

Interim Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Three months ended June 30, 2014 and 2013

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

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

| | As at, | |
|---|------------------|------------------|
| | June 30, 2014 | March 31, 2014 |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 42,505 | 71,365 |
| Restricted short-term investments (3(c)) | 32,906 | 35,792 |
| Other short-term investments | 50,535 | 81,006 |
| Trade and other receivables | 16,379 | 16,577 |
| Prepaid expenses | 18,178 | 6,934 |
| Inventories | 26,090 | 25,073 |
| | 186,593 | 236,747 |
| Non-current assets | | |
| Long-term loan receivable | 24,515 | 24,515 |
| Long-term land lease | 31,490 | 31,604 |
| Property, plant and equipment (note 5) | 1,527,100 | 1,539,162 |
| Intangible assets (note 6) | 56,038 | 53,164 |
| | 1,639,143 | 1,648,445 |
| Total assets | 1,825,736 | 1,885,192 |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 35,993 | 48,134 |
| Interest payable on long-term debt | 16,329 | 19,634 |
| Deferred revenue | 19,424 | 14,563 |
| Derivative liabilities | 33 | 5,274 |
| Current portion of long-term debt (note 3) | 24,000 | 270,250 |
| Current portion of accrued employee future benefits | 2,204 | 2,204 |
| Current portion of obligations under finance lease | 1,120 | 1,120 |
| Provisions | 47,956 | 51,801 |
| | 147,059 | 412,980 |
| Non-current liabilities | | |
| Accrued employee future benefits | 16,028 | 15,931 |
| Long-term debt (note 3) | 1,261,642 | 1,066,531 |
| Obligations under finance lease | 44,543 | 44,821 |
| | 1,322,213 | 1,127,283 |
| Total liabilities | 1,469,272 | 1,540,263 |
| Equity | | |
| Share capital | 75,478 | 75,478 |
| Contributed surplus | 25,000 | 25,000 |
| Retained earnings | 260,030 | 246,142 |
| Total equity before reserves | 360,508 | 346,620 |
| Reserves (note 8 (a)) | (4,044) | (1,691) |
| Total equity including reserves | 356,464 | 344,929 |
| Total liabilities and equity | 1,825,736 | 1,885,192 |
| Commitments (note 5(b)) | | |

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Comprehensive Income (unaudited)

(Expressed in thousands of Canadian dollars)

| | Three months ended, | |
|--|---------------------|-----------------|
| | June 30, 2014 | June 30, 2013 |
| Revenue | | |
| Vehicle and passenger fares | 131,372 | 124,383 |
| Ferry service fees | 45,047 | 44,059 |
| Retail | 19,944 | 19,654 |
| Federal-Provincial Subsidy Agreement | 7,089 | 7,093 |
| Fuel surcharges | 4,362 | - |
| Regulated other income | 3,399 | 2,944 |
| Other income | 1,896 | 1,836 |
| Total revenue | 213,109 | 199,969 |
| Expenses | | |
| Operations | 115,024 | 114,178 |
| Maintenance | 16,649 | 15,560 |
| Administration | 7,613 | 7,031 |
| Cost of retail goods sold | 7,989 | 7,725 |
| Depreciation and amortization | 35,234 | 34,313 |
| Total operating expenses | 182,509 | 178,807 |
| Operating profit | 30,600 | 21,162 |
| Net finance and other expenses | | |
| Net finance expense (note 9) | | |
| Finance income | 1,067 | 799 |
| Finance expenses | (17,712) | (17,692) |
| Net finance expense | (16,645) | (16,893) |
| (Loss) gain on disposal of property, plant and equipment | (67) | 4 |
| Net finance and other expenses | (16,712) | (16,889) |
| Net earnings | 13,888 | 4,273 |
| Other comprehensive (loss) income (note 8(b)) | | |
| Items to be reclassified to net earnings | (2,396) | - |
| Total other comprehensive loss | (2,396) | - |
| Total comprehensive income | 11,492 | 4,273 |

