulatory assets	$ 22,783	$ 8,000
Regulatory liabilities		
Tariffs in excess of price cap (c)	$ 958	$ -

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

(a) Deferred fuel costs:

As prescribed by regulatory order, the Company defers fuel costs in excess of 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 recovery from future tariffs. The order also allows interest to be included in the amount to be recovered. Also prescribed by regulatory order, the Company collects fuel surcharges which are applied against deferred fuel costs. It is expected that the recovery period of deferred fuel costs is two to six years. If the Company were not a regulated entity, earnings for the year ended March 31, 2006 would have been $14.7 million lower due to this deferral (2005: $8.0 million lower).

(b) Performance term submission costs:

The Commissioner has authorized the Company to defer costs of representation associated with the second performance term. The Commissioner will consider these costs in the determination of the price caps set for the four years beginning April 1, 2008. The Commissioner has not included an allowance for a return on investment for this item. It is expected that the recovery period will be the four year period of the second performance term, commencing April 1, 2008. If the Company were not a regulated entity, earnings for the year ended March 31, 2006 would have been $0.1 million lower due to this deferral (2005: nil).

(c) Tariffs in excess of price cap:

The Act contains provisions which ensure that if tariffs charged by the Company exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. At March 31, 2006, tariffs charged to customers on the major route group exceeded the price cap by $1.0 million (2005: nil). A liability has been recorded to recognize the obligation to return this amount to customers. It is expected that the settlement will occur in the next fiscal quarter. In the absence of rate regulated accounting, GAAP would require these revenues to be recognized as income in the year earned, and earnings for the year ended March 31, 2006 would have been $1.0 million higher (2005: nil).

5. 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 year ended March 31, 2005, 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, 2006, the improvements were complete. Long-term land lease has been increased in the year ended March 31, 2006 by $1.1 million (2005: $3.9 million) with regard to these highway improvements. The increases to long-term land lease will be amortized over the remaining lease period, commencing the month following completion of improvements.

6. 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 multiemployer 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 multiemployer plan provides disability income benefits after employment, but before retirement.

(columnar dollars expressed in thousands)

6. Accrued employee future benefits (continued):

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, 2006, 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 $17.6 million (2005: $16.6 million).

(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.

	Other benefit plans	
Accrued benefit obligations	2006	2005
Balance, beginning of year	$ 18,276	$ 18,059
Current service cost	493	556
Interest cost	816	853
Benefits paid	(1,156)	(1,841)
Actuarial (gains) losses	(51)	649
Balance, end of year	$ 18,378	$ 18,276

(columnar dollars expressed in thousands)

6. Accrued employee future benefits (continued):

Reconciliation of funded status of the benefit plans to the amounts recorded in the financial statements	Other benefit plans 2006	2005
Fair value of plan assets	$ -	$ -
Accrued benefit obligation	18,378	18,276
Funded status of plans – deficit	(18,378)	(18,276)
Unamortized net actuarial loss	841	796
Accrued benefit liability	(17,537)	(17,480)
Current portion of accrued employee future benefits	800	631
Accrued employee future benefits	$ (16,737)	$ (16,849)

Elements of defined benefit costs recognized in the year	Other benefit plans 2006	2005
Current service cost, net of employee contributions	$ 493	$ 556
Interest cost	771	853
Actuarial (gains) losses	(51)	649
Elements of employee future benefits costs before adjustments to recognize the long-term nature of employee future benefit costs	1,213	2,058
Difference between actuarial (gain) loss recognized for year and actual actuarial (gain) loss on accrued benefit obligation for year	-	(796)
Defined benefit costs recognized	$ 1,213	$ 1,262

Significant assumptions The significant assumptions used are as follows (weighted average):	Other benefit plans 2006	2005
Accrued benefit obligation as of March 31:		
Discount rate	4.6%	4.6%
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	4.5%	5.0%
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%

(columnar dollars expressed in thousands)

6. Accrued employee future benefits (continued):

(d) Multiemployer plans:

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

	2006	2005
Public Service Pension Plan contributions (i)	$ 14,237	$ 12,682
Long-term disability plan contributions	2,183	2,086
Long-term disability plan amortization of surplus (ii)	64	64
	$ 16,484	$ 14,832

i) The March 31, 2005 actuarial valuation report for the Public Service Pension Plan was received by the Public Service Pension Board of Trustees on December 14, 2005. This report indicated that the pension fund has an unfunded liability of $767 million. Under the terms of the plan's joint trust agreement, plan members and employers share in any increase or decrease in contribution rates. In order to address the unfunded liability, the plan trustees have increased the member and employer contribution rates by 1.88%, effective April 1, 2006.

