

Interim Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Three months ended June 30, 2012 and 2011

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statement of Financial Position (unaudited)
(Expressed in thousands of Canadian dollars)

| | As at, | | |
|---|---------------|----------------|---------------|
| | June 30, 2012 | March 31, 2012 | April 1, 2011 |
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents | 7,412 | 7,700 | 33,335 |
| Restricted short-term investments (note 5(b)) | 35,705 | 35,705 | 37,040 |
| Other short-term investments | 26,930 | 26,880 | 64,074 |
| Trade and other receivables | 22,734 | 42,341 | 20,619 |
| Prepaid expenses | 16,359 | 6,725 | 5,648 |
| Inventories | 22,179 | 22,016 | 19,957 |
| Derivative assets | 8 | - | - |
| | 131,327 | 141,367 | 180,673 |
| Non-current assets | | | |
| Long-term loan receivable | 24,515 | 24,515 | 24,247 |
| Long-term land lease | 32,406 | 32,521 | 32,979 |
| Property, plant and equipment (note 3) | 1,581,121 | 1,596,507 | 1,593,194 |
| Intangible assets (note 4) | 44,267 | 41,758 | 34,929 |
| | 1,682,309 | 1,695,301 | 1,685,349 |
| Total assets | 1,813,636 | 1,836,668 | 1,866,022 |
| Liabilities | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | 35,483 | 50,708 | 49,872 |
| Short-term debt (note 5a) | 7,995 | 17,737 | 3,949 |
| Interest payable on long-term debt | 14,977 | 18,249 | 18,261 |
| Deferred revenue | 16,184 | 13,784 | 15,596 |
| Derivative liabilities | - | 12 | 23 |
| Current portion of long-term debt (note 5) | 9,000 | 9,000 | 22,125 |
| Current portion of accrued employee future benefits | 1,600 | 1,600 | 1,200 |
| Current portion of obligations under finance lease | 974 | 974 | 1,040 |
| Provisions | 50,183 | 50,481 | 49,571 |
| | 136,396 | 162,545 | 161,637 |
| Non-current liabilities | | | |
| Accrued employee future benefits | 14,363 | 14,506 | 14,459 |
| Long-term debt (note 5) | 1,285,475 | 1,285,232 | 1,327,014 |
| Obligations under finance lease | 46,765 | 47,013 | 47,723 |
| | 1,346,603 | 1,346,751 | 1,389,196 |
| Total liabilities | 1,482,999 | 1,509,296 | 1,550,833 |
| Equity | | | |
| Share capital | 75,478 | 75,478 | 75,478 |
| Contributed surplus | 25,000 | 25,000 | - |
| Retained earnings | 227,982 | 224,717 | 239,711 |
| Total equity before reserves | 328,460 | 325,195 | 315,189 |
| Revaluation reserve (note 11 (c)) | 2,177 | 2,177 | - |
| Total equity including reserves | 330,637 | 327,372 | 315,189 |
| Total liabilities and equity | 1,813,636 | 1,836,668 | 1,866,022 |
| Commitments (note 3) | | | |

See accompanying notes to the interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statement of Comprehensive Income (Loss) (unaudited)

(Expressed in thousands of Canadian dollars)

| | Three months ended, | |
|---|---------------------|-----------------|
| | June 30, 2012 | June 30, 2011 |
| Revenue | | |
| Vehicle and passenger fares | 114,422 | 114,401 |
| Ferry service fees | 46,228 | 40,249 |
| Retail | 19,162 | 19,399 |
| Federal-Provincial Subsidy Agreement | 7,019 | 6,872 |
| Fuel surcharges | 6,030 | 1,155 |
| Regulated other income (note 7) | 3,109 | 3,399 |
| Other income | 1,630 | 1,482 |
| Total revenue | 197,600 | 186,957 |
| Expenses | | |
| Operations | 111,006 | 108,808 |
| Maintenance | 17,217 | 17,645 |
| Administration | 7,169 | 7,418 |
| Cost of retail goods sold | 7,508 | 7,463 |
| Depreciation and amortization | 34,001 | 31,939 |
| Total operating expenses | 176,901 | 173,273 |
| Operating profit | 20,699 | 13,684 |
| Net finance and other expenses | | |
| Net finance expenses (note 8) | | |
| Finance income | 537 | 671 |
| Finance expenses | (17,988) | (17,935) |
| Total net finance expenses | (17,451) | (17,264) |
| Loss on disposal of capital assets | 17 | 29 |
| Total net finance and other expenses | (17,434) | (17,235) |
| Net earnings (loss) | 3,265 | (3,551) |
| Other comprehensive income (loss) | - | - |
| Total comprehensive income (loss) | 3,265 | (3,551) |

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statement of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

| | Three months ended, | |
|---|---------------------|---------------|
| | June 30, 2012 | June 30, 2011 |
| Cash flows from operating activities | | |
| Net earnings (loss) | 3,265 | (3,551) |
| Items not affecting cash | | |
| Net finance costs recognized in net income | 17,451 | 17,264 |
| Depreciation and amortization of non-current assets | 34,001 | 31,938 |
| Gain on disposal of property, plant and equipment | (17) | (29) |
| (Decrease) increase in employee future benefits | (143) | 581 |
| Increase in derivative assets | (8) | - |
| Decrease in derivative liabilities | (12) | (12) |
| (Decrease) increase in provisions | (298) | 995 |
| Other non-cash adjustments to property, plant & equipment | (275) | 206 |
| Decrease in long-term land lease | 115 | 114 |
| Increase in accrued net financing | 589 | 375 |
| Total non-cash items | 51,403 | 51,432 |
| Movements in operating working capital | | |
| Decrease (increase) in accounts receivable | 19,607 | (2,634) |
| Increase in prepaid expenses | (9,634) | (10,245) |
| Increase in inventories | (162) | (896) |
| Decrease in accounts payable and accrued liabilities | (15,225) | (7,781) |
| Increase in deferred revenue | 2,400 | 4,599 |
| Change in non-cash working capital | (3,014) | (16,957) |
| Change attributable to capital asset acquisitions | 11,313 | (3,527) |
| Change attributable to contributed surplus | (25,000) | - |
| Change in non-cash operating working capital | (16,701) | (20,484) |
| Cash generated from operating activities | 37,967 | 27,397 |
| Interest rate support received (note 8(a)) | - | 638 |
| Interest received | 149 | 186 |
| Interest paid | (21,656) | (21,860) |
| Net cash generated by operating activities | 16,460 | 6,361 |

