Management's Discussion & Analysis
of
Financial Condition
and
Results of Operations

For the fiscal year ended March 31, 2012
Dated June 15, 2012

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

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

BUSINESS OVERVIEW

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

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

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

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

Significant events during or subsequent to fiscal 2012:

- On June 2, 2011, the *Coastal Ferry Amendment Act*, *2011* (Bill 14) was enacted. Bill 14 established a price cap increase for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012 (as established by the Commissioner) effective April 1, 2012, for the first year of performance term three. (See "Corporate Structure – Economic Regulatory Environment" for more detail)

- On July 26, 2011, we announced a 90-day, one-time only refund to customers who purchased assured loading tickets between 1984 and July 25, 2011 and no longer want the tickets. This decision was made prior to completion of fiscal 2011 and a liability was reflected in the fiscal 2011 financial statements to provide for these refunds. We received approximately 3,500 refund requests during the 90-day period. We have completed our validation of these requests and processing of the refunds. The liability established at March 31, 2011 was sufficient to cover the refunds.

- On September 15 and 22, 2011, we paid down $45 million in debt consisting of the principal amounts outstanding under the second tranche of the two 12-year, 4.98% loans with the KfW bank group (KfW). These loan agreements were also amended to transfer the principal payments on these loans for the next three years to the second tranche, on which interest only is paid at a floating rate. The principal on the second tranche is due at maturity. (See “Liquidity and Capital Resources” for more detail.)

- On December 6, 2011, our Board announced the appointment of Michael J. Corrigan as President and CEO effective January 1, 2012. Mr. Corrigan was previously our Chief Operating Officer and has been a senior executive with us since joining the company in 2003 and was responsible for initiating and leading our SailSafe program, a joint initiative with the BC Ferry & Marine Workers’ Union that has established a comprehensive safety culture. He was also responsible for our new vessel construction program, overseeing the construction and introduction of seven new and numerous upgraded vessels to the fleet as well as a host of terminal upgrades and improvements. Our previous President and CEO, David L. Hahn, retired December 31, 2011.

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

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

  (See “Financial and Operational Overview” for more detail).

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

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

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

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

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

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

CORPORATE STRUCTURE

Coastal Ferry Services Contract (the Contract)

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

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

Economic Regulatory Environment

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

FINANCIAL AND OPERATIONAL OVERVIEW

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

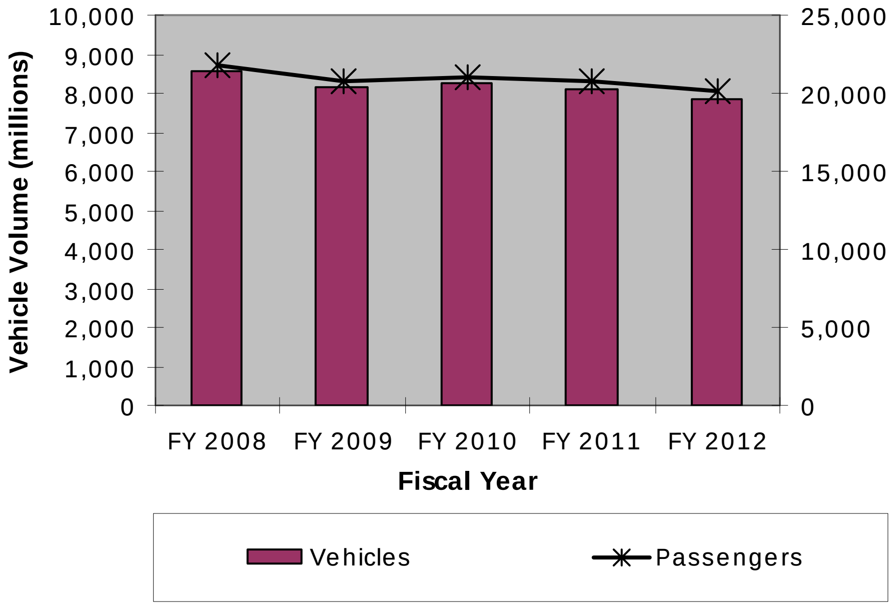
	Year ended March 31		
($ millions)	**2012**	**2011**	**2010**
Total revenue	738.2	739.3	732.3
% (decrease) increase	*(0.1%)*	*1.0%*	*7.4%*
Operating expenses	682.7	672.2	660.0
Earnings from operations	55.5	67.1	72.3
Interest and other	72.0	63.3	68.9
Net (loss) earnings and comprehensive (loss) income	(16.5)	3.8	3.4
	As at March 31		
	2012	**2011**	**2010**
Total assets	1,819.5	1,857.6	1,807.0
Total long-term financial liabilities	1,343.4	1,387.2	1,363.9
Dividends on preferred shares	6.0	6.0	6.0