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

| | Three months ended, | |
|---|---------------------|---------------|
| | June 30, 2014 | June 30, 2013 |
| Cash flows from operating activities | | |
| Net earnings | 13,888 | 4,273 |
| Items not affecting cash | | |
| Net finance expense | 16,645 | 16,893 |
| Depreciation and amortization | 35,234 | 34,313 |
| Loss (gain) on disposal of property, plant and equipment | 67 | (4) |
| Other non-cash adjustments to property, plant & equipment | (405) | - |
| Changes in | | |
| Long-term accrued employee future benefits | 97 | (271) |
| Derivative assets | - | (13) |
| Derivative liabilities recognized in net earnings | 15 | (12) |
| Provisions | (3,845) | 2,649 |
| Long-term land lease | 114 | 115 |
| Accrued interest costs | 20 | 394 |
| Total non-cash items | 47,942 | 54,064 |
| Movements in operating working capital | | |
| Trade and other receivables | 198 | (651) |
| Prepaid expenses | (11,244) | (5,694) |
| Inventories | (1,017) | (555) |
| Accounts payable and accrued liabilities | (12,141) | (16,762) |
| Deferred revenue | 4,861 | 3,984 |
| Change in non-cash working capital | (19,343) | (19,678) |
| Change attributable to capital asset acquisitions | 6,116 | 7,088 |
| Change in non-cash operating working capital | (13,227) | (12,590) |
| Cash generated from operating activities | 48,603 | 45,747 |
| Interest received | 1,045 | 392 |
| Interest paid | (21,496) | (21,370) |
| Net cash generated by operating activities | 28,152 | 24,769 |

See accompanying notes to the interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Cash Flows (unaudited)

(Expressed in thousands of Canadian dollars)

| | Three months ended, | |
|---|---------------------|-----------------|
| | June 30, 2014 | June 30, 2013 |
| Cash flows from financing activities | | |
| Proceeds from issuance of bonds | 200,000 | - |
| Repayment of long-term debt | (250,000) | - |
| Repayment of finance lease obligations | (278) | (264) |
| Deferred financing costs incurred | (1,315) | - |
| Hedge losses on interest rate forward contracts | (7,652) | - |
| Net cash used in financing activities | (59,245) | (264) |
| Cash flows from investing activities | | |
| Proceeds from disposal of property, plant and equipment | 43 | 15 |
| Purchase of property, plant and equipment and intangible assets | (31,167) | (28,004) |
| Decrease of debt service reserves | 2,886 | - |
| Proceeds from short-term investments | 30,471 | 9,453 |
| Net cash provided by (used in) investing activities | 2,233 | (18,536) |
| Net (decrease) increase in cash and cash equivalents | (28,860) | 5,969 |
| Cash and cash equivalents, beginning of period | 71,365 | 36,641 |
| Cash and cash equivalents, end of period | 42,505 | 42,610 |

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Changes in Equity (unaudited)

(Expressed in thousands of Canadian dollars)

| | Share capital | Contributed surplus | Retained earnings | Total equity before reserves | Reserves (note 8 (a)) | Total equity including reserves |
|---|---------------|---------------------|-------------------|------------------------------|-----------------------|---------------------------------|
| Balance as at March 31, 2013 | 75,478 | 25,000 | 234,187 | 334,665 | 3,233 | 337,898 |
| Net earnings for the three months ended June 30, 2013 | - | - | 4,273 | 4,273 | - | 4,273 |
| Other comprehensive income for the three months ended June 30, 2013 | - | - | - | - | - | - |
| Balance as at June 30, 2013 | 75,478 | 25,000 | 238,460 | 338,938 | 3,233 | 342,171 |
| Balance as at March 31, 2014 | 75,478 | 25,000 | 246,142 | 346,620 | (1,691) | 344,929 |
| Net earnings for the three months ended June 30, 2014 | - | - | 13,888 | 13,888 | - | 13,888 |
| Other comprehensive income for the three months ended June 30, 2014 | - | - | - | - | (2,396) | (2,396) |
| Hedge losses reclassified to net earnings | - | - | - | - | 43 | 43 |
| Balance as at June 30, 2014 | 75,478 | 25,000 | 260,030 | 360,508 | (4,044) | 356,464 |

See accompanying notes to the interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2014 and 2013
(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 for 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:

Except as described in note 1(f), the same accounting policies and methods of computation are followed in the interim consolidated financial statements as compared with the annual consolidated financial statements for the year ended March 31, 2014.

