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Performance Review of the Efficiency of BC Ferries

British Columbia Ferry Commission

March 2015

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Executive Summary

PricewaterhouseCoopers LLP (“PwC”) was engaged by the British Columbia Ferry Commission (the “Commission”) to conduct a performance review of the efficiency of British Columbia Ferry Services Inc. (“BC Ferries’).

The Coastal Ferry Act allows for the Commissioner to conduct a performance review of one or more aspects of BC Ferries’ operations. The purpose of the performance reviews is to hold BC Ferries accountable and by doing so to raise public confidence that the company is operating efficiently, making prudent use of its resources, and operating in such a way as to keep ferry fares as low as reasonably possible.

Our review included the following tasks:

- Assessing the efficiency of operating, maintenance and administration costs;
- Assessing the efficiency of labour costs; and
- Assessing the efficiency of BC Ferries organizational design.

Our assessment is based on analysis of BC Ferries financial and other data primarily over the F2009-F2014 period, interviews with BC Ferries management and comparisons with benchmark data.

The significant findings of our report are as follows:

- BC Ferries is demonstrating good cost control, especially in the area of Administrative expenses. Overall Administrative expenses have been reduced as a result of lower executive compensation and reduced head count. Lower scheduled and unscheduled overtime hours have also assisted in moderating overall labour cost increases.

- Cost control has been achieved while obtaining good outcomes with customer satisfaction and passenger and employee safety.

- The assessment of financial and management controls and processes addressed planning, budgeting, reporting and internal controls has been conducted at a high level. The assessment determined that these controls and processes appear to be appropriate.

- BC Ferries appear to have a strong culture of efficiency, based on its sound budgeting process, and alignment of performance pay with corporate objectives.

- BC Ferries executive compensation compares favourably against that of several provincial Crown corporations. BC Ferries executive compensation policies and procedures appear appropriate for an organization of its size and complexity.

- BC Ferries complies with PSEC guidelines for at-risk compensation, organizational layers and direct reports to the CEO. The number of managers does not appear to be excessive.

Notice to Reader

This Report is issued by PwC for the exclusive use of the Commission in connection with its performance reviews of BC Ferries.

Our work did not constitute an audit conducted in accordance with generally accepted auditing standards, an examination of internal controls nor attestation nor review services in accordance with the standards established by the Canadian Institute of Chartered Accountants. Accordingly, we do not express an opinion nor any other form of assurance on the financial or other information, or operating internal controls, of BC Ferries.

PwC did not examine, compile or apply agreed upon procedures to satisfy the requirements of the Canadian Institute of Chartered Accountants to the financial information used in this Report and we therefore are unable to express assurances on such information except where expressly stated in the Report to form part of the scope of our work.

Further this Report does not constitute an opinion as to legal matters, including the interpretation of the Coastal Ferry Act or any other similar matters. The economic impact of the various procurement options is also outside the scope of PwC's work.

Our work is based primarily on the information and assumptions listed in the body of this Report. While we read information from various sources we did not perform checking or verification procedures except where expressly stated in the Report to form part of the scope of our work. Our work and commentary is subject to assumptions, which may change with the benefit of further detailed information. We make no representation regarding the sufficiency of our work and had we been asked to perform additional work, additional matters may have come to our attention that would have been reported to the Commission.

Some of the documents and figures we reviewed were produced by third parties. We did not corroborate or verify these documents and figures with these parties. It is outside the scope of our review to evaluate the methodology used to conduct independent studies; therefore, we have accepted the information as presented, including conclusions. We did review the credentials of external consultants that BC Ferries management relied upon and that we were unfamiliar with.

The outputs of the Report are intended to provide the Commissioners with information to assist in informing their decision making process pertaining to BC Ferries. PwC accepts no liability in respect of any loss, damage or expense of whatsoever nature caused by any use the reader may choose to make of this Report, or which is otherwise consequent upon the gaining of access to the Report by the reader.

Our Report, including its schedules, must be considered in its entirety by the reader. Selecting and relying on specific portions of the analyses, or factors considered by us in isolation may be misleading.

Background

In April 2003, the Province of British Columbia (the "Province") established the British Columbia Ferry Authority (the "Authority"), an independent corporation that holds the single issued voting share of BC Ferries.

BC Ferries, as the operating subsidiary of the Authority, provides coastal ferry services on the west coast of British Columbia. With 35 vessels travelling between 47 terminals, on 24 routes, BC Ferries is one of the largest ferry operators in the world, both in terms of fleet size and passengers carried. Its fleet includes a number of older vessels and BC Ferries has undertaken a process to upgrade its fleet and conduct necessary maintenance.

A Coastal Ferry Services Contract existing between the Province and BC Ferries defines service levels on each regulated route and the British Columbia Ferry Commission sets price caps across the route groups every four years. Within its operating framework, BC Ferries can decide on fares, and can access capital markets directly. The Commission is a provincial regulatory agency operating under the Coastal Ferry Act with responsibilities for making regulatory decisions affecting ferry operators in the Province, including BC Ferries.

Under Section 46.1 of the Coastal Ferry Act the Commissioner may conduct a performance review of one or more aspects of a ferry operator's operations including ancillary services. The purpose of the performance reviews is to identify any opportunities for further efficiencies in the operations of BC Ferries which may be incorporated in the determination of the price caps for future performance terms.

In conjunction with the price review which commenced early in October 2014, the Commission is conducting performance reviews of several areas. The Commission sought the assistance of PwC to conduct the performance reviews including the efficiency of BC Ferries.

Scope and Approach

Our assessment of efficiency examines BC Ferries' performance since the beginning of Performance Term 2 (PT2) in April 2008. The scope of the performance review includes the following:

1. **Assessing the efficiency of operating, maintenance and administration ("OM&A") costs with a focus on the latter**

We assessed the efficiency of OM&A by:

- Reviewing past performance reviews;
- Analyzing historical trends on a gross and per nautical mile basis;
- Analyzing the significant drivers of OM&A costs and the degree to which BC Ferries has control over these costs; and
- Analyzing the changes in OM&A versus measures of profitability.

2. **Assessing the efficiency of labour costs**

We assessed the efficiency of labour costs by:

- Analyzing historical trends including comparison to changes in CPI over a comparable period;
- Analyzing historical trends in both exempt and non-exempt employees and executive compensation including comparison to provincial Crown corporations that are required to comply with PSEC guidelines ; and
- Analyzing human capital metrics.

3. **Assessing the efficiency of BC Ferries' organizational design**

We assessed the efficiency of organizational design through:

- Interviews with management;
- Analyzing the number of layers of management;
- Analyzing the span of control of management; and
- Comparing both layers of management and span of control metrics to comparable organizations.

The current assessment has a focus on operating costs, including administrative and labour costs. Other aspects of BC Ferries operations, including fuel management, BC Ferries Vacations and homeporting arrangements, are the subject of separate performance reviews. The assessment of BC Ferries' *Strategies for Enhanced Efficiency in Performance Term Four* and Beyond is part of the Commission's review of BC Ferries September 30, 2014 PT4 Submission.

Results

Past Reviews of Efficiency of BC Ferries

Assessing the efficiency of ferry operators is challenging, as comparisons across jurisdictions are made difficult by varying labour and operational requirements, amongst other factors.

A number of reviews have been conducted that support the notion of BC Ferries as being relatively efficient:

- The previous reviews conducted by the Commission of BC Ferries Price Cap Submissions that were conducted with the support of external consultants found that the cost estimates were reasonable with few exceptions.

- A 2009 review by the Office of the Comptroller General found BC Ferries' operations to be well managed and reasonably effective, with the exception of compensation. The review found that appropriate financial and management controls and processes are established including planning, budgeting, monitoring, reporting, internal controls, a capital asset management framework, procurement policies, and an active internal audit function. While the current governance framework has the components to be effective, the implementation and the decisions made by parties suggest improvements were required to ensure strong oversight and accountability. A number of steps have been taken by BC Ferries since to address these issues.

- The BC Ferries board and management have implemented long term performance measures to gauge the progress of its operations. KPIs targets over the F2009-F2014 period that are discussed in the report have been largely met.

- A 2010 global benchmarking study commented favourably on a number of BC Ferries' policy features and operational strategies, including its partnerships and business ventures, the introduction of the BC Ferries Experience Card, the use of fuel surcharges, administration restructuring that has led to reductions of 77 staff, and a new operations and security centre to enable increased coordination of responses to service disruptions and occurrences.

- There is limited availability of data on utilisation with many ferry systems due to commercial confidentiality issues. Also different characteristics of routes will result in varying utilisation making comparisons difficult. BC Ferries's average capacity utilization of 49.9% in F2014 appears to compare reasonably well against other systems, although capacity utilization is low on several routes.

- BC Ferries does comparatively well with Farebox Recovery. BC Ferries' Farebox Recovery was 84.7% in F2014. A Farebox Recovery of 80% is considered a good result for subsidized routes. Starting in 2001, the Washington State government has set farebox recovery targets for Washington State Ferries to increase from approximately 60% to 80% over six years, plus a long term goal of reaching 90% farebox recovery. With Marine Atlantic Inc, (MAI) the federally owned corporation that provides ferry services to Newfoundland, the federal government announced in 2007 a two-phase revitalization strategy that aimed at moving MAI toward a more commercial orientation, increasing cost recovery to between 60 and 65 percent.

- BC Ferries also does well with ancillary revenues. Its per passenger totals are significantly higher than Washington State Ferries. The margins on these sales have helped BC Ferries achieve 100% cost recovery based on operational costs.

Recent Operational Performance

BC Ferries tracks and publishes a number of corporate Key Performance Indicators which are set by its board of directors. A profile of the corporate KPIs and their achievement relative to targets since F2009 is shown in the following chart.