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

Traffic

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

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



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

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

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

Cost containment

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

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

Safety & training

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

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

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

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

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

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

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

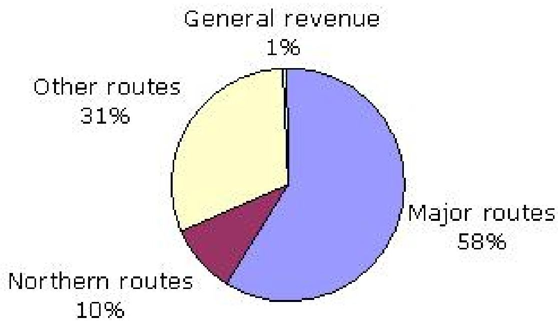
Customer service

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

Collective agreement

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

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



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

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

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

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

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

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

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

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

Year to Year Comparison of Revenues 2012 – 2011

Major Routes

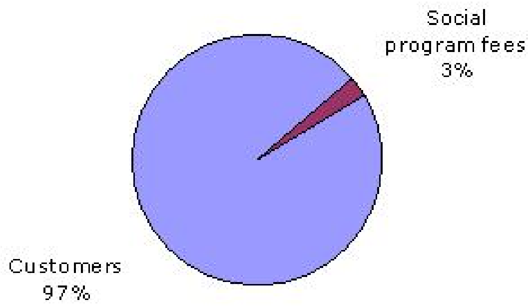
Direct Route Revenue ($ thousands)	**Years ended March 31**			
	2012	**2011**	**Increase (Decrease)**	
Vehicle traffic (volume)	*3,546,137*	*3,703,923*	*(157,786)*	*(4.3%)*
Vehicle tariff	209,770	211,551	(1,781)	(0.8%)
Passenger traffic (volume)	*10,381,444*	*10,738,599*	*(357,155)*	*(3.3%)*
Passenger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

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

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

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

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



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

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

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

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

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

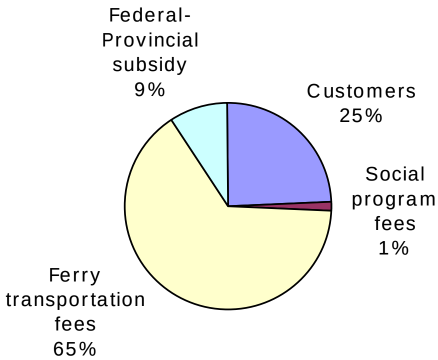
Fees for assured loading were lower due to a drop in usage of this product which is partly due to the reduced traffic levels.

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

Northern Routes

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

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



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

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

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

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

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

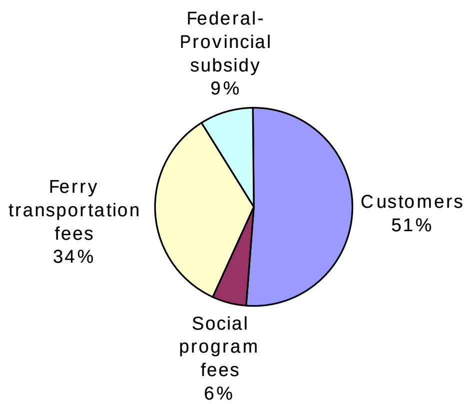
We receive ferry transportation fees for these routes under the Contract. These fees are higher in fiscal 2012, reflecting an increase in funding related to the *Queen of Chilliwack* life extension, partially offset by the impact of lower net book value of the vessels used on these routes. The transportation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

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

Other Routes

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

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



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

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

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

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

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

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

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

Year to Year Comparison of Revenues 2011 – 2010

Major Routes

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

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

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

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

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

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

Northern Routes

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

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

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

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

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

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

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

Other Routes

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

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

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

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

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

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

Expenses

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

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

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

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

Year to Year Comparison of Expenses 2012 – 2011

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

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

Partially offset by:

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

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

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

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

Interest expenses decreased $0.2 million primarily due to:

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

partially offset by;

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

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

Year to Year Comparison of Expenses 2011 – 2010

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

- $6.7 million increase in wages and benefits, including:
    - Approximately $6.4 million in bargaining unit wage rate increases (averaging about 3%) in accordance with the Collective Agreement; $0.4 million increase in long-term disability premiums; $1.5 million additional labour for the full year operation of the operations and security centre, opening of our travel centre and expanded drop trailer operations; partially offset by a $1.5 million reduction in incentive compensation;
- $2.9 million or 3.1% increase in fuel expense as a result of higher fuel prices, partially offset by a 0.5% decrease in fuel consumption; and
- $2.7 million increase consisting of $0.4 million due to the July 1, 2010 implementation of HST; $0.3 million in credit card service fees; $0.3 million in lease costs; and a further $1.7 million in a number of miscellaneous items.

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

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

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

Interest expenses increased $4.5 million primarily due to:

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

partially offset by;

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

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

Deferred Fuel Cost Accounts

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

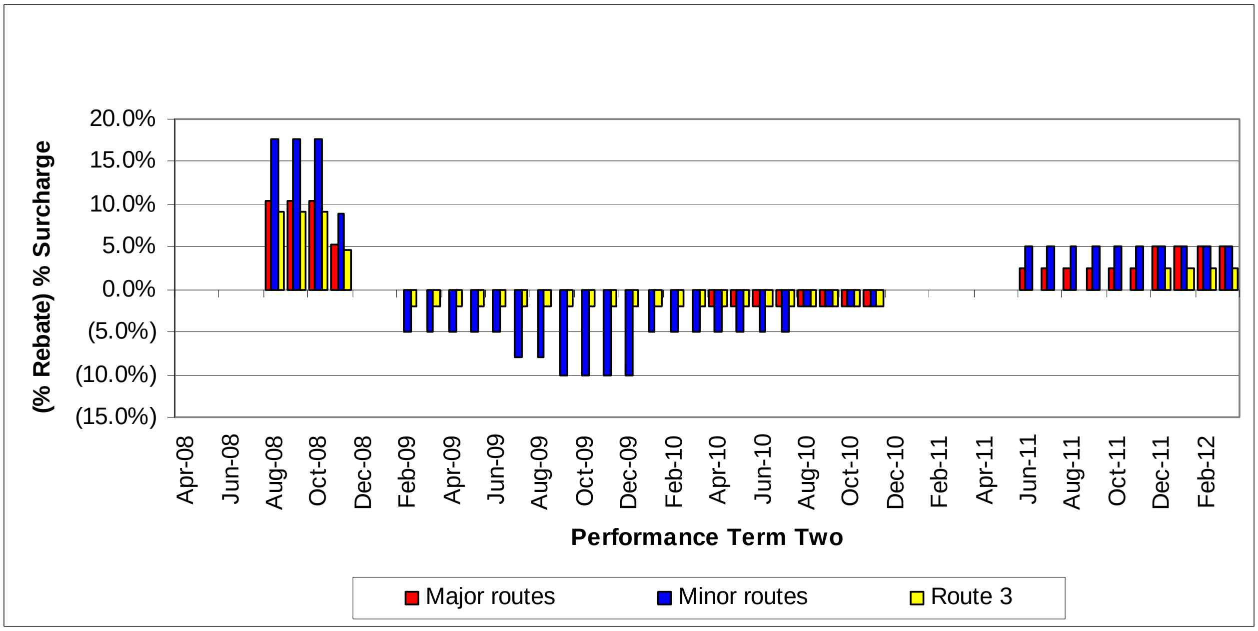
Commencing April 1, 2004, the Commissioner established set prices for fuel for each of the years until March 31, 2008. At the start of each fiscal year, the set prices increased by the CPI (Vancouver). On March 30, 2007, the Commissioner authorized the continued use of inflation-adjusted set prices and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

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

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

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

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



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

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

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

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

LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Resources

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

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

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

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

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

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

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

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

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

Long-Term Debt
Our long-term debt is summarized below:

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

* Floating rate as at March 31, 2012

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

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

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

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

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

Terminal Leases

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

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

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

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

Other Long-Term Liabilities

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

Sources & Uses of Cash

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

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

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

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

- $17.6 million in fuel and interest costs deferred; and

partially offset by:

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

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

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

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

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

Cash used in financing activities consisted of:

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

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

Cash used in investing activities consisted primarily of:

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

partially offset by:

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

FOURTH QUARTER RESULTS

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

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

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

Revenue

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

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

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

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

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

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

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

Expenses

Expenses are shown in the following table:

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

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

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

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

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

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

INVESTING IN OUR CAPITAL ASSETS

Assets acquired under Capital Lease

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

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

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

Capital Expenditures

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

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

Vessel Upgrades and Modifications

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

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

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

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

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

Terminal Marine Structures

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

Terminal marine structures
($ millions)

Terminal	Description	March 31, 2012 3 Months	March 31, 2012 12 Months
Swartz Bay	Berth 4 and 5 replacement and refurbishment	1.9	14.2
Hornby Island	Replacement of ramp, wingwalls, towers & dolphins	0.8	9.0
Tsawwassen	Refurbishment of decks and berth 5 upgrades	0.1	8.0
Denman Island	Replacement of ramp, wingwalls, towers & dolphins	0.7	5.9
Various	Other projects	1.9	6.9
		5.4	44.0

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

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

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

Information Technology

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

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

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

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

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

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

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

Terminal and Building Upgrades and Equipment

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

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

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

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

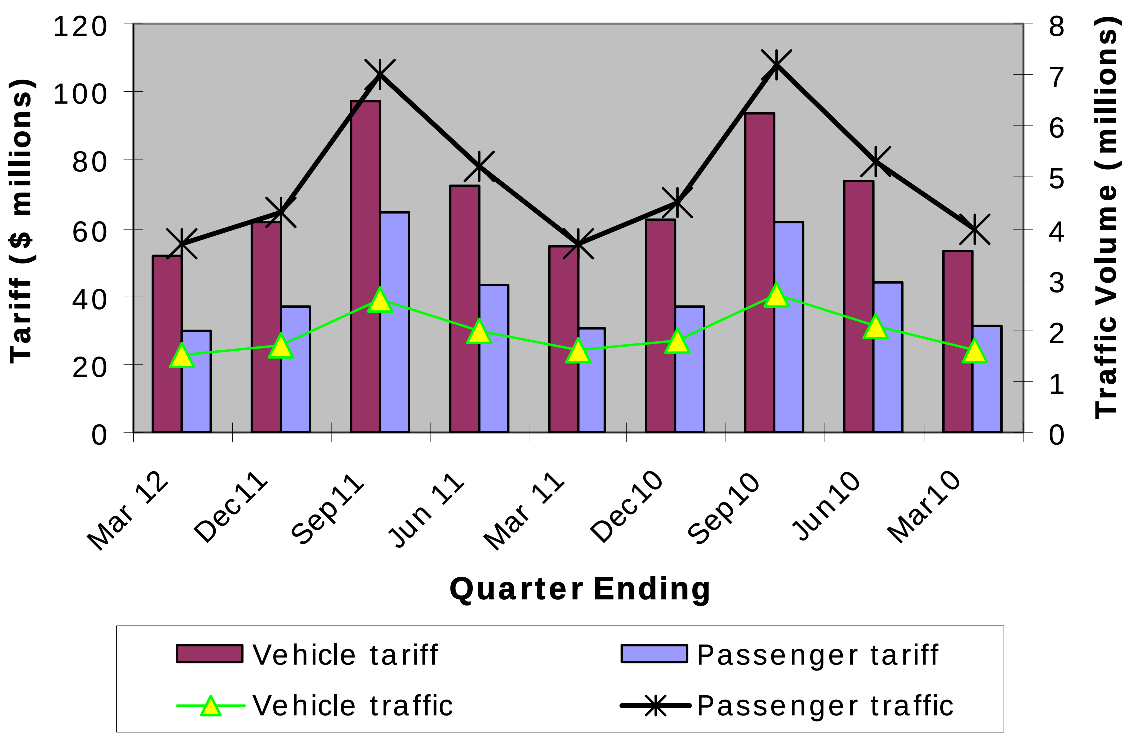
Other projects include seismic upgrades of certain of our maintenance facilities and security upgrades at some of our terminals.