(a) 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, 2014 and 2013 comprise the Company and its subsidiaries (together referred to as the “Group”).

(b) 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 (IAS) 34 *Interim Financial Reporting*.

These interim consolidated financial statements should be read in conjunction with the Group’s annual consolidated financial statements and the notes thereto for the year ended March 31, 2014.

These interim consolidated financial statements were approved by the Board of Directors on August 21, 2014.

(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, 2014 and 2013
(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) Embedded derivatives:

As at June 30, 2014, the Group has no embedded derivatives that meet the requirements of IAS 39 *Financial Instruments: Recognition and Measurement*, which would require that they are separated from host contracts and valued separately at fair value.

(f) Adoption of new accounting standards:

International Financial Reporting Interpretations Committee (IFRIC) 21 *Levies*:

Effective April 1, 2014, the Group retrospectively applied IFRIC 21, *Levies*. This IFRIC provides guidance on when to recognize a liability for a levy imposed by a government. The application of this IFRIC has had no impact on the Group's interim consolidated financial statements.

2. Future accounting changes:

IFRS 9 Financial Instruments:

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 receivables. 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.

In November 2013, the International Accounting Standards Board issued amendments to IFRS 9. The amendments include changes which will align hedge accounting more closely with risk management activities. Although the amendments do not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness; more hedging strategies used for risk management will qualify for hedge accounting. The amendments removed the mandatory effective date of January 1, 2015 for adoption of IFRS 9 with a new date to follow. In February 2014, the IASB decided on a mandatory effective date for IFRS 9 of January 1, 2018. Early adoption of IFRS 9 is permitted. The Group does not expect the application of IFRS 9 to have any impact on its consolidated financial statements and is considering the timing of its adoption.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
 Three months ended June 30, 2014 and 2013
 (columnar dollars expressed in thousands of Canadian dollars)

3. Loans:

| Long-term debt: | June 30, 2014 | As at. March 31, 2014 |
|---|---------------|--------------------------|
| 5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate of 5.92%) | - | 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 |
| 4.70% Senior Secured Bonds, Series 13-1, due October 2043 (effective interest rate of 4.75%) | 200,000 | 200,000 |
| 4.29% Senior Secured Bonds, Series 14-1, due April 2044 (effective interest rate of 4.45%) | 200,000 | - |
| 12 Year Loan, maturing March 2020 | | |
| Tranche A (effective interest rate of 5.17%) | 43,125 | 45,000 |
| Tranche B (floating interest rate of 1.57% at June 30, 2014) | 22,500 | 20,625 |
| 12 Year Loan, maturing June 2020 | | |
| Tranche A (effective interest rate of 5.18%) | 45,000 | 46,875 |
| Tranche B (floating interest rate of 1.58% at June 30, 2014) | 22,500 | 20,625 |
| 2.95% Loan, maturing January 2021 (effective interest rate of 3.08%) | 63,000 | 63,000 |
| | 1,296,125 | 1,346,125 |
| Less: Deferred financing costs and unamortized bond discounts | (10,483) | (9,344) |
| Current portion | (24,000) | (270,250) |
| | 1,261,642 | 1,066,531 |

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Three months ended June 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

3. Loans (continued):

(a) Bonds:

On April 28, 2014, the Group issued \$200 million of senior secured bonds. The Series 14-1 bonds bear interest at 4.289% per annum, payable semi-annually and will mature April 28, 2044. A debt service reserve for these bonds has been established in the amount of \$4.3 million. The net proceeds from the sale of the bonds were, together with additional cash on hand, used to repay the \$250 million Series 04-1 bonds, which matured on May 27, 2014 and to fund the related debt service reserve.