See accompanying notes to the interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statement of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

| | Three months ended, | |
|---|---------------------|-----------------|
| | June 30, 2012 | June 30, 2011 |
| Cash flows from financing activities | | |
| Repayment of long-term debt | - | (1,875) |
| Repayment of short-term loans | (9,743) | (3,949) |
| Repayment of finance lease obligations | (248) | (276) |
| Contributed surplus payment from Province | 25,000 | - |
| Net cash generated by (used in) financing activities | 15,009 | (6,100) |
| Cash flows from investing activities | | |
| Proceeds from disposal of property, plant and equipment | 29 | 29 |
| Purchase of property, plant and equipment and intangibles | (31,736) | (28,460) |
| Advancement of long-term loan | - | (268) |
| (Purchase of) proceeds from short-term investments | (50) | 5,000 |
| Net cash used in investing activities | (31,757) | (23,699) |
| Net decrease in cash and cash equivalents | (288) | (23,438) |
| Cash and cash equivalents, beginning of period | 7,700 | 33,335 |
| Cash and cash equivalents, end of period | 7,412 | 9,897 |

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statement of Changes in Equity (unaudited)

(Expressed in thousands of Canadian dollars)

| | Share Capital | Contributed Surplus | Retained Earnings | Total Equity Before Reserves | Revaluation Reserve | Total Equity Including Reserves |
|---|------------------|------------------------|----------------------|---------------------------------------|------------------------|--|
| Balance as at April 1, 2011 | 75,478 | - | 239,711 | 315,189 | - | 315,189 |
| Net loss for the three months ended June 30, 2011 | - | - | (3,551) | (3,551) | - | (3,551) |
| Other comprehensive income for the three months ended June 30, 2011 | - | - | - | - | - | - |
| Balance as at June 30, 2011 | 75,478 | - | 236,160 | 311,638 | - | 311,638 |
| Balance as at April 1, 2012 | 75,478 | 25,000 | 224,717 | 325,195 | 2,177 | 327,372 |
| Net earnings for the three months ended June 30, 2012 | - | - | 3,265 | 3,265 | - | 3,265 |
| Other comprehensive income for the three months ended June 30, 2012 | - | - | - | - | - | - |
| Balance as at June 30, 2012 | 75,478 | 25,000 | 227,982 | 328,460 | 2,177 | 330,637 |

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

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

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

The Company’s business is seasonal in nature, with the highest activity in the summer (second quarter) and the lowest activity in the winter (fourth quarter), due to the high number of leisure travellers and their preference to travel during the summer months. The Company also takes advantage of the low activity during the winter months to perform a significant portion of the required annual maintenance on vessels and terminals.

1. Accounting Policies:

(a) Statement of compliance:

These interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations and comply with International Accounting Standard 34 *Interim Financial Reporting*. The Company’s interim consolidated financial statements were previously prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). Other than as discussed in notes 1 (h), 1 (s) and 11 these interim consolidated financial statements follow the same accounting policies and methods of their application as set out in the British Columbia Ferry Services Inc. consolidated financial statements and the notes thereto for the year ended March 31, 2012 and should be read in conjunction with those statements.

These interim consolidated financial statements were approved by the Board of Directors on August 23, 2012.

(b) Basis of preparation:

British Columbia Ferry Services Inc. is a company domiciled in Canada. The address of the Company’s registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These interim consolidated financial statements of the Company as at and for the three months ended June 30, 2012 and 2011 comprise the Company and its subsidiaries (together referred to as the “Group”).

(c) Basis of measurement:

These interim consolidated financial statements have been prepared using the historical cost method, with the exception of the following assets and liabilities which are measured at fair value: land, derivatives, financial instruments held for trading and available-for-sale financial assets.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting Policies (continued):

(d) Functional and presentation currency:

These interim consolidated financial statements are presented in Canadian dollars ("Cdn") which is the Group's functional currency. All financial data is presented in Canadian dollars rounded to the nearest thousand.

(e) Uses of estimates and judgements:

The preparation of consolidated financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting methods and the amounts recognized in the financial statements. These estimates and the underlying assumptions are established and reviewed continuously on the basis of past experience and other factors considered reasonable in the light of the circumstances. They therefore serve as the basis for making judgements about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from the estimates.

Significant estimates relate to:

(i) Property, plant and equipment and intangible assets

The calculation of depreciation and amortization involves estimates concerning the economic life and salvage value of property, plant and equipment and intangible assets.

(ii) Future employee benefits

Accounting for the costs of future employee benefits is based on actuarial valuations, relying on key estimates for discount rates, future salary increases, employee turnover rates and mortality tables.

Significant judgments relate to the provision for contingencies including asset retirement obligations. In forming these judgments, the Company is required to consider the probability of future payments.

(f) Basis of consolidation – subsidiaries:

A subsidiary is an entity controlled by the Group. Control exists when the Group has the power to manage, either directly or indirectly, the entity's financial and operational policies in order to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The financial statements of all subsidiaries are prepared to the same reporting date as the Group using consistent accounting policies.

The subsidiary holdings of the Group as at June 30, 2012 are:

Pacific Marine Ventures Inc.

BCF Captive Insurance Company Ltd.

Pacific Marine Leasing Inc.

BCF Global Services Inc.

All inter-Group transactions, balances and any unrealized income and expenses on inter-Group transactions are eliminated on consolidation.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting Policies (continued):

(g) Foreign currency transactions:

Transactions denominated in foreign currencies are translated by applying the exchange rate prevailing on the date of the transaction. At each reporting date, all monetary assets and liabilities denominated in foreign currencies are translated into Cdn at the closing exchange rate. Any resulting translation adjustments are recorded in net earnings or loss.

(h) Property, plant and equipment:

Property, plant and equipment, excluding land assets, are valued at cost plus direct overhead and financing costs, less depreciation and impairment. Land is valued at fair value using the annual assessed values for property tax purposes as being representative of the fair values of these assets.