BC Ferries have been generally successful in meeting certain KPI targets including good performance with on-time sailings, customer satisfaction and passenger and employee safety. We note that targets have been increased once they have been achieved suggesting an objective of continual improvement.

BC Ferries Key Performance Indicators		Y/E 2009	Y/E 2010	Y/E 2011	Y/E 2012	Y/E 2013	Y/E 2014
Employee safety	Actual	2.48	1.54	1.53	1.34	1.04	0.67
	Target	3.42	2.50	1.56	1.31	1.22	0.90
Passenger safety	Actual	22.54	20.16	17.09	15.31	13.28	13.28
	Target	22.80	21.50	21.50	18.11	15.45	13.49
Reliability index	Actual	99.67%	99.60%	99.83%	99.76%	99.75%	99.71%
	Target	99.4-99.59%	99.4-99.59%	99.4-99.59%	99.4-99.59%	99.5-99.69%	99.5-99.69%
Customer satisfaction	Actual	86%	91%	89%	88%	88%	87%
	Target	82%	84%	84%	83%	88%	88%
Cost per passenger	Actual	$ 20.69	$ 20.96	$ 21.90	$ 23.04	$ 23.74	N/A
	Target	$ 20.34	$ 20.67	$ 21.66	$ 23.29	$ 23.85	N/A
EBITDA	Actual	$ 152.0	$ 186.0	$ 180.9	$ 190.2	$ 221.7	$ 232.3
	Target	$ 162.0	$ 189.0	$ 195.6	$ 189.1	$ 206.4	$ 218.0

Note that cost per passenger was discontinued as a KPI beginning in fiscal 2014.

Analysis of Operating, Maintenance and Administration Costs

Figure 1 illustrates the relationship between total revenue and operating, maintenance and administration costs.

Both revenue and OM&A expenditures increased moderately over the period. Revenue has tracked in line with operating expenditure growth and has been sufficient to meet debt obligations.

The average annual increase in revenue was 2.54% over the period, compared to an increase in OM&A of 2.76%.

Figure 1

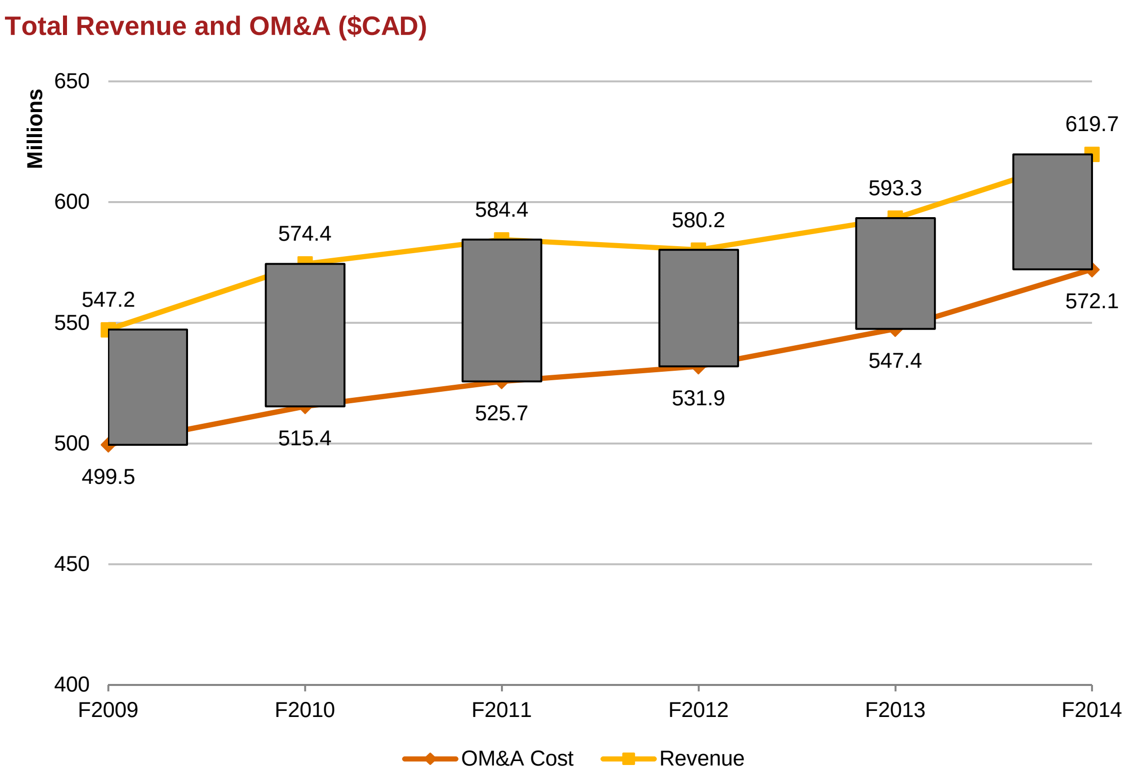


Figure 2 illustrates the relationship between revenue, OM&A and earnings before interest, taxes, depreciation and amortization (EBITDA) on a per nautical mile sailed basis.

The EBITDA margin per nautical mile increased from 28% to 36% due to a decrease in nautical miles sailed with service reductions that began in F2013.

Figure 2

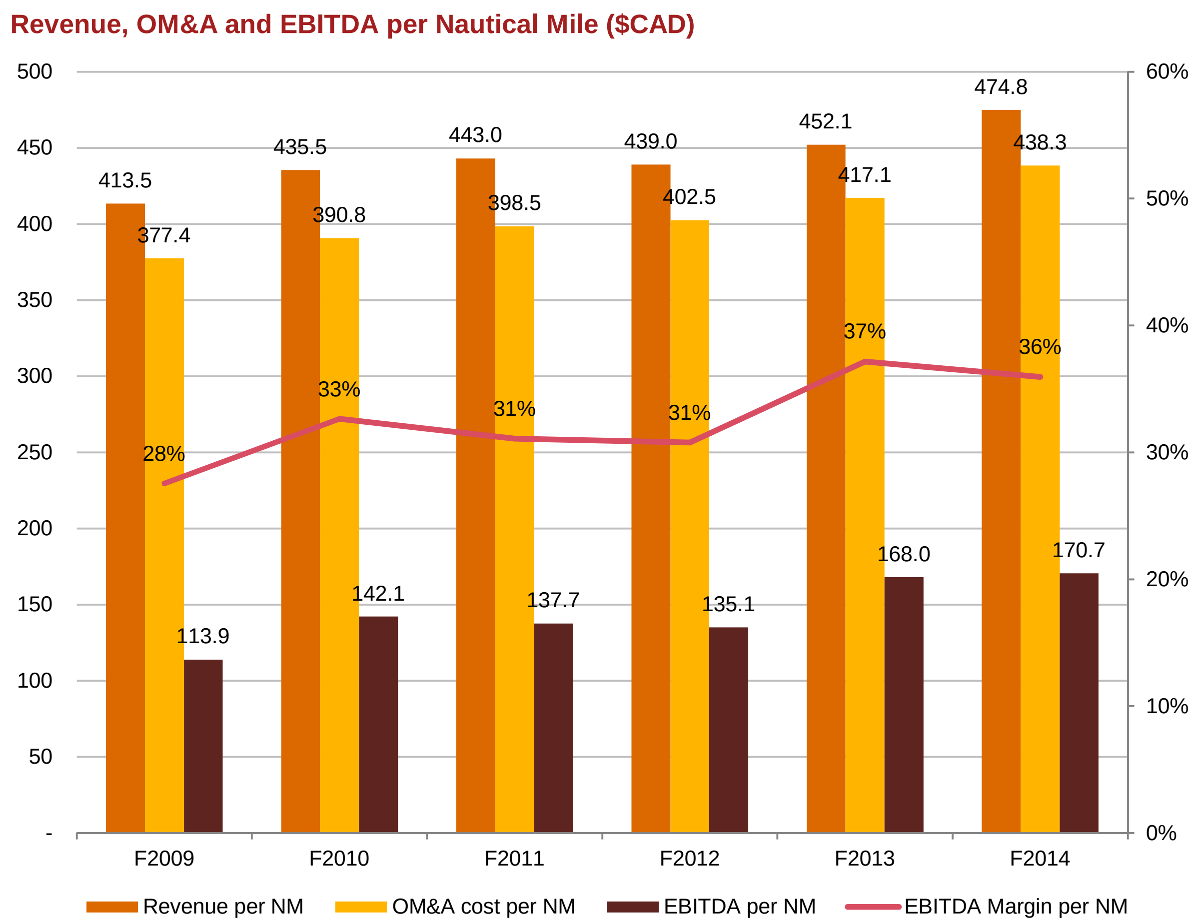
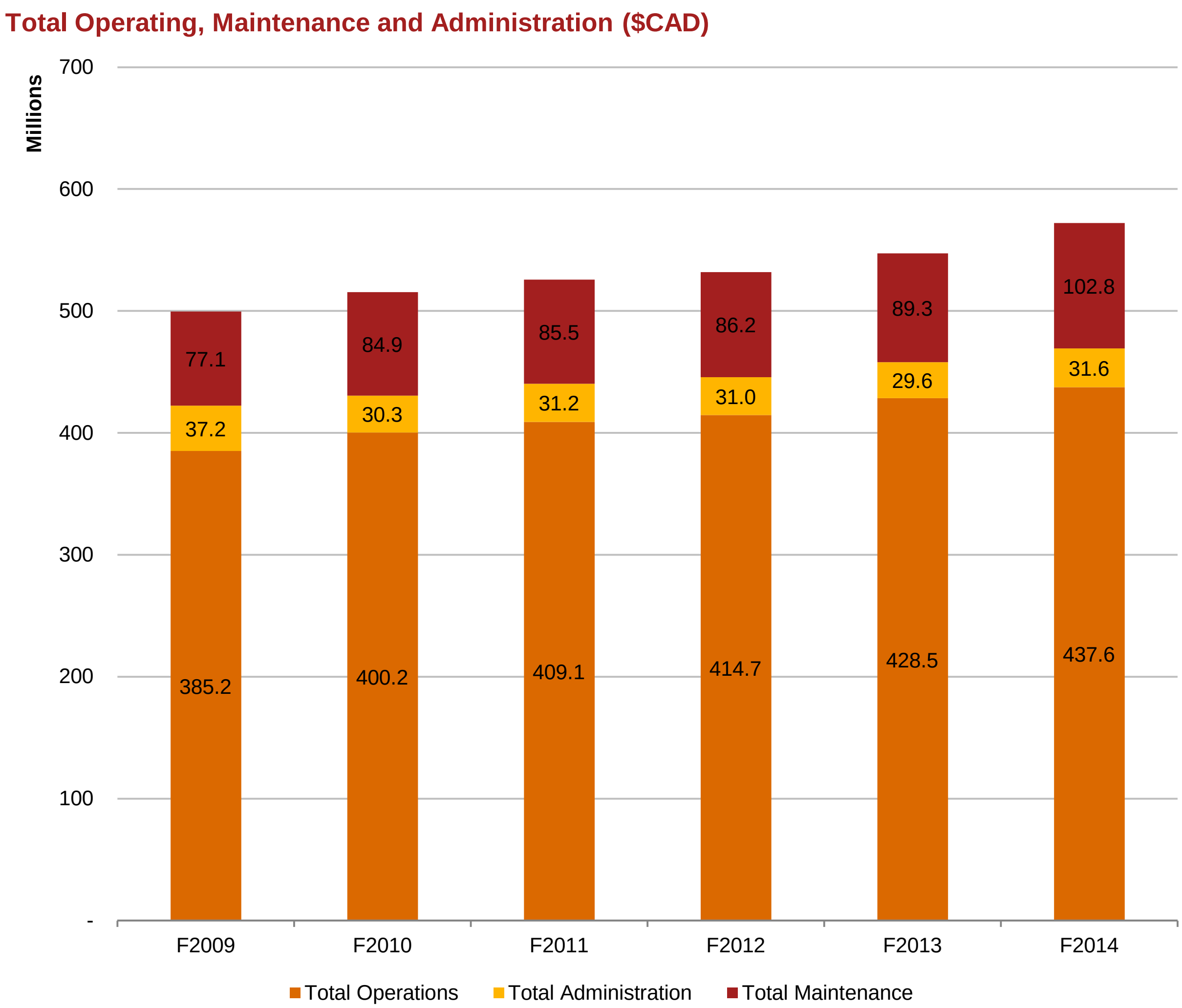


