Interim Consolidated Financial Statements of

BRITISH COLUMBIA FERRY SERVICES INC.

Three months ended June 30, 2016 and 2015

(unaudited)

BRITISH COLUMBIA FERRY SERVICES INC.

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

	As at	
	June 30, 2016	March 31, 2016
Assets		
Current assets		
Cash and cash equivalents	78,093	79,113
Restricted short-term investments (note 3(b))	31,891	31,986
Other short-term investments	57,749	61,464
Trade and other receivables	21,180	16,249
Prepaid expenses	17,076	8,550
Inventories	25,669	23,988
	231,658	221,350
Non-current assets		
Loan receivable	24,515	24,515
Land lease	30,573	30,688
Property, plant and equipment (note 6)	1,543,791	1,539,957
Intangible assets (note 7)	87,931	82,741
	1,686,810	1,677,901
Total assets	1,918,468	1,899,251
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	46,445	53,575
Interest payable on long-term debt	16,053	18,262
Deferred revenue	23,106	18,883
Derivative liabilities (note 8)	5,230	17,879
Current portion of long-term debt (note 3)	24,000	24,000
Current portion of accrued employee future benefits	1,900	1,900
Current portion of obligations under finance lease	1,531	1,514
Provisions	54,725	53,321
	172,990	189,334
Non-current liabilities		
Accrued employee future benefits	19,268	19,361
Long-term debt (note 3)	1,214,455	1,218,106
Obligations under finance lease	41,614	42,003
Other liabilities	1,500	1,500
	1,276,837	1,280,970
Total liabilities	1,449,827	1,470,304
Equity		
Share capital	75,478	75,478
Contributed surplus	25,000	25,000
Retained earnings	379,677	352,692
Total equity before reserves	480,155	453,170
Reserves (note 10(a))	(11,514)	(24,223)
Total equity including reserves	468,641	428,947
Total liabilities and equity	1,918,468	1,899,251

Commitments (note 6(b))

See accompanying notes to the interim consolidated financial statements.

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Comprehensive Income (unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended June 30	
	2016	2015
Revenue		
Vehicle and passenger fares	158,364	147,415
Ferry service fees	42,156	41,259
Net retail (note 11)	13,711	12,675
Federal-Provincial Subsidy Agreement	7,289	7,182
Fuel rebates (note 15)	(4,699)	(1,626)
Other income	2,378	2,143
Total revenue	219,199	209,048
Expenses (note 12)		
Operations	112,712	112,230
Maintenance	21,073	20,592
Administration	8,027	7,984
Depreciation and amortization	36,840	35,111
Total operating expenses	178,652	175,917
Operating profit	40,547	33,131
Net finance and other expenses		
Net finance expense (note 13)		
Finance income	1,035	897
Finance expenses	(14,412)	(15,242)
Net finance expense	(13,377)	(14,345)
(Loss) gain on disposal and revaluation of property, plant and equipment, intangible assets and inventory	(185)	11
Net finance and other expenses	(13,562)	(14,334)
Net earnings	26,985	18,797
Other comprehensive income (note 10(b))		
Items to be reclassified to net earnings	10,328	3,458
Total other comprehensive income	10,328	3,458
Total comprehensive income	37,313	22,255

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	
	2016	2015
Cash flows from operating activities		
Net earnings	26,985	18,797
Items not affecting cash		
Net finance expense	13,377	14,345
Depreciation and amortization	36,840	35,111
Loss (gain) on disposal and revaluation of property, plant and equipment, intangible assets and inventory	185	(11)
Other non-cash adjustments to property, plant and equipment	(345)	79
Changes in		
Accrued employee future benefits	(93)	(202)
Derivative liabilities recognized in net earnings	(1)	23
Provisions	1,404	1,992
Long-term land lease	115	114
Accrued financing costs	316	514
Total non-cash items	51,798	51,965
Movements in operating working capital		
Trade and other receivables	(4,931)	(413)
Prepaid expenses	(8,526)	(9,818)
Inventories	(1,681)	(702)
Accounts payable and accrued liabilities	(7,130)	(6,794)
Deferred revenue	4,223	4,868
Change in non-cash working capital	(18,045)	(12,859)
Change attributable to capital asset acquisitions	(1,990)	(3,142)
Change in non-cash operating working capital	(20,035)	(16,001)
Cash generated from operating activities	58,748	54,761
Interest received	704	391
Interest paid	(18,316)	(18,494)
Net cash generated by operating activities	41,136	36,658

BRITISH COLUMBIA FERRY SERVICES INC.