SUMMARY OF QUARTERLY RESULTS
The table below compares earnings by quarter for the most recent eight quarters:

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

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

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



OUTLOOK

Traffic Levels

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

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

Vehicle Traffic by fiscal year

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

Passenger Traffic by fiscal year

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

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

Market Opportunities

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

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

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

Asset Renewal Program

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

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

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

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

Cable Ferry

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

Fuel conversion

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

Alternative Service Providers

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

Financial Outlook

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

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

FINANCIAL RISKS AND FINANCIAL INSTRUMENTS

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

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

Credit Risk

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

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

Liquidity Risk

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

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

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

Market Risk

Interest Rate

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

Foreign Currency

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

Fuel Price

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

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

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

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

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

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

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

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

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

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

BUSINESS RISK MANAGEMENT

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

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

Customer Demand

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

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

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

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

Security of information

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

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

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

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

Security

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

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

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

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

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

Economic Regulatory Environment

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

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

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

Access to Capital Markets

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ACCOUNTING PRACTICES

Critical Accounting Policies and Estimates

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

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

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

Workers' Compensation Claims Liability

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

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

Public Service Pension Plan

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

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

Retirement Bonus Liability

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

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

Rate Regulation

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

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

- Deferred fuel costs: the difference between amounts allowed by the regulator in operating expense and those actually incurred with settlement expected through future tariffs, surcharges or rebates;
- Performance term submission costs: costs for incremental contracted services relating to our third performance term submission. Our regulator has approved recovery of these costs over the third performance term ending March 31, 2016.
- Tariffs in excess of price caps: the amount by which average annual tariffs collected at a specific date exceed established price caps set under the terms of the Act. The excess amounts collected will be returned to customers through future tariffs.

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

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

Amortization Expense

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

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

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

Hedging Relationships

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

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

Asset Retirement Obligations

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

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

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

Adoption of New Accounting Standards

No new accounting standards have been adopted for fiscal 2012.

Future Accounting Changes

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

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

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

Our IFRS transition project consists of three phases:

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

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

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

Financial statement preparation
Key activities • Identify differences in Canadian GAAP/IFRS accounting policies • Select ongoing IFRS policies • Develop financial statement format • Select IFRS 1 exemptions for transition • Quantify effects of change at April 1, 2011 (for opening IFRS financial position)
Milestones • Senior management review of policy decisions and illustrative IFRS financial statements and disclosures by June 30, 2011 • Audit & Finance Committee approval of policy decisions and IFRS financial statement format, in principle, by September 30, 2011 • IFRS 1 exemptions finalized and quantified by September 30, 2011 • Policies and procedures in place by March 31, 2012
Status • Scoping and diagnostic phase completed in fiscal 2009, with high-level review of the major differences between Canadian GAAP and IFRS • Highest areas of impact identified, review prioritized, and in-depth analysis complete • Accounting policy alternatives analyzed and recommendations made for key accounting policy decisions • IFRS 1 exemptions reviewed and analyzed • Senior management review of policy decisions complete • Preparation and review of illustrative financial statements and note disclosures complete • IFRS 1 exemptions finalized and quantified • Policies and procedures complete • Preparation of fiscal 2012 comparatives complete • Preparation of first interim financial statements under IFRS, including first-time adoption reconciliations required under IFRS 1, in progress

Information technology infrastructure
Key activities • Confirm system upgrades required for IFRS reporting • Review/revise data gathering processes • Review/revise budgeting and forecasting processes
Milestones • System configuration changes complete by March 31, 2010 • System reporting changes required to accommodate both current Canadian GAAP and IFRS complete by August 31, 2010 • Changes to budgeting and forecasting processes complete by June 30, 2011
Status • Detailed reporting requirements to accommodate the transition to IFRS identified and documented • Overall system approach selected • System configuration to accommodate both current Canadian GAAP and IFRS complete • System changes to accommodate reporting requirements complete • Review to determine effects on the project of the two one-year deferrals of changeover date complete • Review to determine recording and reporting impacts of the absence of a standard on rate regulation complete • Changes required to budgeting and forecasting processes complete