The cost of self constructed assets includes expenditures on materials, direct labour, financing costs and an allocated proportion of project overheads. When parts of an item of property, plant and equipment have different estimated useful lives, they are accounted for as separate items (major components) of property, plant and equipment. The cost of replacing an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the item will flow to the Group, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of the item of property, plant and equipment and are recognized in net earnings or loss. The costs of the day-to-day servicing of items of property, plant and equipment are recognized in net earnings or loss as incurred.

Where components of an asset have different estimated useful lives, depreciation is calculated on each separate component. Depreciation commences when an asset is available for use. Estimates of remaining useful lives and residual values are reviewed annually and adjusted if appropriate. Property, plant and equipment, including assets under finance leases, are depreciated on a straight-line basis over the estimated useful lives of the assets at the following rates:

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

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting Policies (continued):

(i) Intangible assets:

Intangible assets consist of acquired computer software and licenses as well as internally developed computer software and website. These assets are valued at their acquisition cost plus direct overhead and financing costs, less amortization and impairment.

Software costs are capitalized if it is probable that the asset created will generate future economic benefits, the costs can be reliably measured, the product is technically feasible and the Group intends to, and has sufficient resources to, complete development and use the asset. Website costs are capitalized where the expenditure is incurred on developing an income generating website. Software and website costs capitalized include materials, direct labour and financing costs. Subsequent expenditure is capitalized only if it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognized in net earnings or loss as incurred.

Intangible assets with finite useful lives are amortized on a straight line basis over their estimated useful lives (3 to 7 years) since this most closely reflects the expected pattern of consumption of future economic benefits embodied in the asset. Amortization is recognized in net earnings or loss from the date that intangible assets are available for use. The amortization methods and estimated remaining lives are reviewed annually.

(j) Inventories:

Inventories are measured at the lower of cost and net realizable value. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale. No amounts are carried at net realizable value.

The cost of general and catering inventories is accounted for using the weighted average formula, while the cost of fuel inventories is based on the first-in–first-out principle. The cost of inventories includes expenditures incurred in acquiring the inventories and other direct costs incurred in bringing them to their existing location and condition.

(k) Employee benefits:

The Group has a number of defined benefit pension and post-retirement plans. The plans are generally funded by payments from employees and by the Group, taking into account the recommendations of independent qualified actuaries.

Defined contribution plan accounting is applied to the Group's multi-employer defined benefit pension and long-term disability plans. These multi-employer plans are administered by external parties and the Group does not have sufficient information to apply defined benefit plan accounting. The cost of these benefits is charged to net earnings or loss as contributions are made to the plans.

The actuarial determination of the accrued benefit obligations for retirement benefits uses the projected benefit method prorated on service (which incorporates management's best

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting Policies (continued):

(k) Employee benefits (continued):

estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors). Under the projected benefit method, the cost of these benefits is charged to net earnings or loss so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries who carry out a full valuation of the plans on a regularly scheduled basis. The pension obligation is measured as the present value of estimated future cash outflows using interest rates based on the yield of long-term high quality corporate bonds with maturities matching the pension obligation.

Assets are valued at fair value for the purpose of calculating the expected return on plan assets.

Actuarial gains (losses) arise from the difference between the actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period and from changes in actuarial assumptions used to determine the accrued benefit obligation. For the Group's retirement bonus and death benefit plans, the excess of the net accumulated actuarial gain (loss) over 10 percent of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the retirement bonus and death benefit plans was 7.0 years as at March 31, 2011, the date of the most recent actuarial valuation.

Past service costs arising from plan amendments are recognized immediately to the extent that the benefits are already vested but are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment where the benefits are not already vested. The full liability for all plan deficits is recorded, as adjusted for any past service costs still to be amortized.

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

(l) Provisions:

A provision is recorded when:

- the Group has a current obligation (legal or implicit) resulting from a past event; and
- it is likely that an outflow of resources representing economic benefits will be required to settle the obligation; and
- the amount of the obligation can be measured reliably.

If these conditions are not met, no provision is recorded.

Provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as finance expenses.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting Policies (continued):

(m) Revenues:

Tariff revenue is recognized when transportation is provided. The value of fares sold for which payment is received in advance of providing transportation is included in the statement of financial position as deferred revenue. These advance payments include prepaid vehicle and passenger fares, assured loading tickets and other reservation fees.

Retail revenue consists primarily of food services and gift shop sales. Parking revenues are received from both owned and subcontracted parking facilities and are recognized when service is provided. Revenue is generated from various advertising contracts and recognized according to the individual agreement.

Construction contract revenue is recognized using the percentage of completion method. At each reporting period, an estimate is made of the total profit or loss expected for the contract and the percentage of work completed. These estimates are used to measure the fair value of the consideration receivable for the contract and the amount of costs to be recognized in the period. If contract costs are not probable of being recovered they are immediately expensed.

(n) Finance leases:

Assets held under finance leases are initially recognized as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(o) Operating leases:

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

(p) Taxes:

The Group is a "Tax Exempt Corporation" as described in the *Income Tax Act* and as such is exempt from federal and provincial income taxes.

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

(q) Impairment of non-financial assets:

Non-financial assets with finite lives are tested for impairment when events or changes in circumstances indicate that their carrying amounts may not be recoverable.

The impairment charged to net earnings or loss is the excess of the carrying value over the recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting Policies (continued):

(q) Impairment of non-financial assets (continued):

For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The Group defines a cash generating unit as a route group. Price caps for each route group are set by the Commissioner based on the costs necessary to provide service on each route group as defined in the Coastal Ferry Services Contract with the Province.

The Group evaluates impairment losses for potential reversals when events or changes warrant such consideration. An impairment is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined had no impairment been recognized. A reversal of impairment is charged to net earnings or loss.

(r) Financial assets and liabilities:

Financial assets include trade receivables, loan receivables, derivatives with a positive market value, investment in securities and cash.

Financial liabilities include bank borrowings, bonds, obligations related to lease contracts, derivatives with a negative market value and trade payables.

Financial assets and liabilities presented are "non-current" except those with a maturity of less than twelve months from the year-end date. Those with maturities of less than twelve months are presented as "current assets" or "cash equivalents" depending on the circumstances.

(i) *Recognition and measurement of financial assets (excluding derivatives)*

In accordance with IAS 39, "*Financial Instruments: Recognition and Measurement*", financial assets are broken down into four categories:

- assets held-to-maturity (securities' giving entitlement to fixed or fixable payments on set dates, and which the Group is able and intending to hold to maturity);
- loans and receivables (non-derivative financial assets subject to fixed or fixable payments, and which are not quoted on an active market);
- assets held-for-trading (investments and securities bought and held primarily with a view to a short-term resale); and
- assets held for sale (all financial assets not recognized in one of the three previous categories).