Interim Consolidated Statements of Cash Flows (unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended June 30	
	2016	2015
Cash flows from financing activities		
Repayment of long-term debt	(3,750)	(3,750)
Repayment of finance lease obligations	(372)	(287)
Net cash used in financing activities	(4,122)	(4,037)
Cash flows from investing activities		
Proceeds from disposal of property, plant and equipment	63	12
Purchase of property, plant and equipment and intangible assets	(41,907)	(32,273)
Changes in debt service reserve	95	95
Net proceeds from short-term investments	3,715	4,019
Net cash used in investing activities	(38,034)	(28,147)
Net (decrease) increase in cash and cash equivalents	(1,020)	4,474
Cash and cash equivalents, beginning of period	79,113	65,574
Cash and cash equivalents, end of period	78,093	70,048

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 10(a))	Total equity including reserves
Balance as at March 31, 2015	75,478	25,000	289,177	389,655	(11,450)	378,205
Net earnings	-	-	18,797	18,797	-	18,797
Other comprehensive income	-	-	-	-	2,827	2,827
Realized hedge losses recognized in fuel swaps	-	-	-	-	631	631
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	62	62
Balance as at June 30, 2015	75,478	25,000	307,974	408,452	(7,930)	400,522
Balance as at March 31, 2016	75,478	25,000	352,692	453,170	(24,223)	428,947
Net earnings	-	-	26,985	26,985	-	26,985
Other comprehensive income	-	-	-	-	10,328	10,328
Realized hedge losses recognized in fuel swaps	-	-	-	-	2,319	2,319
Hedge losses on interest rate forward contract reclassified to net earnings	-	-	-	-	62	62
Balance as at June 30, 2016	75,478	25,000	379,677	480,155	(11,514)	468,641

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:

These interim financial statements do not include all disclosures normally provided in annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and the related notes for the year ended March 31, 2016, as they follow the same accounting policies, unless otherwise indicated.

(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 as at and for the three months ended June 30, 2016 and 2015 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 were approved by the Board of Directors on August 18, 2016.

(c) Basis of measurement:

These interim consolidated financial statements have been prepared using the historical cost method, except for land, land under finance lease, derivatives, and cash and cash equivalents, which are measured at fair value.

1. Accounting policies (continued):

(d) Functional and presentation currency:

These interim consolidated financial statements are presented in Canadian dollars ("CAD") which is the Group's functional currency. All tabular financial data is presented in thousands of Canadian dollars.

(e) Revenues:

Revenue from fuel surcharges, passenger fares and vehicles fares, which include reservation fees, is recognized when transportation is provided. Payments for fares sold in advance of providing transportation are included in the statement of financial position as deferred revenue. These advance payments include prepaid vehicle and passenger fares, assured loading tickets and reservation fees.

Ferry service fees and federal-provincial subsidies are recognized as revenue as services specified in the related agreements with the Province are performed.

Net retail revenue consists primarily of food services and gift shop sales less the cost of goods sold. 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.

(f) Comparative figures:

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

2. Adoption of new and amended standards and interpretations:

(a) Changes in accounting policies:

The International Accounting Standards Board ("IASB") and International Financial Reporting Interpretations Committee have issued the following standards, amendments or interpretations to existing standards that were applied by the Group during the three months ended June 30, 2016:

Amendments to IAS 1 *Presentation of Financial Statements*:

The IASB has published amendments to IAS 1 *Presentation of Financial Statements,* to improve the effectiveness of presentation and disclosure in financial reports, with the objective of reducing immaterial note disclosures. The amendments are effective for annual periods beginning on or after January 1, 2016. The application of these amendments did not have any impact on the Group's interim consolidated financial statements. Any immaterial disclosures are expected to be removed from the Group's annual consolidated financial statements.

2. Adoption of new and amended standards and interpretations (continued):

(a) Changes in accounting policies (continued):

Amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets:*

The IASB has issued *Clarification of Acceptable Methods of Depreciation and Amortization*. The amendments clarify that a revenue-based depreciation method is not considered to be an appropriate manifestation of consumption because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The amendments apply prospectively and are effective for annual periods beginning on or after January 1, 2016. The application of these amendments did not have any impact on the Group's interim consolidated financial statements.