Training, Education & Communication
Key activities • Determine required level of IFRS expertise within all areas of the company • Ensure appropriate training of key members within Finance • Provide appropriate education and communication to affected departments • Provide department specific training on revised policies and procedures • Provide timely communication to both internal and external stakeholders on impacts of the transition to IFRS
Milestones • Topic-specific training for IFRS working committee complete prior to March 31, 2010 • Department-specific training completed by March 31, 2012 • Impacts of transition to IFRS communicated to external stakeholders by March 31, 2012
Status • Core IFRS project team members completed topic-specific training, and successfully completed the "IFRS Award Program, Certificate Level" • Interdepartmental workshops provided on specific topics, including property, plant and equipment; IFRS 1; and the IFRS Framework • Throughout the project, communications with key stakeholders, including direct communication with the Commissioner, our Agent Bank, rating agencies, our Board of Directors, and with investors indirectly through our website • Interdepartmental training on specific topics complete • Impacts of transition communicated in December 31, 2011 and March 31, 2012 Management's Discussion & Analysis (MD&A)

Control environment
Key activities • Accounting policy determination, documentation and implementation • MD&A ongoing communications
Milestones • All internal control process descriptions updated by March 31, 2012 • Publish quantitative effects of conversion on April 1, 2011 opening balance sheet in December 31, 2011 MD&A
Status • Analysis of control issues complete • Review and update of process descriptions complete • Policies and procedures complete • April 1, 2011 opening IFRS statement of financial position published in the MD&A for both December 31, 2011 and March 31, 2012 (included below at the end of this discussion of Future Accounting Changes)

Business policy assessment
Key activities • Financial covenants assessment • Compensation arrangements assessment • Customer and supplier contract evaluation
Milestones • Potential impact on compensation arrangements determined by December 31, 2011 • Impact on customer/supplier contracts determined by December 31, 2011 • Impact on financial covenants quantified by March 31, 2012
Status • All relevant GAAP-dependent covenants and contracts have been identified • Analysis to determine effects of IFRS on existing covenants and contracts is complete • Impact on compensation arrangements analyzed

First-time adoption of IFRS

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

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

- *Property, plant and equipment and Intangible assets:* There is a choice of valuation of property, plant and equipment and intangible assets at April 1, 2011, either to:
  - retrospectively apply IFRS to the valuation of the assets; or
  - to revalue items, on an asset by asset basis, at fair value and use that fair value as deemed cost; or
  - use previous GAAP carrying amounts at transition as the deemed cost for assets used in rate-regulated operations as detailed in the amendment to IFRS 1 published May 6, 2010.

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

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

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

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

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

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

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

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

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

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

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

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

CORPORATE STRUCTURE AND GOVERNANCE

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

FORWARD LOOKING STATEMENTS

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

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

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

SCHEDULE A
Corporate Structure and Governance
Board of Directors

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

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

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

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

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

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

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

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

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

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

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

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

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

Directorships

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

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

Orientation and Continuing Education

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

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

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

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

Ethical Business Conduct

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

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

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

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

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

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

Nomination of Directors

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

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

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

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

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

Executive Compensation

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

Executive Compensation Plan

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

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

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

Executive Compensation Process

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

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

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

Director Compensation

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

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

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

Protocol Agreement

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

Board Committees

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

Audit & Finance Committee:

Members during the fiscal year ended March 31, 2012:

Chair: Brian G. Kenning

Members: Elizabeth J. Harrison, P. Geoffrey Plant and Graham M. Wilson

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

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

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

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

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

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

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

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

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

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

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

***Safety, Health, Environment & Security Committee*:**
Members during the fiscal year ended March 31, 2012:
Chair: Wayne H. Stoilen
Members: Holly A. Haston-Grant, Gordon R. Larkin and Maureen V. Macarenko

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

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

Governance & Nominating Committee:
Members during the fiscal year ended March 31, 2012:
Chair: Elizabeth J. Harrison
Members: Gordon R. Larkin, P. Geoffrey Plant and Wayne H. Stoilen

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

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

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

Human Resources & Compensation Committee:

Members during the fiscal year ended March 31, 2012:

Chair: Graham M. Wilson

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

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

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

Assessments

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

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

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