Classification depends on the nature and objective of each financial asset and is determined when first recognized.

(ii) *Loans and advances (loans and receivables category)*

When initially recognized, loans and advances are measured at fair value. These financial assets are then carried at amortized cost using the effective interest rate method. Loans and advances are subject to recoverable value tests, carried out whenever there are objective indicators that the recoverable value of these assets would be lower than the carrying value and, at the very least, on each statement of financial position date.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting Policies (continued):

(r) Financial assets and liabilities (continued):

(iii) *Trade receivables (loans and receivables category)*

Trade and other receivables are recorded at fair value (in most cases the same as nominal value) minus any loss of value recorded in a special impairment account. As receivables are due in less than one year, they are not discounted. If there is any indication that these assets may be impaired, they will be subject to an analysis based primarily on the following criteria: age of the receivable, the debtor's financial position and negotiation of a payment schedule. The difference between the carrying amount and the recoverable value is recorded as a provision in net earnings or loss. Impairment may be reversed if the asset regains its value in future periods and the reversal is booked in the same item as the initial provision. Impairment is deemed permanent when the receivable itself is considered to be permanently non-recoverable and written off.

(iv) *Cash and cash equivalents (loans and receivable category)*

Cash and cash equivalents include cash on hand and demand deposits, with a maturity of less than three months, can be liquidated or sold on short notice, and do not bear any significant risk of loss in value. Short-term investments are measured at liquidation value at each end of periods. Changes in liquidation value are recognized in net finance expenses.

(v) *Borrowings and other financial liabilities*

Trade and other debts are initially recorded at fair value, which is generally the same as nominal value. Bank borrowings and other financial liabilities are measured at amortized cost calculated using the effective interest rate method. Interest accrued on borrowings is included in "accounts payable and accrued liabilities" on the statement of financial position. Cash flows linked to short-term recoverable amounts are not discounted. Long-term cash flows are discounted whenever the impact is significant.

(vi) *Recognition and measurement of financial derivatives*

Financial derivatives are held from time to time to manage exposure to fuel, interest rate and foreign exchange risks. Derivatives are initially recorded at fair value and associated transaction costs are booked in net earnings or loss when incurred. After initial recognition, derivatives are measured at fair value based on market prices at each statement of financial position date. Changes in the fair value of these instruments are recorded in net earnings or loss. The Group derecognizes a financial liability when its contractual obligations are discharged, cancelled or expired.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2012 and 2011
(columnar dollars expressed in thousands of Canadian dollars)

1. Accounting Policies (continued):

(s) Borrowing costs:

The Group capitalizes borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets, as a part of the cost of those assets, until such time as the assets are substantially ready for their intended use. The Group identifies a qualifying asset as one that necessarily takes six months or more to get ready for its intended use.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the Group capitalizes the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of these borrowings.

To the extent that the obtaining of a qualifying asset is funded by general borrowings, the Group determines the borrowing costs eligible for capitalization by applying the weighted average cost of borrowings for the period to the expenditures on that asset.

All other borrowing costs are recognized in net earnings or loss in the period in which they are incurred.

(t) Segment reporting:

The Group operates within a single industry and within a single geographical area. All review of operating results and decisions about resources to be allocated are done at a corporate level. Accordingly no segment reporting is presented in these interim consolidated financial statements.

2. Future accounting changes:

(a) IAS 19 *Employee Benefits*:

This standard has been amended to make certain changes to the recognition, presentation and disclosure of defined benefit plans, and becomes effective for the Group beginning April 1, 2013. As a result of these amendments, actuarial gains and losses of defined benefit plans will be immediately recognized in other comprehensive income instead of profit and loss. The option to use the corridor approach to recognize these costs over time will no longer be available. The amendments also introduce the net interest approach to disaggregate defined benefit cost. This is calculated by applying the discount rate used to measure the obligation to the net defined benefit liability (asset). It is expected that these amendments will not have a significant impact on the consolidated financial statements of the Group.

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Notes to the Interim Consolidated Financial Statements (unaudited)
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2. Future accounting changes (continued):

(b) IFRS 9 *Financial Instruments (2010)*:

This standard replaces the guidance in IAS 39 *Financial Instruments: Recognition and Measurement*, on the classification and measurement of financial assets. The Standard eliminates the existing IAS 39 categories of held to maturity, available-for-sale and loans and receivable. Financial assets will be classified into one of two categories on initial recognition: financial assets measured at amortized cost; or financial assets measured at fair value. The Group intends to adopt IFRS 9 (2010) in its financial statements for the annual period beginning on April 1, 2015. The extent of the impact of adoption of IFRS 9 (2010) has not yet been determined.

(c) IFRS 13 *Fair Value Measurement*:

This standard replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Group intends to adopt IFRS 13 prospectively in its financial statements for the annual period beginning on April 1, 2013. The Group does not expect IFRS 13 to have a material impact on the consolidated financial statements.

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3. Property, plant and equipment:

(a) Continuity of property, plant and equipment:

| | Vessels | Berths, Building & Equipment under Finance Lease | Berths Building & Equipment | Land under Finance Lease | Land | Construction in Progress | Total |
|---|------------------|--|-----------------------------------|-----------------------------------|---------------|-----------------------------|------------------|
| Cost: | | | | | | | |
| Balance at April 1, 2011 | 1,077,392 | 426,338 | 42,672 | 5,177 | 13,101 | 28,514 | 1,593,194 |
| Additions | - | 268 | - | - | - | 128,807 | 129,075 |
| Revaluation | - | - | - | 235 | 1,942 | - | 2,177 |
| Disposals | (1,998) | (189) | (85) | - | - | (415) | (2,687) |
| Reclassification | (43) | (99) | 99 | - | - | - | (43) |
| Transfers from construction in progress | 68,289 | 56,965 | 9,826 | - | 471 | (135,551) | - |
| Balance at March 31, 2012 | 1,143,640 | 483,283 | 52,512 | 5,412 | 15,514 | 21,355 | 1,721,716 |
| Additions | - | - | - | - | - | 16,984 | 16,984 |
| Disposals | (2,388) | - | (163) | - | - | - | (2,551) |
| Reclassification | (11) | - | - | - | - | - | (11) |
| Transfers from construction in progress | 12,857 | (2) | 947 | - | - | (13,802) | - |
| Balance at June 30, 2012 | 1,154,098 | 483,281 | 53,296 | 5,412 | 15,514 | 24,537 | 1,736,138 |