Amendments to IAS 7 *Statement of Cash Flows*:

On January 29, 2016, the IASB published amendments to IAS 7 *Statement of Cash Flows*. The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities. These amendments require a disclosure of changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The mandatory effective date of amendments to IAS 7 is for annual periods beginning on or after January 1, 2017. The Group early adopted effective April 1, 2016. The application of IAS 7 did not have any impact on the Group's interim consolidated financial statements, other than additional disclosure as presented in note 4.

(b) Future changes in accounting policies:

IFRS 15 *Revenue from Contracts with Customers***:**

IFRS 15 *Revenue from Contracts with Customers* will replace IAS 11 *Construction Contracts* and IAS 18 *Revenue*. It provides a single, principles based five-step model to be applied to all contracts with customers. IFRS 15 also requires additional disclosures. The mandatory effective date of IFRS 15 is for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Group is in the process of assessing the impact of the application of IFRS 15 on its consolidated financial statements.

IFRS 9 *Financial Instruments (2014):*

On July 24, 2014, the IASB issued the completed version of IFRS 9. IFRS 9 (2014) introduces a new expected credit loss model for calculating impairment, and incorporates the guidance on the classification and measurement of financial assets and the final general hedge accounting requirements originally published in IFRS 9 (2013). The mandatory effective date of IFRS 9 (2014) is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. Early adoption is permitted. The Group is in the process of assessing the impact of the application of IFRS 9 (2014) on its consolidated financial statements.

2. Adoption of new and amended standards and interpretations (continued):

(b) Future changes in accounting policies (continued):

IFRS 16 *Leases*:

On January 13, 2016, the IASB issued IFRS 16 *Leases,* which will replace IAS 17 *Leases*. The standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. The standard is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted if IFRS 15 *Revenue from Contracts with Customers,* has also been applied. The Group is in the process of assessing the impact of the application of IFRS 16 on its consolidated financial statements.

(Tabular amounts expressed in thousands of Canadian dollars)

3. Loans:

	As at	
Long-term debt:	June 30, 2016	March 31, 2016
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	200,000
12 Year Loan, maturing March 2020		
Tranche A (effective interest rate of 5.17%)	28,125	30,000
Tranche B (floating interest rate of 1.19% at June 16, 2016)	22,500	22,500
12 Year Loan, maturing June 2020		
Tranche A (effective interest rate of 5.18%)	30,000	31,875
Tranche B (floating interest rate of 1.19% at June 23, 2016)	22,500	22,500
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	45,000	45,000
	1,248,125	1,251,875
Less: Unamortized deferred financing costs and bond discounts	(9,670)	(9,769)
Current portion	(24,000)	(24,000)
Total	**1,214,455**	**1,218,106**

3. Loans (continued):

(a) Credit facility:

The Group has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of $155.0 million, was renewed on March 15, 2016 to extend the maturity date to April 20, 2021. There were no draws on this credit facility as at June 30, 2016 and as at March 31, 2016. There was no interest expensed during the three months ended June 30, 2016 and June 30, 2015. Letters of credit outstanding against this facility as at June 30, 2016 totalled $0.1 million (March 31, 2016: $0.3 million).

(b) Debt service reserves:

Long-term debt agreements require the Group to maintain debt service reserves equal to a minimum of six months of interest payments, to be increased under certain conditions. As at June 30, 2016, debt service reserves of $31.9 million were held in short-term investments and have been classified as restricted short-term investments on the statements of financial position (March 31, 2016: $32.0 million).

(c) Debt service coverage:

Debt service coverage (earnings before interest, taxes, depreciation, amortization, and rent) is required to be at least 1.25 times the debt service cost under the credit facility agreement. As at June 30, 2016, the debt service coverage ratio was 3.22.

In addition, there are other covenants contained in the Master Trust Indenture (“MTI”) (May 2004) available at www.SEDAR.com. The Group was in compliance with all of its covenants at June 30, 2016 and at March 31, 2016.

(d) 2.09% Loan:

On November 12, 2015, the Group entered into a loan agreement with KfW, a German export credit bank. This loan agreement is secured under the MTI and allows for three loans of up to $45.3 million each. These amortizing loans will be repaid over a 12-year term and bear an interest rate of 2.09% per annum. Receipt of proceeds from the loans will coincide with the conditional acceptance of each of the three new Salish Class vessels from the shipyard and the net proceeds will be used to partially finance the Group’s purchase of these vessels. As at June 30, 2016, no amounts were drawn under the loan agreement.