Figure 3 shows the breakout of operating, maintenance and administration costs.

While Operations and Maintenance expenses increased 13.6% and 33.3%, respectively, over the period, Administration expenses declined 15.1%, from $37.2 million to $31.6 million.

Figure 3



The maintenance expense increase noted in fiscal 2014 is due to the timing of maintenance cycles. The majority of minor and intermediate vessels are docked on a 4 year cycle while major vessels are docked on a 5 year cycle. In the years immediately preceding vessel retirement, maintenance that is not required for safety or regulatory purposes may be reduced due to upcoming decommissioning. New vessels generally do not require significant repairs during the first 5 years of service. Each of these factors contributes to the variability in maintenance costs over the period including the increase in fiscal 2014.

Figure 4 illustrates the relationship between fuel costs and total operating costs.

Fuel is the most significant operating cost. The vast majority of operating cost increases are not fuel related as fuel costs have not increased over the period.

Figure 4

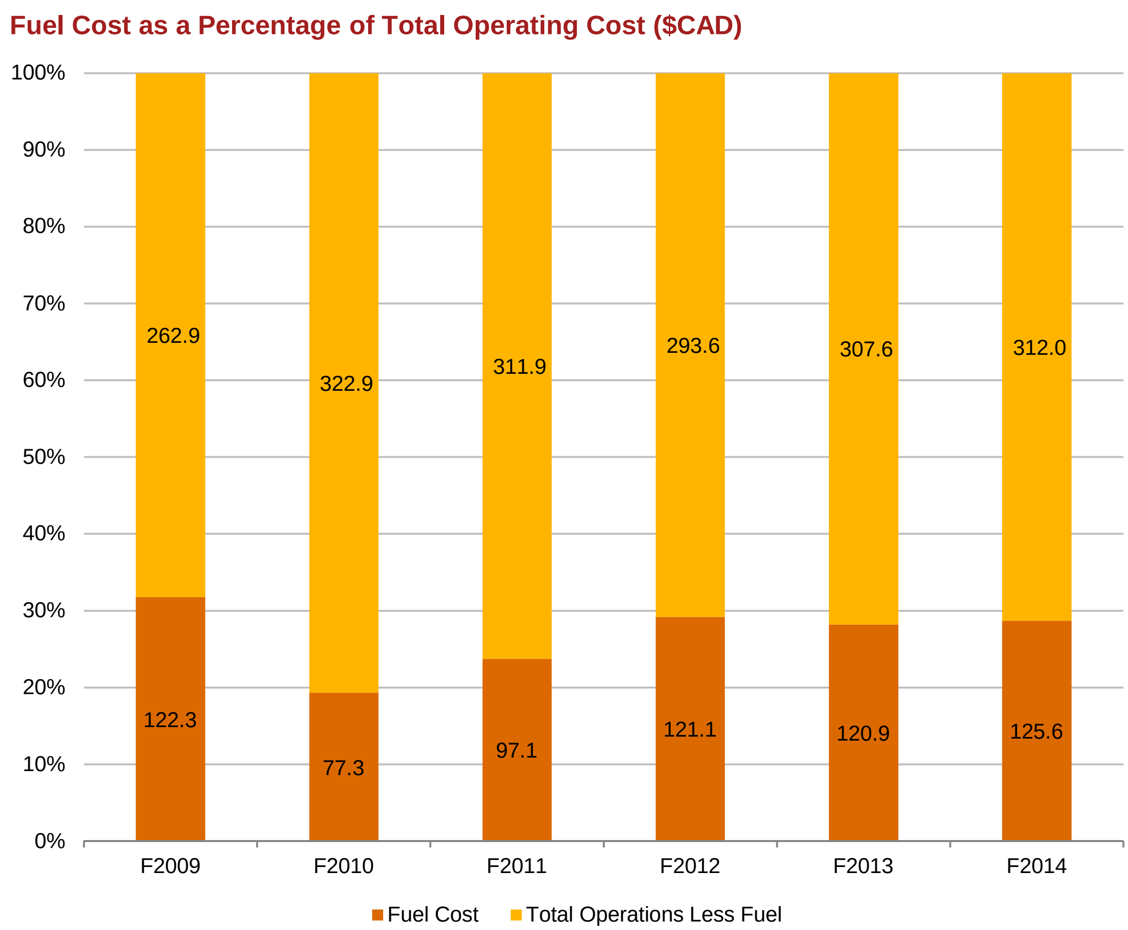
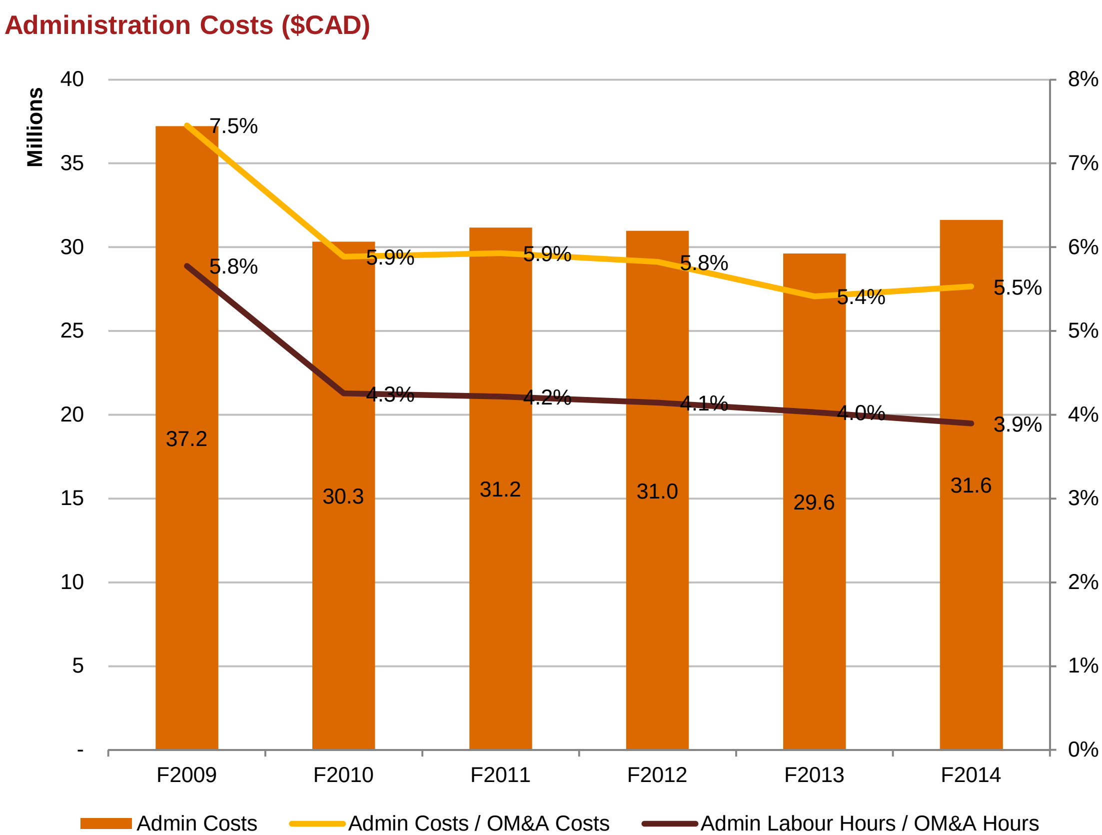


Figure 5 illustrates the relationship between total administration costs and total administration labour hours as a percentage of total OM&A costs and total OM&A hours, respectively. Both of these measures have declined since 2009.