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3. Property, plant and equipment (continued):

(a) Continuity of property, plant and equipment (continued):

| | Vessels | Berths, Building & Equipment under Finance Lease | Berths, Building & Equipment | Land under Finance Lease | Land | Construction in Progress | Total |
|----------------------------------|------------------|--|------------------------------------|-----------------------------------|---------------|-----------------------------|------------------|
| Accumulated depreciation: | | | | | | | |
| Balance at April 1, 2011 | - | - | - | - | - | - | - |
| Depreciation for the year | 96,751 | 22,568 | 7,947 | - | - | - | 127,266 |
| Disposals | (1,801) | (189) | (67) | - | - | - | (2,057) |
| Reclassification | - | (99) | 99 | - | - | - | - |
| Balance at March 31, 2012 | 94,950 | 22,280 | 7,979 | - | - | - | 125,209 |
| Depreciation for the period | 24,356 | 5,874 | 2,082 | - | - | - | 32,312 |
| Disposals | (2,352) | - | (152) | - | - | - | (2,504) |
| Balance at June 30, 2012 | 116,954 | 28,154 | 9,909 | - | - | - | 155,017 |
| Net carrying value: | | | | | | | |
| As at April 1, 2011 | 1,077,392 | 426,338 | 42,672 | 5,177 | 13,101 | 28,514 | 1,593,194 |
| As at March 31, 2012 | 1,048,690 | 461,003 | 44,533 | 5,412 | 15,514 | 21,355 | 1,596,507 |
| As at June 30, 2012 | 1,037,144 | 455,127 | 43,387 | 5,412 | 15,514 | 24,537 | 1,581,121 |

(b) Other disclosures - property, plant and equipment:

For the three months ended June 30, 2012 capitalized financing costs during construction amounted to \$0.2 million (June 30, 2011: \$0.4 million) with an average capitalization rate of 5.64% (June 30, 2011: 5.65%). In addition to the construction in progress referenced above, the contractual commitments at June 30, 2012 for assets to be constructed totalled \$14.6 million (March 31, 2012: \$13.1 million).

Depreciation expense for assets under finance lease for the three months ended June 30, 2012 totalled \$5.9 million (June 30, 2011: \$5.3 million).

During the three months ended June 30, 2012, the Company received \$0.3 million (June 30, 2011: \$0.3 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated depreciation of \$11.9 million and \$0.6 million respectively, as at June 30, 2012.

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4. Intangible assets:

(a) Continuity of intangible assets:

| | Acquired Software, Licenses & Rights | Internally Developed Software & Website | Assets under Development | Total |
|---|---|--|-----------------------------|---------------|
| Cost: | | | | |
| Balance at April 1, 2011 | 16,708 | 8,269 | 9,952 | 34,929 |
| Additions | - | - | 13,112 | 13,112 |
| Disposals | - | - | - | - |
| Transfers from assets under development | 6,077 | 2,510 | (8,587) | - |
| Balance at March 31, 2012 | 22,785 | 10,779 | 14,477 | 48,041 |
| Additions | - | - | 4,198 | 4,198 |
| Impairment Loss | - | - | - | - |
| Transfers from assets under development | 146 | 32 | (178) | - |
| Balance at June 30, 2012 | 22,931 | 10,811 | 18,497 | 52,239 |
| Accumulated amortization and impairment: | | | | |
| Balance at April 1, 2011 | - | - | - | - |
| Amortization for the year | 4,050 | 2,233 | - | 6,283 |
| Disposals | - | - | - | - |
| Balance at March 31, 2012 | 4,050 | 2,233 | - | 6,283 |
| Amortization for the period | 1,124 | 565 | - | 1,689 |
| Impairment loss | - | - | - | - |
| Balance at June 30, 2012 | 5,174 | 2,798 | - | 7,972 |
| Net carrying value: | | | | |
| As at April 1, 2011 | 16,708 | 8,269 | 9,952 | 34,929 |
| As a March 31, 2012 | 18,735 | 8,545 | 14,478 | 41,758 |
| As at June 30, 2012 | 17,757 | 8,013 | 18,497 | 44,267 |

(b) Other disclosures - intangible assets:

Capitalized financing costs during construction for intangible assets for the three months ended June 30, 2012 totalled \$0.2 million (June 30, 2011: \$0.1 million).

During the three months ended June 30, 2012, intangible assets totalling \$4.0 million (June 30, 2011: \$2.1 million) were acquired and \$0.2 million (June 30, 2011: \$0.3 million) were internally developed.

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5. Loans:

| Long-term debt: | June 30, 2012 | As at. March 31, 2012 |
|--|---------------|--------------------------|
| 5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate of 5.92%) | 250,000 | 250,000 |
| 6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate of 6.41%) | 250,000 | 250,000 |
| 5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate of 5.06%) | 250,000 | 250,000 |
| 5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate of 5.62%) | 200,000 | 200,000 |
| 6.21% Senior Secured Bonds, Series 08-2, due December 2013 (effective interest rate of 6.33%) | 140,000 | 140,000 |
| 12 Year Loan, maturing March 2020 | | |
| Tranche A (effective interest rate of 5.17%) | 58,125 | 60,000 |
| Tranche B (floating interest rate of 1.41% at June 30, 2012) | 7,500 | 5,625 |
| 12 Year Loan, maturing June 2020 | | |
| Tranche A (effective interest rate of 5.18%) | 60,000 | 61,875 |
| Tranche B (floating interest rate of 1.41% at June 30, 2012) | 7,500 | 5,625 |
| 2.95% Loan, maturing January 2021 (effective interest rate of 3.08%) | 81,000 | 81,000 |
| | 1,304,125 | 1,304,125 |
| Less: Deferred financing costs and unamortized bond discounts | (9,650) | (9,893) |
| Current portion | (9,000) | (9,000) |
| | 1,285,475 | 1,285,232 |

(a) Credit facility:

Draws on this facility totalled \$8.0 million as at June 30, 2012 (March 31, 2012: \$17.7 million), and are shown as short-term debt. Interest expensed during the three months ended June 30, 2012 was \$0.1 million (June 30, 2011: \$0.1 million). Letters of credit outstanding against this facility at June 30, 2012 totalled \$0.1 million (March 31, 2012: \$0.1 million).