(b) Credit facility:

There were no draws on the \$155.0 million credit facility as at June 30, 2014 (March 31, 2014: nil). Interest expensed during the three months ended June 30, 2014 was \$0.1 million (June 30, 2013: \$0.1 million). Letters of credit outstanding against this facility at June 30, 2014 totalled \$0.3 million (March 31, 2014: \$0.1 million).

(c) Debt service reserves:

The Group is required to maintain debt service reserves for the Series 04-4, 07-1, 08-1, 13-1, and 14-1 bonds equal to not less than six months forecast debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 12 year loans and the 2.95% loan equal to not less than six months forecast debt service, to be increased under certain conditions.

As a result of their redemption on May 27, 2014, the Group is no longer required to maintain a debt service reserve for the Series 04-1 bonds. As at June 30, 2014, debt service reserves of \$32.9 million were held in short-term investments and have been classified as restricted short-term investments on the statement of financial position (March 31, 2014: \$35.8 million).

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
 Three months ended June 30, 2014 and 2013
 (columnar dollars expressed in thousands of Canadian dollars)

4. Financial instruments:

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

| | As at June 30, 2014 | | As at March 31, 2014 | |
|---|------------------------|----------------------|-------------------------|----------------------|
| | Carrying Value | Approx Fair Value | Carrying Value | Approx Fair Value |
| Available for sale ¹ | | | | |
| Cash | 20,396 | 20,396 | 11,783 | 11,783 |
| Financial assets/liabilities at fair value through net earnings or loss ² | | | | |
| Cash equivalents | 7,109 | 7,109 | 3 | 3 |
| Derivative liabilities | 33 | 33 | 7 | 7 |
| Financial assets/liabilities at fair value through other comprehensive income ³ | | | | |
| Derivative liabilities | - | - | 5,267 | 5,267 |
| Held-to-maturity ⁴ | | | | |
| Cash equivalents | 15,000 | 15,000 | 59,579 | 59,579 |
| Restricted short-term investments | 32,906 | 32,906 | 35,792 | 35,792 |
| Other short-term investments | 50,535 | 50,535 | 81,006 | 81,006 |
| Loans and receivables ⁴ | | | | |
| Trade and other receivables | 16,379 | 16,379 | 16,577 | 16,577 |
| Long-term loan receivable ⁵ | 24,515 | 24,515 | 24,515 | 24,515 |
| Other financial liabilities ⁴ | | | | |
| Accounts payable and accrued liabilities | 35,993 | 35,993 | 48,134 | 48,134 |
| Interest payable on long-term debt | 16,329 | 16,329 | 19,634 | 19,634 |
| Provisions | 47,956 | 47,956 | 51,801 | 51,801 |
| Long-term debt, including current portion ^{6,7} | 1,285,642 | 1,487,296 | 1,336,781 | 1,515,137 |

¹ Measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the statement of financial position. Due to the nature of this financial instrument, carrying value approximates fair value.

² Measured at fair value with all gains and losses included in net earnings in the period in which they arise. Fair values for the derivative liabilities have been estimated using period-end market rates. These fair values approximate the amount that the Group would pay to settle the contract at the date of the statement of financial position.

³ If the hedge is effective, measured at fair value with all gains and losses initially included in other comprehensive income in the period in which they arise and subsequently in net earnings or loss when realized or when the hedge ceases to be effective. If the hedge is ineffective, measured at fair value with all gains and losses recognized in net earnings or loss. Fair values for the derivative liabilities have been estimated using period-end market rates. These fair values approximate the amount that the Group would pay to settle the contract at the date of the statement of financial position.

⁴ Measured at amortized cost. Due to the nature of these financial instruments and/or short-term maturity of these financial instruments, carrying value approximates fair value except as noted.