The decline in Administration expenses is due to reduced head count and reduced compensation for executives.

Note that a total of $3.1m severance was paid between fiscal 2009 and fiscal 2010 in connection with the elimination of 77 positions.

Figure 5



Analysis of Labour Costs and Metrics

BC Ferries average weekly earnings are equal to $1,339 per week for bargaining unit and exempt employees combined. They fall between the Canadian Transportation / Warehouse Sector and Utilities Sector and do not appear excessive. As illustrated in figure 6, based on Statistics Canada data from December 2014, average weekly earnings are $1,064 per week for the Transportation / Warehousing Sector and $1,852 for the Utilities Sector.

Figure 6

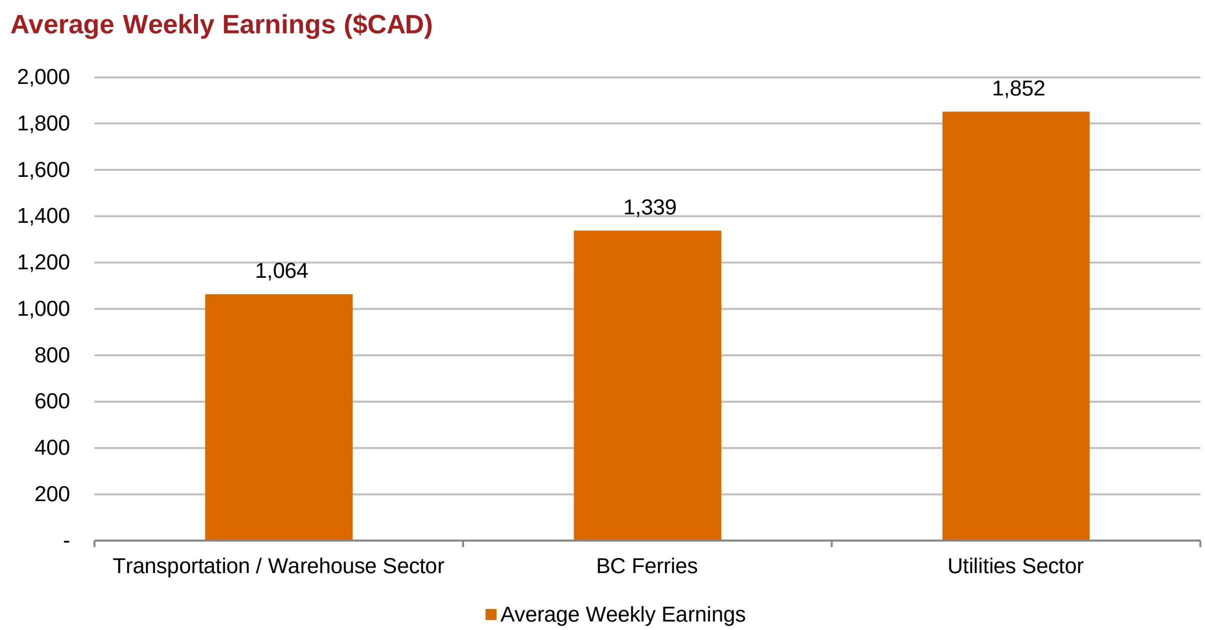


Figure 7 illustrates the relationships between total labour costs and labour cost per nautical mile sailed.

Labour cost per nautical mile has increased 10.3% over the period compared to an 8.7% increase in labour costs.

Figure 7

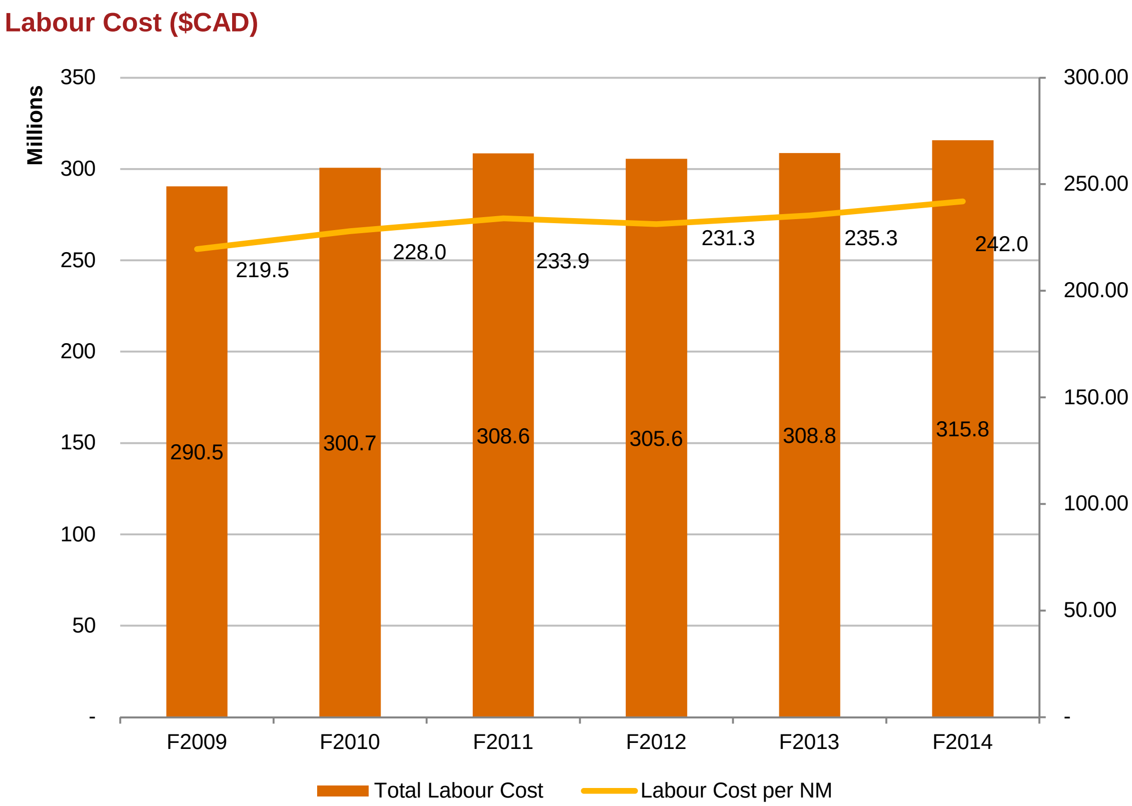


Figure 8 illustrates the relationship between labour costs attributable to exempt employees versus labour costs attributable to bargaining unit employees.

Note that certain employees from the bargaining unit were reclassified to the exempt classification beginning in fiscal 2012. The labour costs associated with this reclassification are shown in Figure 14.

The ratio of exempt to bargaining has increased over the period from 20% to 26%.

Figure 8

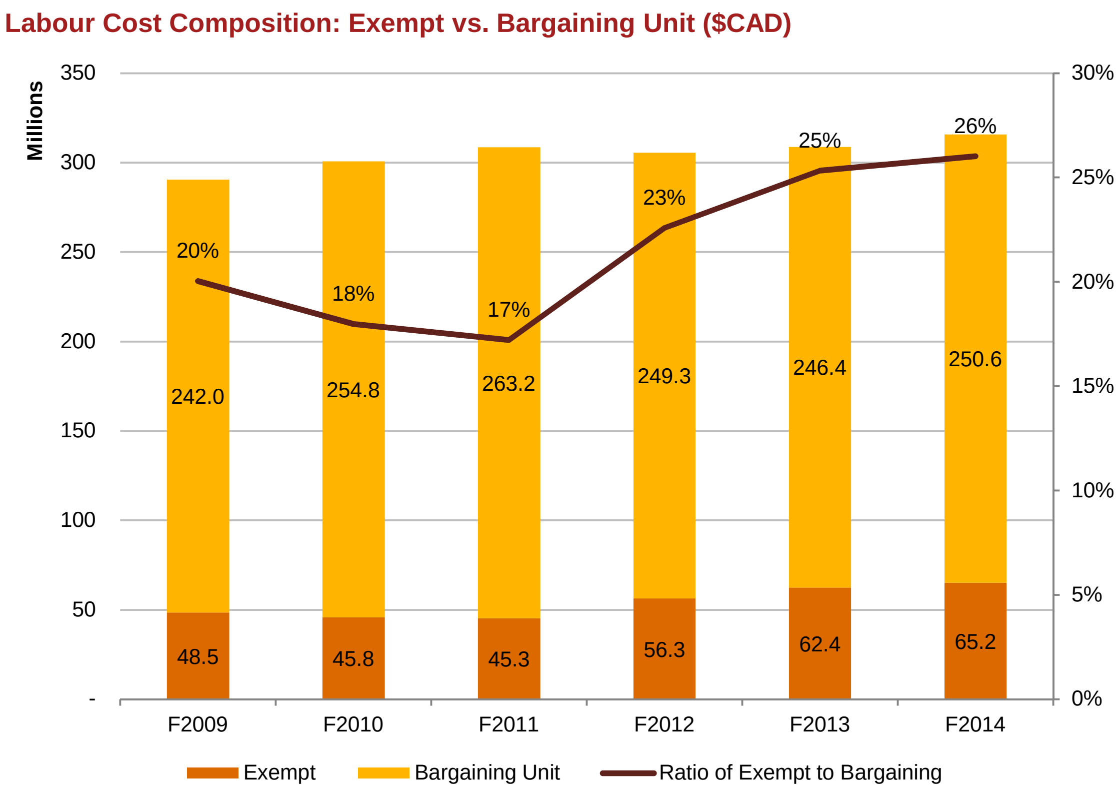


Figure 9

Figure 9 shows that when the exempt labour costs are broken out between reclassified and pre-existing, it shows that the pre-existing exempt labour costs have declined. The results suggest that the higher percentage of exempt labour has provided BC Ferries with more flexibility to manage overall labour costs.