(Tabular amounts expressed in thousands of Canadian dollars)

4. Liabilities arising from financing activities:

Continuity of liabilities arising from financing activities:

	Long-term debt	Obligations under finance lease	Interest payable on long-term debt
Balance at March 31, 2016			
Current	24,000	1,514	18,262
Non-current	1,218,106	42,003	-
	1,242,106	43,517	18,262
Additions	-	-	15,505
Payments	(3,750)	(372)	(17,714)
Amortization of debt issue costs	99	-	-
Balance at June 30, 2016	1,238,455	43,145	16,053
Current	24,000	1,531	16,053
Non-current	1,214,455	41,614	-
Balance at June 30, 2016	1,238,455	43,145	16,053

5. Financial instruments:

The carrying values of the Group's financial instruments approximate fair value as at June 30, 2016 and March 31, 2016 for all financial instruments except for long-term debt.

	As at June 30, 2016		As at March 31, 2016	
	Carrying Value	Approx Fair Value	Carrying Value	Approx Fair Value
Long-term debt, including current portion [1]	1,238,455	1,582,193	1,242,106	1,529,186

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

Carrying value is measured at amortized cost using the effective interest rate method. 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 statements of financial position, or by using available quoted market prices.

(Tabular amounts expressed in thousands of Canadian dollars)

5. Financial instruments (continued):

The following items shown in the consolidated statements of financial position as at June 30, 2016 and March 31, 2016 are carried at fair value on a recurring basis using level 1 or 2 inputs. There were no financial assets and liabilities at June 30, 2016 or at March 31, 2016, valued using level 3 inputs.

	As at June 30, 2016		As at March 31, 2016	
	Level 1	Level 2	Level 1	Level 2
Asset (liability):				
Cash [1]	56,966	-	58,119	-
Cash equivalents [1]	2,003	-	5,900	-
Derivatives [2]	-	(5,230)	-	(17,879)
	58,969	**(5,230)**	**64,019**	**(17,879)**

[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.

No amounts have been reclassified into or out of their initially designated fair value classifications in the three months ended June 30, 2016. Financial assets have been pledged as security for liabilities under the MTI.

During the three months ended June 30, 2016, 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 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 period end dates.

(Tabular amounts expressed in thousands of Canadian dollars)

6. Property, plant and equipment:

(a) Continuity of property, plant and equipment:

	Vessels	Berths, buildings & equipment under finance lease	Berths, buildings & equipment	Land under finance lease	Land	Construction in progress	Total
Cost:							
Balance at March 31, 2016	1,280,303	625,948	94,115	5,883	15,655	105,209	2,127,113
Additions	-	-	-	-	-	39,196	39,196
Disposals	(2,223)	-	(6)	-	-	-	(2,229)
Transfers from construction in progress	40,848	-	1,352	-	-	(42,200)	-
Balance at June 30, 2016	**1,318,928**	**625,948**	**95,461**	**5,883**	**15,655**	**102,205**	**2,164,080**
Accumulated depreciation:							
Balance at March 31, 2016	422,867	122,483	41,806	-	-	-	587,156
Depreciation for the period	25,983	6,808	2,565	-	-	-	35,356
Disposals	(2,223)	-	-	-	-	-	(2,223)
Balance at June 30, 2016	**446,627**	**129,291**	**44,371**	-	-	-	**620,289**
Net carrying value:							
As at March 31, 2016	**857,436**	**503,465**	**52,309**	**5,883**	**15,655**	**105,209**	**1,539,957**
As at June 30, 2016	**872,301**	**496,657**	**51,090**	**5,883**	**15,655**	**102,205**	**1,543,791**

6. Property, plant and equipment (continued):

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

During the three months ended June 30, 2016, financing costs capitalized during construction amounted to $1.0 million (June 30, 2015: $0.8 million) with an average capitalization rate of 5.03% (June 30, 2015: 5.06%). In addition to the construction in progress referenced above, the contractual commitments as at June 30, 2016, for assets to be constructed totalled $272.8 million (March 31, 2016: $284.6 million). These contractual commitments include $131.9 million of the total contract value of $165 million for construction of the three new Salish class vessels and $109.8 million of the total contract value of $140 million for the mid-life upgrade and conversion to dual fuel of the two Spirit class vessels.

The Government of Canada, through the Shore Power Technology for Ports Program, agreed to provide funding of $2.0 million to help offset the costs of shore power upgrades at certain of the Group's terminals. The Group has received $0.6 million and $1.0 million during the years ended March 31, 2015 and 2016, respectively, and expects to receive the remaining $0.4 million during the year ending March 31, 2017.