⁵ Measured at amortized cost. Carrying value approximates fair value as the rate of return is variable and is expected to return a market rate of interest.

⁶ Carrying value is measured at amortized cost using the effective interest rate method.

⁷ Fair value is calculated by discounting the future cash flows of each debt issue at the estimated yield to maturity for the same or similar issues at the date of the statement of financial position, or by using available quoted market prices.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
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 (columnar dollars expressed in thousands of Canadian dollars)

4. Financial instruments (continued):

The following items shown in the consolidated statements of financial position at June 30, 2014 and March 31, 2014 are measured at fair value on a recurring basis using level 1 or 2 inputs. The fair value of the financial assets and liabilities at June 30, 2014 and at March 31, 2014, using level 3 inputs, was \$nil.

| | As at June 30, 2014 | | As at March 31, 2014 | |
|--|------------------------|--------------------|-------------------------|--------------------|
| | Level 1 | Level 2 | Level 1 | Level 2 |
| Asset (liability): | | | | |
| Cash ¹ | 20,396 | - | 11,783 | - |
| Cash equivalents ¹ | 7,109 | - | 3 | - |
| Derivatives ² | - | (33) | - | (5,274) |
| Long-term debt, including current portion ² | - | (1,487,296) | - | (1,515,137) |
| | 27,505 | (1,487,329) | 11,786 | (1,520,411) |

¹ Classified in level 1 as the measurement inputs are derived from observable, unadjusted quoted prices in active markets for identical assets.

² Classified in level 2 as the significant measurement inputs used in the valuation models are indirectly observable in active markets (derived from prices).

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 market prices are not available, fair values are estimated using discounted cash flow analysis based on the Group's current borrowing rate for similar borrowing arrangements.

No amounts have been reclassified into or out of fair value classifications in the three months ended June 30, 2014. Financial assets have been pledged as security for liabilities under the master trust indenture. The Group does not hold any multiple embedded derivative financial assets or liabilities. No loans or receivables or financial liabilities have been categorized as fair value through net earnings or loss.

As at June 30, 2014, all available for sale and held-for-trading financial instruments are classified as level 1 in the fair value hierarchy with quoted prices in active markets.

During the three months ended June 30, 2014, no profits resulting from the use of valuation techniques used to measure level 2 or 3 instruments in the fair value hierarchy (i.e. those with no active market price) have been recognized.

The Group may use derivative instruments to hedge its exposure to fluctuations in fuel prices, interest rates and foreign currency exchange rates. The fair value of commodity derivatives reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that the Group would receive or pay should the derivative contracts be terminated at the stated dates.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
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 (columnar dollars expressed in thousands of Canadian dollars)

5. 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 March 31, 2014 | 1,225,140 | 548,765 | 72,487 | 5,559 | 15,887 | 25,734 | 1,893,572 |
| Additions | - | - | - | - | - | 21,387 | 21,387 |
| Disposals | (117) | (53) | (80) | - | - | (64) | (314) |
| Transfers from construction in progress | 8,648 | 8,959 | 1,238 | - | - | (18,845) | - |
| Balance at June 30, 2014 | 1,233,671 | 557,671 | 73,645 | 5,559 | 15,887 | 28,212 | 1,914,645 |
| Accumulated depreciation: | | | | | | | |
| Balance at March 31, 2014 | 260,915 | 69,470 | 24,025 | - | - | - | 354,410 |
| Depreciation for the period | 24,808 | 6,295 | 2,236 | - | - | - | 33,339 |
| Disposals | (116) | (53) | (35) | - | - | - | (204) |
| Balance at June 30, 2014 | 285,607 | 75,712 | 26,226 | - | - | - | 387,545 |
| Net carrying value: | | | | | | | |
| As at March 31, 2014 | 964,225 | 479,295 | 48,462 | 5,559 | 15,887 | 25,734 | 1,539,162 |
| As at June 30, 2014 | 948,064 | 481,959 | 47,419 | 5,559 | 15,887 | 28,212 | 1,527,100 |