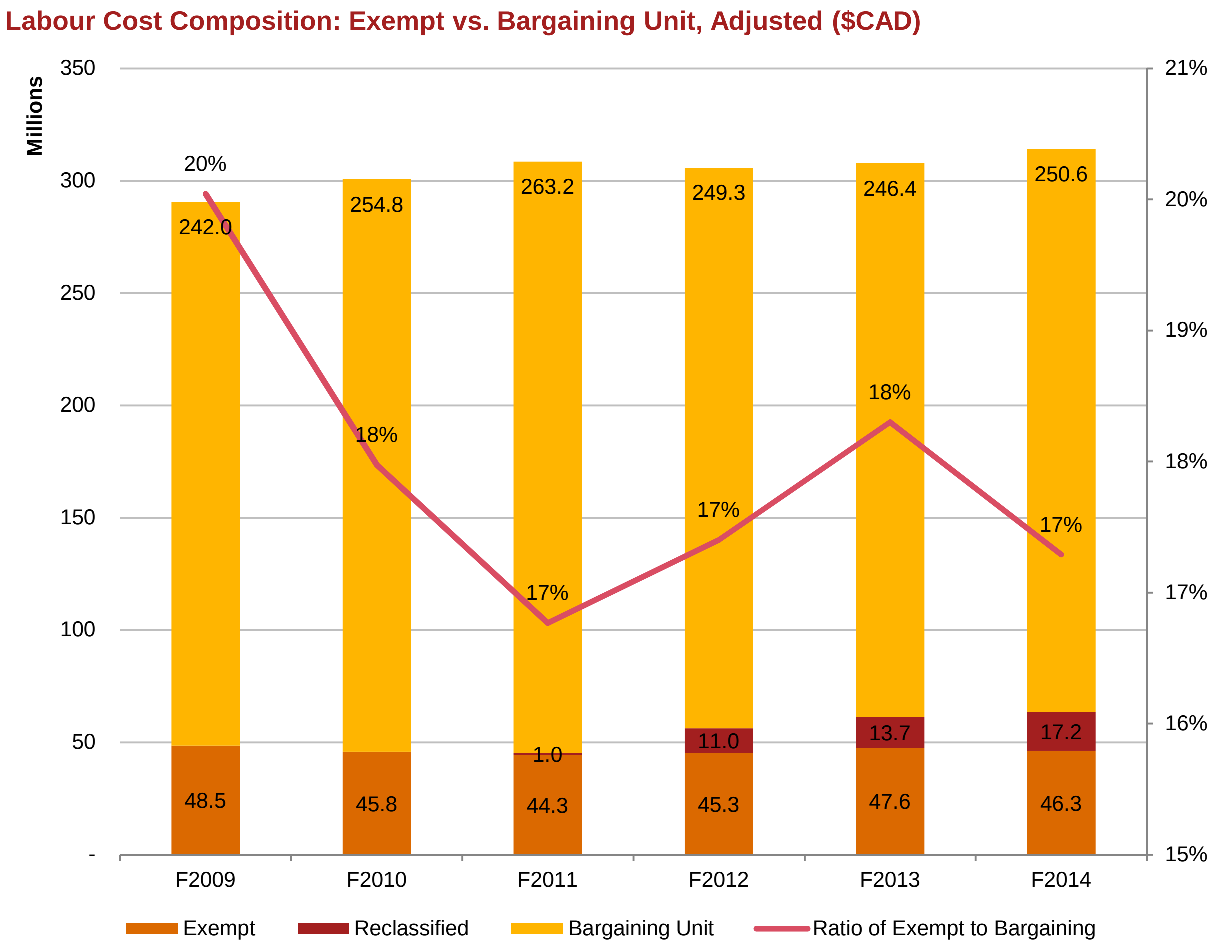


Figure 10 illustrates the relationship between total labour costs and CPI.

Labour costs have generally been tracking in line with CPI. Labour costs increased 8.7% over the period compared to 6.7% for CPI. Overall labour costs are highly influenced by the collective agreement with the union.

Figure 10

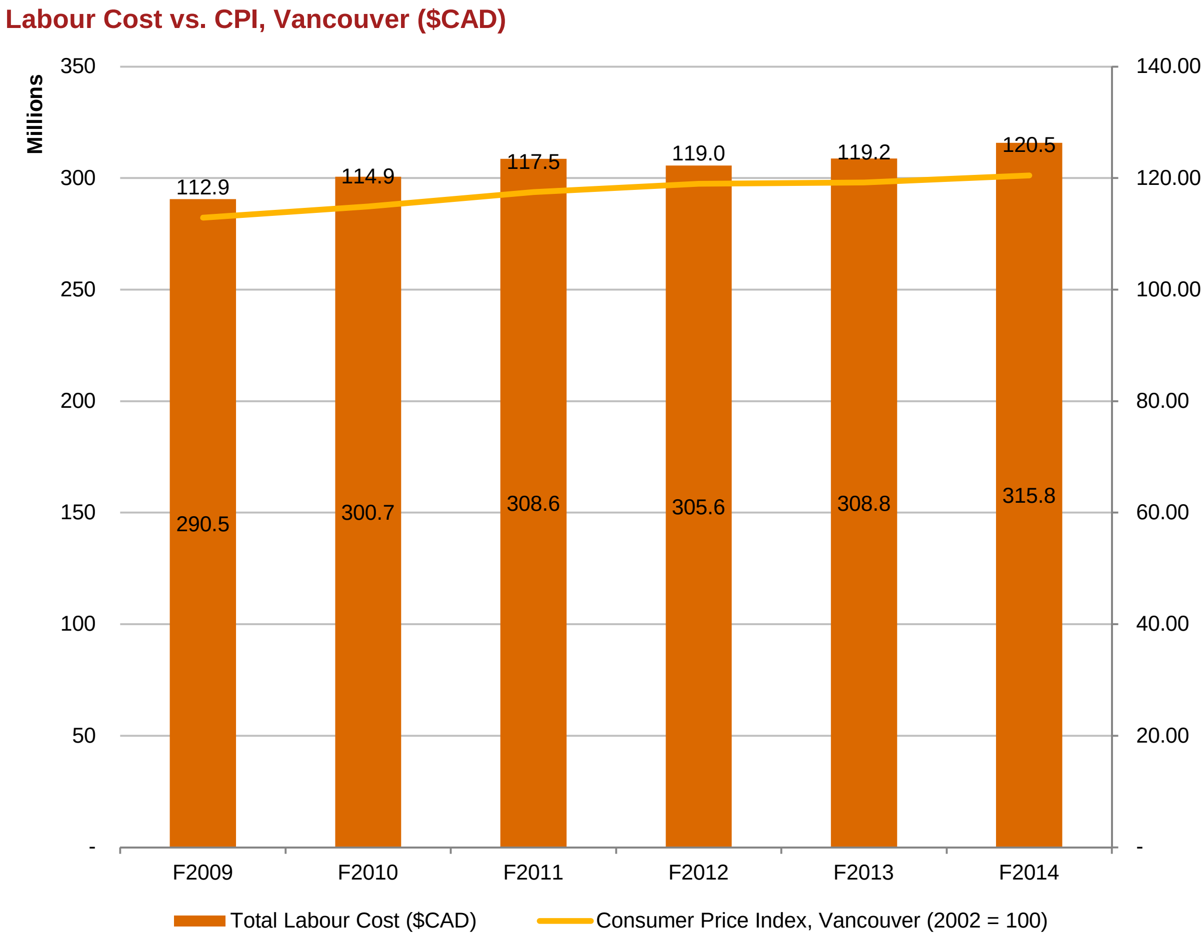


Figure 11 illustrates the relationship between total labour cost per labour hour and CPI.

Labour costs per labour hour increased 8.9% over the period, compared to the 6.7% for CPI.