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5. Loans (continued):

(b) Debt service reserves:

The Group is required to maintain debt service reserves for the Series 04-1, 04-4, 07-1, 08-1 and 08-2 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 4.98% and 2.95% loans equal to not less than six months forecasted debt service, to be increased under certain conditions.

As at June 30, 2012, debt service reserves of \$35.7 million were held in short-term investments and have been classified as restricted short-term investments on the balance sheet (March 31, 2012: \$35.7 million).

6. Accrued employee future benefits:

During the three months ended June 30, 2012 the Company recognized total defined benefit costs of \$0.3 million (June 30, 2011: \$1.3 million). The amount recognized in the three months ended June 30, 2011 included a cost of \$1.0 million to reflect the actuarial valuation of the residual liability at March 31, 2011 for workers' compensation claims arising from the Workers' Compensation Board deposit class coverage system in which our predecessor entity participated prior to April 1, 2003.

7. Regulated other income:

In May 2012, the *Province of British Columbia* enacted changes to the Act (Bill 20) that among other things, includes reservation fees as a regulated tariff for the purposes of determining adherence to price caps established by the Commissioner effective April 1, 2012. These fees were not regulated by the Commissioner prior to April 1, 2012.

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8. Net finance expenses:

| | Three months ended, | |
|---|---------------------|---------------|
| | June 30, 2012 | June 30, 2011 |
| Finance expenses | | |
| Long-term debt | 17,671 | 18,062 |
| Short-term debt | 139 | 56 |
| Finance leases | 586 | 597 |
| Amortization of deferred financing costs and bond discounts | 243 | 240 |
| Interest capitalized in the cost of qualifying assets | (439) | (491) |
| Interest rate support (a) | (212) | (529) |
| Total finance expenses | 17,988 | 17,935 |
| Finance income | (537) | (671) |
| Net finance expenses | 17,451 | 17,264 |

(a) Interest rate support:

During the years ended March 31, 2012 and 2011, the Government of Canada agreed to provide \$1.6 million and \$1.0 million respectively in the form of interest rate support to the Group for major refurbishment of one vessel in each year. During the quarter ended June 30, 2012, interest rate support recorded as a reduction of interest expense totalled \$0.2 million (June 30, 2011: \$0.5 million) and \$nil as a reduction of capitalized interest (June 30, 2011: \$0.2 million).

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

9. Economic effect of rate regulation:

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

IFRS does not have a standard for rate-regulated activities and therefore does not allow the recognition of regulatory assets and regulatory liabilities that result from the regulated price cap setting process. Regulatory assets generally represent incurred costs that have been deferred for purposes of rate regulation because they are probable of future recovery in tariffs. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes the regulatory assets at June 30, 2012 detailed below are probable of future recovery and that the obligations represented by the regulatory liabilities will be settled through future tariff reductions.

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9. Economic effect of rate regulation (continued):

If the Group was permitted under IFRS to recognize the effects of rate regulation, the following regulatory assets and regulatory liabilities would be shown on the consolidated statement of financial position:

| Regulatory accounts | As at, | |
|---|----------------|----------------|
| | June 30, 2012 | March 31, 2012 |
| Deferred first performance term costs (a): | | |
| Balance – beginning of period | - | 4,775 |
| Current period amortization | - | (4,775) |
| Balance – end of period | - | - |
| Continuing regulatory accounts: | | |
| Deferred fuel costs: | | |
| Balance – beginning of period | 1,256 | (1,790) |
| Fuel costs deferred (including realized hedge gains and losses) | 3,942 | 19,486 |
| (Surcharges collected) | (6,030) | (13,098) |
| Fuel price risk (recoveries from) payments to the Province | (197) | (1,799) |
| Other payments from the Province | (362) | (1,503) |
| Interest payable | 4 | (40) |
| Balance – end of period | (1,387) | 1,256 |
| Tariffs in excess of price cap (b) | - | (2,461) |
| Performance term submission costs | 306 | 327 |
| Total of regulatory accounts | (1,081) | (878) |
| Total regulatory (liabilities) | (1,081) | (878) |
| Current regulatory assets (liabilities) | 82 | (2,379) |
| Total long term regulatory (liabilities) assets | (1,163) | 1,501 |

(a) Deferred first performance term costs:

During the four year period ended March 31, 2012, the Group recovered in tariffs \$19.1 million of costs incurred during the first performance term. These costs primarily consisted of the cost of fuel consumed that was acquired at prices greater than those recovered through tariffs during the first performance term.

(b) Tariffs in excess of price cap:

The Act contains provisions which ensure that if tariffs charged by the Group exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. Tariffs charged to customers on all route groups were below established price caps at both June 30, 2012 and June 30, 2011. At March 31, 2012, tariffs charged to customers on the Major Route Group exceeded the price cap by \$2.5 million.

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9. Economic effect of rate regulation (continued):

If the Group was permitted under IFRS to recognize the affects of rate regulation and to record regulatory assets and regulatory liabilities, total comprehensive income for the three months ended June 30, 2012 would have been \$0.2 million lower (2011: \$1.5 million higher) as detailed below:

| Effect of rate regulation on total comprehensive income | Three months ended, | |
|--|---------------------|---------------|
| | June 30, 2012 | June 30, 2011 |
| First performance term accounts: | | |
| Amortization of deferred performance term costs | - | (1,194) |
| Continuing regulatory accounts: | | |
| Deferred fuel costs | (2,643) | 1,578 |
| Performance term submission costs | (21) | 63 |
| Tariffs in excess of price cap | 2,461 | 1,072 |
| Total (decrease) increase in total comprehensive income | (203) | 1,519 |

10. Related party transactions:

In accordance with the Act, the Group is responsible for paying any expenses that are incurred by the Authority, without charge. During the three months ended June 30, 2012, the Group paid \$20,536 (June 30, 2011: \$32,807) of such expenses.