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
Three months ended June 30, 2014 and 2013
(columnar dollars expressed in thousands of Canadian dollars)

5. Property, plant and equipment (continued):

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

During the three months ended June 30, 2014, capitalized financing costs during construction amounted to \$0.3 million (June 30, 2013: \$0.3 million) with an average capitalization rate of 5.43% (June 30, 2013: 5.64%). In addition to the construction in progress referenced above, the contractual commitments at June 30, 2014 for assets to be constructed totalled \$46.9 million (March 31, 2014: \$25.9 million).

During the three months ended June 30, 2014, the Group received \$0.3 million (June 30, 2013: \$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 \$1.4 million respectively, as at June 30, 2014.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)
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 (columnar dollars expressed in thousands of Canadian dollars)

6. Intangible assets:

(a) Continuity of intangible assets:

| | Acquired software, licenses & rights | Internally developed software & website | Assets under development | Total |
|---|---|--|-----------------------------|---------------|
| Cost: | | | | |
| Balance at March 31, 2014 | 31,373 | 11,516 | 30,223 | 73,112 |
| Additions | - | - | 4,769 | 4,769 |
| Transfers from assets under development | 272 | - | (272) | - |
| Balance at June 30, 2014 | 31,645 | 11,516 | 34,720 | 77,881 |
| Accumulated amortization and impairment: | | | | |
| Balance at March 31, 2014 | 12,902 | 7,046 | - | 19,948 |
| Amortization for the period | 1,281 | 614 | - | 1,895 |
| Balance at June 30, 2014 | 14,183 | 7,660 | - | 21,843 |
| Net carrying value: | | | | |
| As at March 31, 2014 | 18,471 | 4,470 | 30,223 | 53,164 |
| As at June 30, 2013 | 17,462 | 3,856 | 34,720 | 56,038 |

(b) Other disclosures - intangible assets:

Capitalized financing costs during construction for intangible assets for the three months ended June 30, 2014 totalled \$0.4 million (June 30, 2013: \$0.4 million) with an average capitalization rate of 5.43% (June 30, 2013: 5.64%).

During the three months ended June 30, 2014, intangible assets totalling \$4.8 million (June 30, 2013: \$2.7 million) were acquired and \$nil (June 30, 2013: \$0.1 million) were internally developed.

BRITISH COLUMBIA FERRY SERVICES INC.

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7. Accrued employee future benefits:

During the three months ended June 30, 2014 the Group recognized total defined benefit costs of \$0.4 million (June 30, 2013: \$0.4 million).

8. Other comprehensive (loss) income:

(a) Continuity of reserves:

| | Land revaluation reserves | Employee future benefit revaluation reserves | Hedging reserves ¹ | Total |
|---|---------------------------------|--|----------------------------------|----------------|
| Balance at March 31, 2014 | 3,245 | 104 | (5,040) | (1,691) |
| Hedge losses on interest rate forward contracts | - | - | (2,396) | (2,396) |
| Hedge losses reclassified to net earnings in the period | - | - | 43 | 43 |
| Balance at June 30, 2014 | 3,245 | 104 | (7,393) | (4,044) |

(b) Other comprehensive (loss) income:

| | Three months ended June 30, | |
|---|--------------------------------|----------|
| | 2014 | 2013 |
| Items to be reclassified to net earnings: | | |
| Hedge loss on interest rate forward contracts ¹ (note 8 (a)) | (2,396) | - |
| Total other comprehensive (loss) | (2,396) | - |