Figure 11

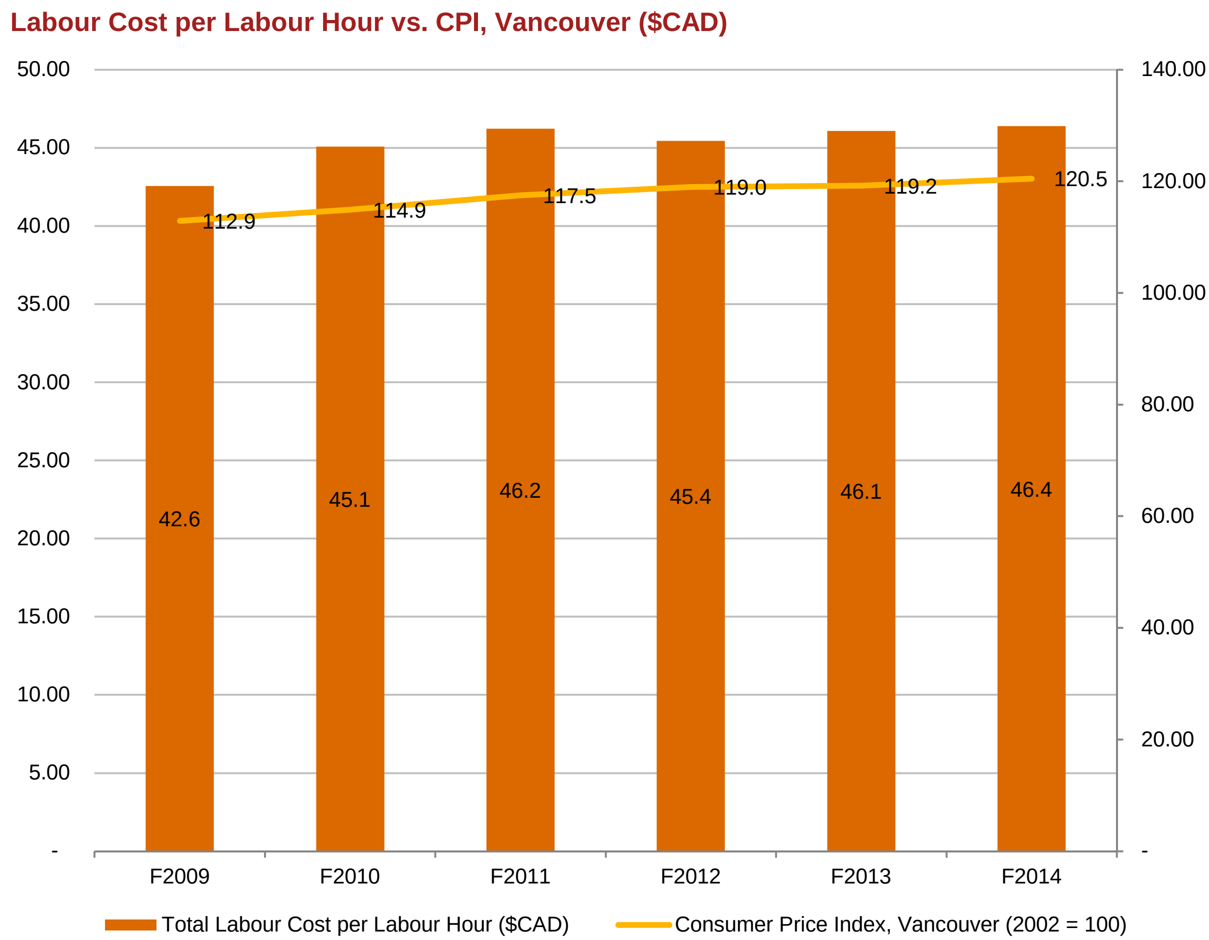


Figure 12 illustrates the relationship between scheduled and unscheduled overtime hours.

A portion of the unscheduled overtime is the result of mechanical or other unforeseen operational issues which dictate that the unscheduled overtime hours be worked.

Scheduled overtime is a function of the duration of some sailings which requires staff to work more than a standard day.

Total overtime hours have declined from 369,200 hours in F2009 to 321,800 in F2014, a 12.8% decrease. Both scheduled and unscheduled overtime hours have declined with unscheduled overtime declining 15.9% and scheduled overtime declining by 6.5%.

Figure 12

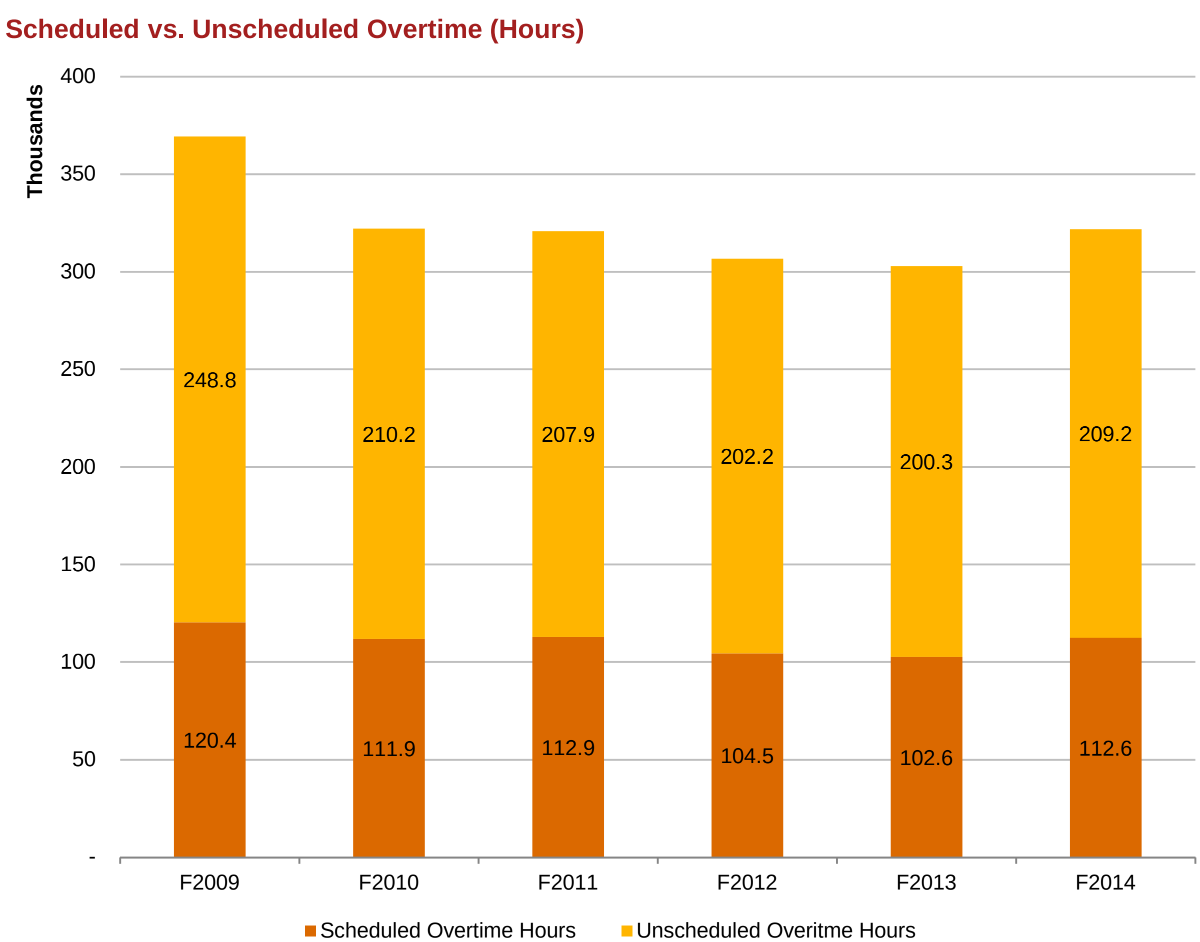


Figure 13 illustrates the relationship between BC Ferries' absenteeism rates and the average per Statistics Canada for the Transportation and Warehousing industry over the same period.

Absenteeism rates have held steady over the period, ranging from a low of 10.3 days per year to a high of 10.9 days per year.

These rates were below the averages for the Transportation and Warehousing Sector reported by Statistics Canada.