During the three months ended June 30, 2016, the Group received $0.3 million (June 30, 2015: $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 $2.3 million, respectively, as at June 30, 2016.

During the three months ended June 30, 2016, the *MV Tenaka* (decommissioned during the year ended March 31, 2016), was sold.

(Tabular amounts expressed in thousands of Canadian dollars)

7. Intangible assets:

(a) Continuity of intangible assets:

	Acquired software, licenses & rights	Internally developed software & website	Assets under development	Total
Cost:				
Balance at March 31, 2016	36,700	12,448	67,397	116,545
Additions	-	-	6,871	6,871
Disposals	-	-	(197)	(197)
Transfers from assets under development	-	177	(177)	-
Balance at June 30, 2016	**36,700**	**12,625**	**73,894**	**123,219**
Accumulated amortization:				
Balance at March 31, 2016	22,746	11,058	-	33,804
Amortization for the period	1,315	169	-	1,484
Balance at June 30, 2016	**24,061**	**11,227**	-	**35,288**
Net carrying value:				
As at March 31, 2016	**13,954**	**1,390**	**67,397**	**82,741**
As at June 30, 2016	**12,639**	**1,398**	**73,894**	**87,931**

(b) Other disclosures - intangible assets:

There was no impairment of intangible assets during the three months ended June 30, 2016 or the year ended March 31, 2016.

Capitalized financing costs during construction for intangible assets for the three months ended June 30, 2016 totalled $0.9 million (June 30, 2015: $0.5 million).

During the three months ended June 30, 2016, intangible assets totalling $6.2 million (June 30, 2015: $6.0 million) were acquired and $0.7 million (June 30, 2015: $0.1 million) were internally developed.

8. Financial risk management:

Fuel price risk:

The Group is exposed to risks associated with changes in the market price of marine diesel fuel. In order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices, the Group may manage its exposure by entering into hedging instruments with certain financial intermediaries. Fuel price hedging instruments are used to reduce fuel price risk and to minimize fuel surcharges, not for generating trading profits. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs. Pursuant to the Group's Financial Risk Management Policy, the term of the contracts is not to extend beyond the greater of three years or the end of the fourth performance term ending March 31, 2020. This policy also limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; 90% of anticipated monthly fuel consumption for the 12 month period thereafter; 85% of anticipated monthly fuel consumption for the period thereafter to the end of the 36 month period; and to 70% of anticipated monthly fuel consumption for the period between 36 months and the end of the fourth performance term.

The Group is also allowed by regulatory order to use deferred fuel cost accounts to mitigate the impact of changes in fuel price on its earnings (note 15).

During the year ended March 31, 2016, the Group entered into Ultra-low Sulfur Diesel (ULSD) fuel swap contracts with a notional value of $78.4 million CAD, and during the three months ended June 30, 2016, the Group entered into ULSD fuel swap contracts with a notional value of $3.4 million CAD to reduce its exposure to changes in the ULSD and foreign exchange risk components associated with forecast diesel fuel purchases and applied hedge accounting to these contracts. The notional value of the fuel swap contracts outstanding as at June 30, 2016 was $70.8 million CAD.

During the three months ended June 30, 2016, the change of $10.3 million in the fair value of fuel swap contracts was recognized in OCI. The realized hedging loss of $2.3 million on fuel swap contracts was reclassified from equity (accumulated other comprehensive income) and included in the Group’s fuel expense during the three months ended June 30, 2016. There was no hedge ineffectiveness for the three months ended June 30, 2016.

8. Financial risk management (continued):

	Fiscal 2017	Fiscal 2018	Total
Cash flow hedges			
Fuel price risk			
Fuel contracts (litres in thousands)	58,000	64,050	122,050
Contract price range ($/litre)	$0.5797 - $0.6025	$0.4931 - $0.5975	

(a) As at June 30, 2016, the Group's derivative liabilities of $5.2 million included foreign exchange forward contracts and fuel swap contracts.