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 employer contribution rate. The next valuation will be as at March 31, 2005 and is expected June, 2006.

7. Long-term debt:

	As at March 31,	
	2006	2005
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (a)	$ 250,000	$ 250,000
Unamortized discount	(108)	(121)
	249,892	249,879
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (a)	250,000	250,000
Unamortized discount	(288)	(298)
	249,712	249,702
	$ 499,604	$ 499,581

7. Long-term debt (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. 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.

(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, and a three year revolving extendible facility in an amount up to $77.5 million. Both facilities are undrawn as at March 31, 2006.

(c) Debt service reserve:

The Company is required to maintain a debt service reserve for the Series 04-1 and 04-4 bonds 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.

In addition, the Company has entered into loan agreements which make up to $180 million available to finance the Company's purchase of two "Super C" Class vessels. These funds will be released to coincide with the conditional acceptance dates of the vessels, expected in 2008.

8. Obligations under capital lease:

During the prior 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.

(columnar dollars expressed in thousands)

8. Obligations under capital lease (continued):

Future minimum lease payments:

Year ended		
2007	$	66
2008		66
2009		66
2010		66
2011		66
Thereafter		151
Executory costs and imputed interest included in payments		(318)
		163
Current portion of capital lease liability		(25)
	$	138

9. 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,			
	2006		2005	
	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

9. Share capital (continued):

(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.

10. Ferry service fees:

The Company entered into an agreement with the Province of British Columbia 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 annual fees of approximately $107 million.

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. Interest rate support:

The Government of Canada has agreed to provide $5.6 million in the form of interest rate support to the Company for major refurbishments on two vessels. Of this, $0.6 million has been recorded during the year as a reduction of capitalized interest, and $2.0 million has been recorded as a reduction of interest expense (year ended March 31, 2005: nil). The remaining $3.0 million will be recognized over the next eighteen months as a reduction of interest expense.

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.

(columnar dollars expressed in thousands)

13. 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.

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

Year ended	
2007	$ 6,748
2008	6,524
	$ 13,272

14. 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 (also see note 4).

(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, 2006, the Company has no interest rate agreements.

(columnar dollars expressed in thousands)

14. Risk management (continued):

(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, 2006, 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 (2005: $449.9 million).

(d) Fair value of financial instruments:

The fair value of financial instruments not currently carried at market value is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of March 31, 2006 and 2005, are not necessarily indicative of the amounts the Company could have realized in current markets.

Fair market values have been estimated by reference to quoted market prices for the actual or similar instruments where available. The fair values of cash and cash equivalents, short term investments, accounts receivable, accounts payable and accrued liabilities, accrued employee costs, and interest payable on long-term debt approximate their carrying amounts due to their short term to maturity.

As at March 31, 2006, the Company had outstanding fuel hedges with a notional amount of $19.3 million which are marked to market and recognized in the consolidated financial statements at a value of $0.9 million (2005: nil).

The carrying values and approximate fair market values of the Company's longer term financial instruments are:

	As at March 31,			
	2006		2005	
	Carrying Value	Approx FMV	Carrying Value	Approx FMV
Liabilities:				
Long-term debt	$ 499,604	$ 552,968	$ 499,581	$ 531,775
Foreign currency forward contracts	-	45,300	-	2,700
Obligations under capital lease	163	163	190	190

(columnar dollars expressed in thousands)

15. Related party transactions:

In accordance with the Act, the Company is responsible for paying any expenses that are incurred by its parent, British Columbia Ferry Authority ("BCFA"), without charge. During the year ended March 31, 2006, the Company paid $99,702 (2005: $31,796) of such expenses.

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

16. Supplemental cash flow information:

	Years ended March 31, 2006	2005
Cash paid during the year for interest	$ 30,175	$ 12,828

17. 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.

18. Subsequent event:

On March 22, 2006 the vessel *Queen of the North* ran aground and subsequently sank. Subsequent to March 31, 2006, the Company has settled with its Hull and Machinery insurance providers. The Company has received insurance proceeds, net of deductible, of $67.9 million in settlement of the claim under the Hull and Machinery policy. At March 31, 2006, $6.6 million of the proceeds from this claim have been recognized to offset insurable loses (including $4.3 million net book value of capital assets) incurred as a result of this event.