¹ During the quarter ended June 30, 2014, the Group refinanced a portion of the Series 04-1 Bonds which matured in May 2014 by issuing a 30 year Cdn denominated fixed-rate bullet bond. The interest on the new bonds is based on the Government of Canada ("GoC") 30 year Cdn bond plus an applicable corporate spread. As at March 31, 2014, the Group had entered into interest rate forward contracts with a total notional value of \$160 million to reduce its exposure to changes in the GoC 30 year Cdn bond benchmark interest rate and applied hedge accounting. These agreements settled in April 2014 and the impact on net earnings or loss will occur over the next 30 years as the interest on the bond is expensed. The hedge loss recognized on these contracts was \$7.6 million with \$5.3 million recognized in the year ended March 31, 2014 and a further \$2.3 million recognized in the quarter ended June 30, 2014. The effective portion of this loss of \$7.4 million has been recognized in other comprehensive income and will be subsequently reclassified to net earnings. The ineffective portion of \$0.2 million was recognized in net earnings during the year ended March 31, 2014. During the quarter ended June 30, 2014, the Group reclassified \$0.1 million of the hedge loss to net earnings.

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Three months ended June 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

9. Net finance expense:

| | Three months ended, | |
|---|---------------------|---------------|
| | June 30, 2014 | June 30, 2013 |
| Finance expenses | | |
| Long-term debt | 17,607 | 17,498 |
| Short-term debt | 87 | 119 |
| Finance leases | 499 | 511 |
| Amortization of deferred financing costs and bond discounts | 219 | 247 |
| Interest capitalized in the cost of qualifying assets | (700) | (683) |
| Total finance expenses | 17,712 | 17,692 |
| Finance income | (1,067) | (799) |
| Net finance expense | 16,645 | 16,893 |

10. Economic effect of rate regulation:

The Group is regulated by the Commissioner to ensure, among other things, that tariffs are fair and reasonable. 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 14 is an interim standard that addresses the accounting for regulatory deferral accounts; however, it does not allow the recognition of regulatory assets and regulatory liabilities that result from the regulated price cap setting process for entities that have already transitioned to IFRS. As a result, the Group is not permitted to recognize its regulatory assets and regulatory liabilities in its consolidated statements of financial position.

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, 2014 detailed below are probable of future recovery.

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10. 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 statements of financial position:

| Regulatory accounts | As at, | |
|--|---------------|----------------|
| | June 30, 2014 | March 31, 2014 |
| Deferred fuel costs : | | |
| Balance – beginning of period | 6,150 | (1,415) |
| Fuel costs deferred | 3,960 | 14,521 |
| Surcharges collected | (4,360) | (2,690) |
| Fuel price risk recoveries from the Province | (377) | (1,675) |
| Other payments from the Province | (328) | (1,396) |
| Tariffs in excess of price cap (a) | - | (1,195) |
| Balance – end of period | 5,045 | 6,150 |
| Performance term submission costs | 143 | 163 |
| Total of regulatory accounts | 5,188 | 6,313 |
| Total regulatory assets | 5,188 | 6,313 |
| Current regulatory assets | 82 | 82 |
| Total long term regulatory assets | 5,106 | 6,231 |

(a) 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. At March 31, 2014, tariffs charged to customers exceeded the price cap by \$1.2 million. In accordance with the Commissioner's Memorandum 45, this \$1.2 million has been applied to reduce the deferred fuel costs account balance. Tariffs charged to customers were below established price caps at June 30, 2014.

BRITISH COLUMBIA FERRY SERVICES INC.

Notes to the Interim Consolidated Financial Statements (unaudited)

Three months ended June 30, 2014 and 2013

(columnar dollars expressed in thousands of Canadian dollars)

10. 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, 2014 would have been \$1.1 million lower (2013: \$0.7 million lower) as detailed below:

| Effect of rate regulation on total comprehensive income | Three months ended, | |
|--|---------------------|---------------|
| | June 30, 2014 | June 30, 2013 |
| Regulatory accounts: | | |
| Deferred fuel costs | (1,105) | 2,102 |
| Performance term submission costs | (20) | (21) |
| Tariffs in excess of price cap | - | (2,752) |
| Total decrease in total comprehensive income | (1,125) | (671) |

11. 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, 2014, the Group paid \$18,380 (June 30, 2013: \$18,214) 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.