Fuel swap contracts as at June 30, 2016:

					Fair value changes used for calculating hedge ineffectiveness	
	Notional amount of the hedging instrument	Carrying amount of the hedging instrument (liability)	Item location	Cash flow hedge reserve	Hedging instruments	Hedged items
Cash flow hedges						
Fuel price risk	70,770	(5,221)	Derivative liabilities	5,221	5,221	5,231

(b) Cash flow hedge reserve:

	Three months ended June 30	
	2016	2015
Hedging gains recognized in cash flow hedge reserve:		
Fuel swap contracts (note 10(a))	10,328	2,827
	10,328	2,827
Hedging losses reclassified from cash flow hedge reserve:		
Interest rate forward contract – amortization of hedge loss	62	62
Fuel swap contracts – loss recognized in net earnings (note 10(a))	2,319	631
	12,709	3,520
Net change in cash flow hedge reserve	12,709	3,520

(Tabular amounts expressed in thousands of Canadian dollars)

9. Accrued employee future benefits:

During the three months ended June 30, 2016, the Group recognized total defined benefit costs of $0.4 million (June 30, 2015: $0.4 million).

10. Other comprehensive income:

(a) Continuity of reserves:

	Land revaluation reserves	Employee future benefit revaluation reserves	Fuel swaps reserves	Interest rate forward contracts reserves	Total
Balance at March 31, 2016	**3,389**	**(2,786)**	**(17,868)**	**(6,958)**	**(24,223)**
Derivatives designated as cash flow hedges: (note 8(b))					
Net change in fair value	-	-	10,328	-	10,328
Realized losses	-	-	2,319	-	2,319
Amortization of losses (note 8(b))	-	-	-	62	62
Balance at June 30, 2016	**3,389**	**(2,786)**	**(5,221)**	**(6,896)**	**(11,514)**

(b) Other comprehensive income:

	Three months ended June 30	
	2016	2015
Items to be reclassified to net earnings:		
Hedge gains (losses) on fuel swaps (note 8(b))	10,328	3,458
Total other comprehensive income	**10,328**	**3,458**

(Tabular amounts expressed in thousands of Canadian dollars)

11. Net retail:

	Three months ended June 30	
	2016	2015
Retail revenue	22,737	21,326
Cost of goods sold	(9,026)	(8,651)
Net retail	**13,711**	**12,675**

12. Operating expenses:

	Three months ended June 30	
	2016	2015
Salaries, Wages & Benefits	86,003	84,060
Fuel	23,583	26,264
Materials, Supplies & Contracted Services	18,363	17,101
Other operating expenses	13,863	13,381
Depreciation and amortization	36,840	35,111
Total operating expenses	**178,652**	**175,917**

13. Net finance expense:

	Three months ended June 30	
	2016	2015
Finance expenses:		
Long-term debt	15,564	15,782
Short-term debt	84	82
Finance leases	473	489
Amortization of deferred financing costs and bond discounts	160	165
Interest capitalized in the cost of qualifying assets	(1,869)	(1,276)
Total finance expenses	14,412	15,242
Finance income	(1,035)	(897)
Net finance expense	**13,377**	**14,345**

14. 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, 2016, the Group paid $17,353 (June 30, 2015: $19,991) 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.

(Tabular amounts expressed in thousands of Canadian dollars)

15. 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.

In January 2014 the IASB issued IFRS 14, *Regulatory Deferral Accounts*. 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. The Group's transition date to IFRS was April 1, 2011. 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 or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes that the obligations represented by the regulatory liabilities at June 30, 2016, will be settled through future tariff reductions or fuel surcharges.

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

	As at	
Regulatory accounts	June 30, 2016	March 31, 2016
Deferred fuel costs		
Balance – beginning of year	(6,132)	(448)
Fuel costs under set price	(3,166)	(10,971)
Rebates	4,699	6,356
Fuel price risk recoveries payable to the Province	98	157
Other payments from the Province	-	(1,226)
Balance – end of period	(4,501)	(6,132)
Total deferred fuel cost accounts	**(4,501)**	**(6,132)**
Total regulatory liabilities	**(4,501)**	**(6,132)**
Current regulatory liabilities	-	-
Total long-term regulatory liabilities	**(4,501)**	**(6,132)**

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 June 30, 2016, tariffs charged to customers were below established price caps.

(Tabular amounts expressed in thousands of Canadian dollars)

15. Economic effect of rate regulation (continued):

If the Group was permitted under IFRS to recognize the effects of rate regulation and to record regulatory assets and regulatory liabilities, net earnings for the three months ended June 30, 2016 would have been $1.6 million higher (June 30, 2015: $1.5 million lower) as detailed below:

	Three months ended June 30	
Effect of rate regulation on net earnings	2016	2015
Regulatory accounts:		
Deferred fuel costs	1,631	(568)
Performance term submission costs	-	(21)
Tariffs in excess of price cap	-	(878)
Total increase (decrease) in net earnings	**1,631**	**(1,467)**