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

11. Transition to IFRS:

The Group's consolidated financial statements for the year ended March 31, 2013 will be the first annual consolidated financial statements prepared in accordance with IFRS and these interim consolidated financial statements have been prepared as described in note 1, including the application of *First-Time Adoption of International Financial Reporting Standards* ("IFRS 1").

IFRS 1 requires an entity to adopt IFRS in its first annual financial statements prepared in accordance with IFRS by making an explicit and unreserved statement in those financial statements of compliance with IFRS. The Group will make this statement when it issues its fiscal 2013 annual consolidated financial statements.

IFRS 1 also requires that comparative financial information be provided. As a result, the first date at which the Group has applied IFRS is April 1, 2011, the transition date. IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Group will be March 31, 2013. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

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11. Transition to IFRS (continued):

Initial elections upon adoption:

Set forth below are the applicable IFRS 1 exemptions and exceptions applied by the Group in its transition from Canadian generally accepted accounting principles ("GAAP") to IFRS:

IFRS 1 exemption options:

(a) Employee benefits:

IFRS 1 provides the option to either retrospectively apply IAS 19, *Employee Benefits* and recognize all actuarial gains and losses on employee benefit plans in each prior period or, to recognize in opening retained earnings the cumulative gains and losses deferred under Canadian GAAP at the transition date. The Group has elected to recognize all cumulative actuarial gains and losses that existed at its transition date in opening retained earnings. Accordingly, the Group has increased its liability for employee future benefits and decreased retained earnings by \$3.6 million at April 1, 2011. The impact of this change at the transition date and the resulting decrease in amortization of actuarial gains and losses for the three months ended June 30, 2011 and for the year ended March 31, 2012 are shown in the table below:

| Differences from amounts previously reported under Canadian GAAP: | As at, April 1, 2011 | Three months ended, June 30, 2011 | Year ended, March 31, 2012 |
|---|----------------------|-----------------------------------|----------------------------|
| Retained earnings (decrease), beginning of period | - | (3,552) | (3,552) |
| Cumulative actuarial losses recognized | (3,552) | - | - |
| Decrease in amortization of actuarial losses | - | 46 | 217 |
| Retained earnings (decrease), end of period | (3,552) | (3,506) | (3,335) |

(b) Previous GAAP carrying amount as deemed cost:

IFRS 1 provides the option to use as deemed cost at the transition date, the previous GAAP carrying amount of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation. This exemption need not apply to all items. At transition date, an entity must also test for impairment in accordance with IAS 36, each item for which this exemption is used. The Group has elected to recognize all property, plant and equipment and intangible assets that existed at its transition date at previous GAAP carrying amounts, with the exception of land. The carrying amounts of these assets were not in excess of their recoverable amounts and therefore no impairment was recognized. The election of this exemption did not result in a change to the carrying amounts of these assets.

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11. Transition to IFRS (continued):

Initial elections upon adoption (continued):

IFRS 1 exemption options (continued):

(c) Fair value as deemed cost:

IFRS 1 provides the option to measure, at transition date, an item of property, plant and equipment or intangible assets at its fair value and use that fair value as its deemed cost at that date. The Group has elected to recognize all land assets at fair value. Accordingly, the Group has increased property, plant and equipment and retained earnings by \$12.2 million each at April 1, 2011. The impact of this change at the transition date, for the three months ended June 30, 2011, and for the year ended March 31, 2012, is shown in the table below:

| Differences from amounts previously reported under Canadian GAAP: | As at, April 1, 2011 | Three months ended, June 30, 2011 | Year ended, March 31, 2012 |
|---|----------------------|-----------------------------------|----------------------------|
| Retained earnings increase, beginning of period | - | 12,187 | 12,187 |
| Fair value increase in carrying value of land assets | 12,187 | - | 2,177 |
| Retained earnings increase, end of period | 12,187 | 12,187 | 14,364 |

IFRS 1 mandatory exceptions:

(d) Estimates:

The estimates previously made by the Group under Canadian GAAP have not been revised for the application of IFRS except where necessary to reflect any difference in accounting policies.

Significant accounting policy differences:

In addition to the exemptions and exceptions discussed above, the following explains the significant differences between the previous Canadian GAAP policies and the current IFRS policies applied by the Group:

(e) Rate regulation:

The Group followed Accounting Guideline 19 "*Disclosures by Entities Subject to Rate Regulation*" (AcG-19) of the CICA Handbook which established guidelines on certain aspects of the disclosure and presentation of information in the financial statements of entities subject to rate regulation.

In order to recognize the economic effects of rate regulation, timing differences relating to recognition of certain revenues and expenses gave rise to regulatory assets and regulatory liabilities in the financial statements.

IFRS does not currently contain any separate guidance relating to recognition of assets and liabilities that have arisen as a result of rate regulation. Under current IFRS standards, such items have not been recognized on transition.

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11. Transition to IFRS (continued):

Significant accounting policy differences (continued):

(e) Rate regulation (continued):

Accordingly, the Group has derecognized at transition, current regulatory assets of \$3.7 million and long-term regulatory liabilities of \$1.6 million, resulting in a net reduction in retained earnings of \$2.1 million at April 1, 2011. The impact of the derecognition of regulatory assets and regulatory liabilities at the transition date, for the three months ended June 30, 2011, and for the year ended March 31, 2012 are shown in the table below:

| Differences from amounts previously reported under Canadian GAAP: | As at, April 1, 2011 | Three months ended, June 30, 2011 | Year ended, March 31, 2012 |
|---|----------------------|-----------------------------------|----------------------------|
| Derecognition at transition: | | | |
| Current regulatory assets decrease | (3,703) | (3,703) | (3,703) |
| Long-term regulatory liabilities decrease | 1,558 | 1,558 | 1,558 |
| Retained earnings (decrease) – beginning of period | (2,145) | (2,145) | (2,145) |
| Effect of derecognition on net earnings for the period: | | | |
| Vehicle and passenger fares increase | - | (1,017) | 14,487 |
| Ferry service fees (decrease) increase | - | 1,938 | 3,302 |
| Operations expense - fuel expense (increase) | - | (3,604) | (19,487) |
| Administration expense - contracted services (increase) | - | (63) | (94) |
| Amortization expense decrease | - | 1,194 | 4,775 |
| Finance expense decrease | - | 33 | 40 |
| Net earnings (decrease) increase | - | (1,519) | 3,023 |
| Retained earnings (decrease) increase – end of period | (2,145) | (3,364) | 878 |

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11. Transition to IFRS (continued):

Significant accounting policy differences (continued):

(f) Research and training costs:

The Company previously capitalized research and training costs that were directly attributable to assets where these costs were included within the Company's rate-regulated asset base.