Figure 13

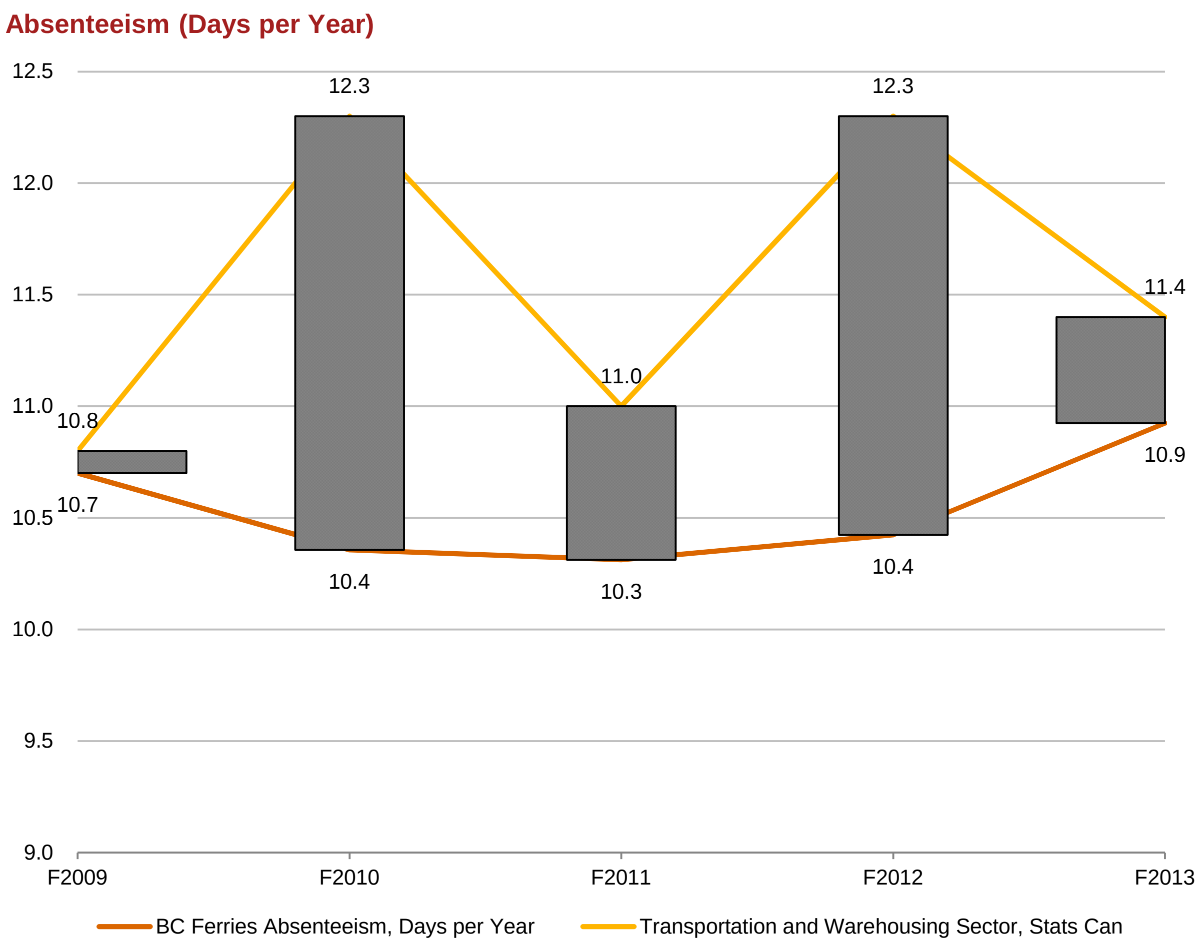
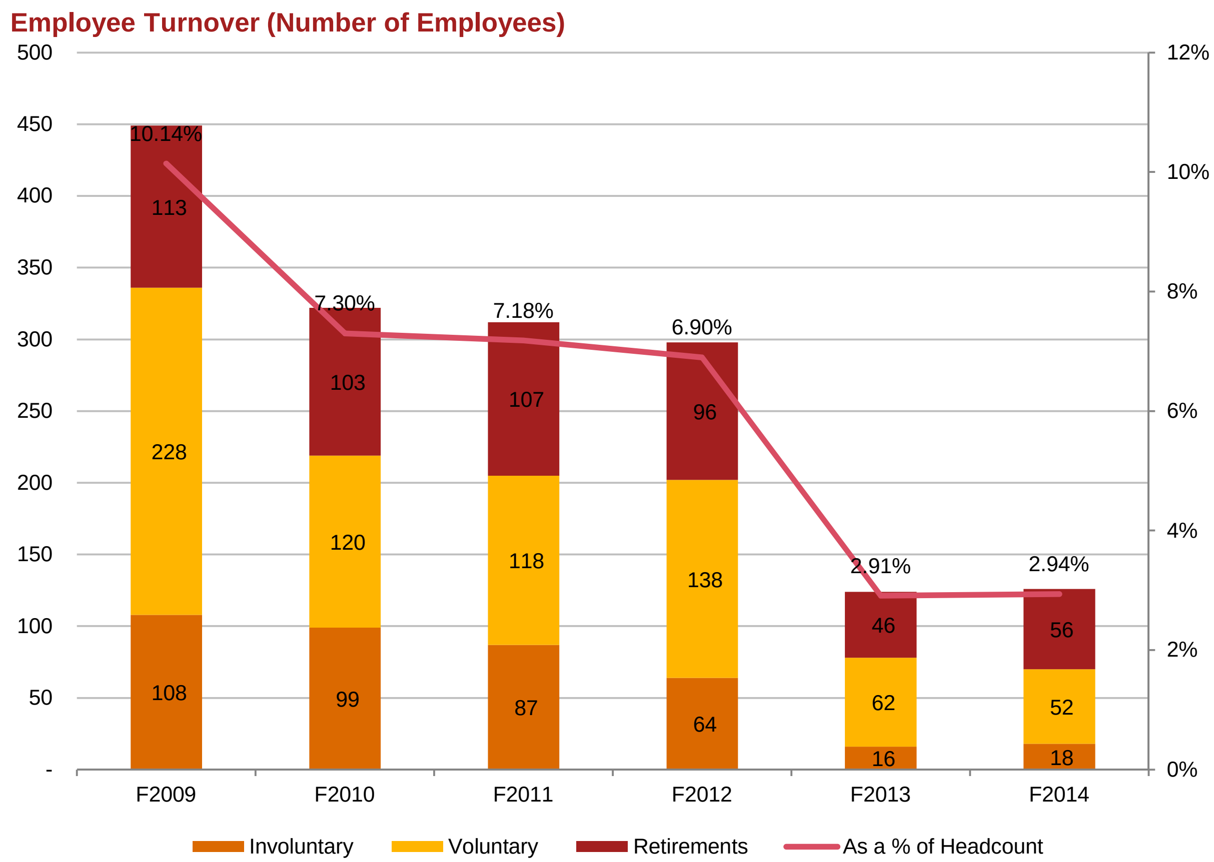


Figure 14 illustrates the relationship between voluntary, involuntary and retirement turnover as well as turnover as a percentage of total headcount.

Employee turnover has declined significantly over the period, from 10.14% in F2009 to 2.94% in F2014.

Involuntary and voluntary turnover and retirements have all declined.

Figure 14



Cost Management

BC Ferries operates under the Coastal Ferry Services Contract between BC Ferries and the Province of British Columbia which dictates the routes and service levels operated by BC Ferries. Furthermore, Transport Canada regulations specify the crewing levels required for each sailing and the agreement between BC Ferry & Marine Workers' Union and BC Ferries dictates the wage rates paid to the majority of employees. Although a significant portion of cost incurred by BC Ferries are driven by these requirements, the Company manages all other costs using a zero based budget in order to ensure efficiency.

The annual budgeting process spans September to February and contains the following processes:

1. Managers with financial responsibility prepare individual budgets;

2. Executive Vice Presidents and Vice Presidents review budgets and amend as necessary;

3. Finance department reviews budgets and amend as necessary;

4. CEO reviews budgets and amends as necessary or items are referred to the Executive Management Committee;

5. Executive Management Committee reviews budgets and amends as necessary;

6. Audit and Finance Committee reviews budget and amends as necessary; and

7. Board of Directors reviews budget and amends as necessary.

Once the annual budget has been set, actual monthly results are evaluated against budgeted expenditures and major variances are explained. All variances are reviewed by the Executive Vice Presidents and Vice Presidents.

In addition to the general financial control processes as noted above, BC Ferries has a cost reduction plan and has implemented multiple strategies for containing and reducing operating costs. Examples of their strategies include:

- A fuel reduction strategy including optimized vessel deployment in order to maximize utilization and fuel efficiency;
- Amalgamation of professional training for finance division professionals in order to minimize disruption;
- Elimination of software licenses if not used within a set time period;
- Optimization of vessel refit and maintenance program to minimize service disruptions; and
- Management of mobile device usage and email account size.

PwC reviewed annual reports to the Audit & Finance Committee and confirmed that they included comparisons of regulatory earnings and operating expenses by G/L and OM&A to both budget and forecast figures, with a corresponding variance explanation provided for each variance from budget or forecast.

Executive Compensation Philosophy

As stated in the BC Ferries Statement of Executive Compensation for the fiscal year ended March 31, 2014, executive compensation is intended to meet the following objectives:

- Attract and retain talented senior executives by providing total compensation competitive with that of other senior executives employed by organizations of a similar size, complexity and lines of business;
- Motivate senior executives to achieve strong financial and operational performance;
- Emphasize performance-based compensation;
- Reward individual performance; and
- Comply with legislative requirements.

Executive compensation is informed by market data and analysis including the use of an independent third-party compensation expert to assist in the process. In August 2011, the BC Ferries Board of Directors engaged Mercer Canada Limited as a principal compensation advisor. Mercer's role included:

- Advising on regulatory development and market trends related to compensation practices;
- Providing advice with respect to the design of compensation programs;
- Reviewing compensation-related materials prepared by management and highlighting potential issues to the chairs of the Human Resources & Compensation Committee and the Governance & Nominating Committee as appropriate;
- Researching and providing data and analyses on compensation provided for similar positions in comparable organizations in Canada; and
- Participating in Human Resources & Compensation Committee and the Governance & Nominating Committee meetings upon the request of the respective committee chair.

The executive compensation plan was developed with reference to the following comparator groups:

- *Canadian Comparators* – Remuneration to be provided was benchmarked against the remuneration provided to individuals who, in organizations in Canada that are of a similar size and scope to BC Ferries, perform similar services or hold similar positions to the executive positions of the Company. This benchmarking review was conducted by the independent compensation advisor, Mercer Canada Limited, and identified median (50th percentile) total direct compensation of the Canadian comparator companies.
- *Public Sector Comparators (British Columbia)* – Remuneration is also benchmarked against provincial public sector employers in British Columbia. This list of comparables includes large commercial crown corporations and a large academic institution. Executive compensation under the plan was set in consideration of the remuneration then provided to the individuals who are preforming similar service and hold similar positions in the commercial crown corporations only, as these organizations are viewed as being the most directly comparable in terms of the nature of the services provided.

The remuneration of the President & CEO is set and administered by the BC Ferries Board of Directors in accordance with the approved executive compensation plan. On an annual basis, the Board, led by the Human Resources & Compensation Committee sets the performance requirements for the President & CEO and evaluates his performance against those requirements. The amount of the salary holdback earned by the President & CEO is determined based on the evaluation results and the available room under the total remuneration limit set in the executive compensation plan. With the assistance of the independent third-party compensation advisor, the Human Resources & Compensation Committee periodically reviews the remuneration limit set in the executive compensation plan in conjunction with market data from appropriate comparator organizations. Changes in the President & CEO's remuneration, if any, are made in consideration of his performance, leadership skills, retention risk, and value to achieving corporate strategy.

The Board, led by the Human Resources & Compensation Committee committee evaluates the performance of each Executive Vice President annually with respect to the achievement of annual performance objectives and targets set by the President & CEO. The evaluation results are used to determine the amount of the salary holdback earned by each Executive Vice President. Changes, if any, are made in consideration of the individual's performance skills, retention risk and value to achieving the corporate strategy and in conjunction with market compensation data obtained by the independent third-party compensation expert.