Under IAS 16 - *Property, Plant and Equipment* and IAS 38 - *Intangible Assets*, research and training costs do not qualify for capitalization. The impact of expensing research and training costs for the three months ended June 30, 2011 and for the year ended March 31, 2012 are shown in the table below:

| Differences from amounts previously reported under Canadian GAAP: | Three months ended, June 30, 2011 | Year ended, March 31, 2012 |
|---|-----------------------------------|----------------------------|
| Property, plant and equipment (decrease) | (209) | (574) |
| Intangible assets (decrease) | - | (158) |
| Decrease in non-current assets | (209) | (732) |
| Operating expenses increase: | | |
| Operations expense - Salaries, wages, benefits and consulting | - | (594) |
| Administration expense - contracted services | (207) | (130) |
| Total operating expenses increase | (207) | (724) |
| Finance expenses increase | (2) | (8) |
| Retained earnings (decrease) | (209) | (732) |

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11. Transition to IFRS (continued):

Significant accounting policy differences (continued):

(g) Major overhauls and inspections

IAS 16, *Property, Plant and Equipment*, requires each item of property, plant and equipment with a significant cost in relation to the total cost and a different useful life to be depreciated separately. The Group incurs significant costs for periodic inspection and maintenance performed on its vessels at predetermined time intervals to maintain the integrity and efficiency of the vessel and its major components. IFRS requires the costs of these activities that restore the service potential of the vessel's hull, propulsion system and generators to be separately capitalized and depreciated over the period until the next inspection and/or overhaul. Under Canadian GAAP these costs have been expensed as incurred. Timing of inspection and major overhauls vary by class of vessel and are done on a periodic basis every two to five years. At transition, the Group quantified these inspection and major overhaul costs for each vessel and reclassified the carrying value to be depreciated over the lesser of the period to the next scheduled inspection and major overhaul or the remaining useful life of the vessel. There is no change to the cost of maintenance activities and no overall impact to earnings over the life of the vessel, only a timing difference in expense recognition. The impact of capitalizing major overhauls and inspections for the three months ended June 30, 2011, and for the year ended March 31, 2012 are shown in the table below:

| Differences from amounts previously reported under Canadian GAAP: | Three months ended, June 30, 2011 | Year ended, March 31 2012 |
|---|-----------------------------------|---------------------------|
| Property, plant and equipment: | | |
| Major overhauls and inspections capitalized | 7,379 | 20,363 |
| Less: Depreciation expense for the period | (3,739) | (15,353) |
| Property, plant and equipment increase | 3,640 | 5,010 |
| Maintenance expense decrease | 7,379 | 20,361 |
| Loss on disposal | - | 2 |
| Depreciation expense (increase) | (3,739) | (15,353) |
| Retained earnings increase | 3,640 | 5,010 |

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11. Transition to IFRS (continued):

Financial Statement Presentation Changes:

IAS 1, *Financial Statements*, requires an entity to present provisions separately on the face of the consolidated statement of financial position. Accordingly, the following reclassifications were made at the transition date, June 30, 2011, and March 31, 2012:

| Differences from amounts previously reported under Canadian GAAP: | As at, | | |
|--|---------------|---------------|----------------|
| | April 1, 2011 | June 30, 2011 | March 31, 2012 |
| Accounts payable and accrued liabilities decrease | 1,377 | 1,402 | 1,277 |
| Accrued employee costs decrease | 48,194 | 49,164 | 49,204 |
| Provisions increase | 49,571 | 50,566 | 50,481 |

Reconciliations of Canadian GAAP to IFRS for comparative periods:

IFRS 1 requires an entity to provide a reconciliation of equity, comprehensive income and cash flows for all comparative periods presented.

Interest paid is now reported within the statement of cash flows, whereas it was previously disclosed as supplementary information. There are no other material differences between the statement of cash flows reported under Canadian GAAP to the statement of cash flows reported under IFRS.

A reconciliation from Canadian GAAP to IFRS equity as at April 1, 2011, June 30, 2011 and March 31, 2012 is provided below with reference to the changes described above:

Reconciliation of Equity:

| | Note | As at, | | |
|---|------|---------------|---------------|----------------|
| | | April 1, 2011 | June 30, 2011 | March 31, 2012 |
| Canadian GAAP equity | | 308,699 | 303,190 | 311,187 |
| IFRS adjustments to equity: | | | | |
| Employee benefits | a | (3,552) | (3,506) | (3,335) |
| Fair value of land | c | 12,187 | 12,187 | 14,364 |
| Derecognition of regulatory assets/liabilities | e | (2,145) | (3,664) | 878 |
| Research and training | f | - | (209) | (732) |
| Major overhauls and inspections | g | - | 3,640 | 5,010 |
| Total IFRS adjustments to equity | | 6,490 | 8,448 | 16,185 |
| IFRS equity | | 315,189 | 311,638 | 327,372 |

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Three months ended June 30, 2012 and 2011

(columnar dollars expressed in thousands of Canadian dollars)

11. Transition to IFRS (continued):

Reconciliations of Canadian GAAP to IFRS for comparative periods (continued):

Reconciliation of Canadian GAAP to IFRS comprehensive income for the three months ended June 30, 2011 and for the year ended March 31, 2012 is provided below with reference to the changes described above:

Reconciliation of Comprehensive Income:

| | Note | Three months ended, June 30, 2011 | Year ended, March 31, 2012 |
|--|------|--------------------------------------|-------------------------------|
| Canadian GAAP comprehensive (loss) income | | (5,509) | (16,474) |
| Employee benefits | a | 46 | 217 |
| Derecognition of regulatory assets/liabilities | e | (1,519) | 3,023 |
| Research and training costs | f | (209) | (732) |
| Major overhauls and inspections | g | 3,640 | 5,010 |
| Total IFRS adjustments to net earnings | | 1,958 | 7,518 |
| Net (loss) | | (3,351) | (8,956) |
| Other comprehensive income: | | | |
| Revaluation increase of land assets | | - | 2,177 |
| IFRS comprehensive (loss) | | (3,351) | (6,779) |