The CEO leads the evaluation of performance of 20 senior management who qualify for at-risk compensation. Under the current system, 50% of the at-risk compensation is dependent on achievement of corporate financial targets. The other half is dependent on personal performance. The maximum is 10 % and 20% depending on level.

Comparison of Executive Compensation and Organizational Design to Public Sector

The Public Sector Employers' Council ("PSEC") supports the provincial government in setting and coordinating strategic directions in human resources management and labour relations for the public sector. PSEC's authority related to labour relations is contained the Public Sector Employers Act and includes administering and managing the development and implementation of labour relations policies and practices in British Columbia public sector. Additionally, PSEC supports the minister responsible for PSEC in directing employers to create compensation plans for both excluded and executive employees that may include Chief Executive Officer compensation, wages, benefits and perquisites.

The PSEC Public Sector Executive Compensation Report Guidelines indicates that organizations subject to the Public Sector Employers Act are statutorily required to disclose all compensation that is both accrued and paid to the Chief Executive Officer and the next four highest ranking or highest paid executives with an annualized base salary of $125,000 or greater during the fiscal year on an annual basis. These disclosures are made available to the public on PSEC's website.

Using the publically available information, PwC compared compensation paid to BC Ferries' CEO and next four highest ranking or highest paid executive with annualized base salaries of $125,000 or greater to selected Crown Corporations in Figure 1. Figure 15 illustrates the relationship between executive compensation levels at BC Ferries and executive compensation levels at four provincial Crown corporations that follow Public Sector Employer's Council guidelines. [1]

Executive compensation is lower than that for BC Hydro, BC Lottery Corporation and the Insurance Corporation of BC and on a par with WorkSafe BC.

Executive compensation at BC Ferries has declined significantly over the period, from $3.0 million in F2009 to $1.8 million in F2014.

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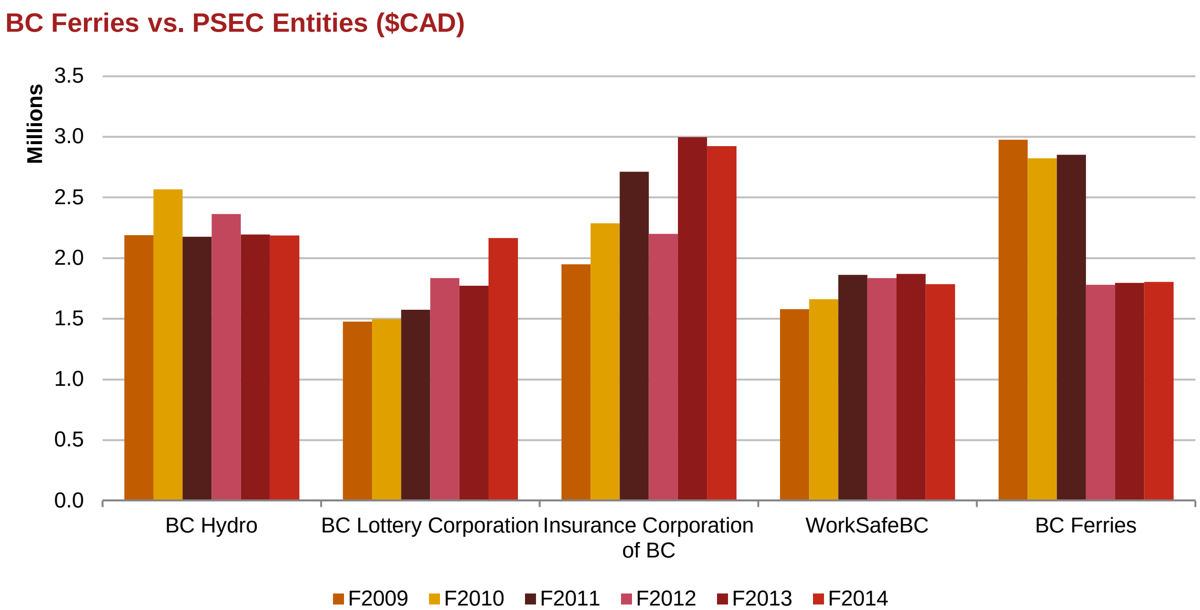
[1] PSEC guidelines require disclose of compensation that is "both accrued a paid to the CEO and the next four highest ranking / paid executives with an annualized base salary of $125,000 or greater during the fiscal year." Although BC Ferries is not subject to PSEC disclosure requirements, PwC obtained the compensation totals for the CEO of BC Ferries and the next four highest ranking / paid executives and compared this total to PSEC disclosures made by comparable organizations.

Figure 15



Based on the results above, the BC Ferries compensation figures are consistent with or lower than the selected Crown Corporations. Furthermore, a significant decrease in the BC Ferries compensation figures occurred starting in F2012. The decrease coincided with the elimination of the EVP & COO position which was the second highest paying executive position as well as the elimination of the long term incentive bonus plan beginning in F2012.

In the Crown Corporate Executive Compensation Policy, PSEC established a more rigorous approach to executive compensation in Crown Corporations and established polices for the payment of bonuses and organizational design. Under the policy, bonuses were eliminated in favour of holdbacks of up to 20% of base salary and organizational layers were limited to six. Furthermore, the report specified that direct reports to the CEO should not exceed seven.

Although BC Ferries is not subject to PSEC guidelines as they are not a Crown Corporation, PwC has assessed BC Ferries executive compensation and organizational design practices against PSEC guidelines in respect of incentive pay and organization design. The results are summarized in the table below.

PSEC Guideline	BC Ferries Practice	Result
Holdbacks limited to 20% of base salary	In fiscal 2014, holdbacks paid to the CEO and next four highest paid employees ranged from 11% to 20% of base salary.	BC Ferries complies with PSEC guidelines.
Organizational layers are limited to six	BC Ferries has a total of five organizational layers at the date of this report.	BC Ferries complies with PSEC guidelines.
Direct reports to the CEO are limited to seven	BC Ferries has a total of seven direct reports to the CEO at the date of this report.	BC Ferries complies with PSEC guidelines.

Additional details of BC Ferries organizational design are detailed below. Figure 16 compares the number of bargaining unit to exempt employees and figure 17 illustrates what proportion of those exempt employees are considered management.

Figure 16

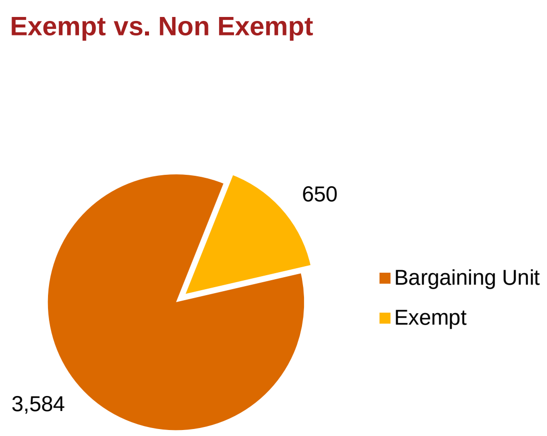
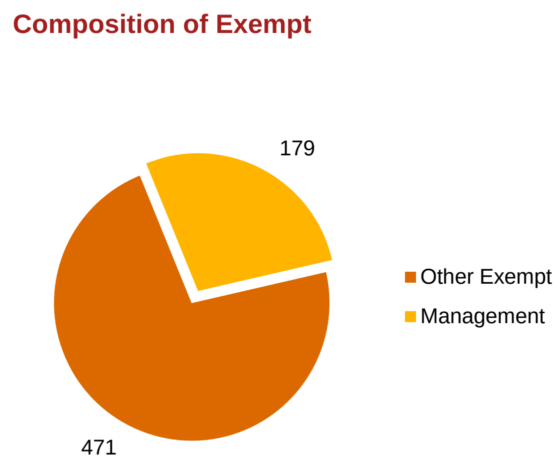


Figure 17



Of the 4,234 total employees at BC Ferries, 650 employees, or approximately 15%, are exempt. Of those 650 exempt employees, 179 meet the definition of management in so far as they have budgeting authority and direct reports.[2]

Figure 4 indicates that the 179 managers within BC Ferries are organized into 5 layers with the top layer consisting of the CEO and with each layer representing the number of direct reports between them and the CEO.

A summary by department is shown below.

CEO	1
Corporate Affairs	1
HR & CD	5
IT	11
Finance	17
Customer Services	37
Engineering	55
Fleet Ops	52
Total	179

The 179 managers within BC Ferries are organized into 5 layers with the top layer consisting of the CEO and with each layer representing the number of direct reports between them and the CEO.

Defined as the proportion of managers to bargaining unit, the management span of control ratio at BC Ferries is equal to approximately 20.0:1.

[2] Note that for the purpose of this performance review, PwC considers a BC Ferries employee to be management when they have both budgeting authority and direct reports.

	Ratio
Bargaining to Exempt	5.5:1
Bargaining to Managers	20.0:1

According to a Global Organizational Efficiency Survey White Paper that included 31 Fortune 1000 companies, the best in class span of control range is between 30:1 to 40:1 and the average for an organization with 6 organizational layers is 7.0:1. Based on the data set, BC Ferries' management span of control ratio of 20.0:1 is higher than the average but less than best in class.

The performance holdbacks or other forms of at risk performance compensation have been eliminated for the majority of exempt staff. In the past, approximately 75% of exempt staff qualified for bonuses. At the date of this report, holdbacks apply to 20 management staff.

The Long Term Incentive Plan was eliminated in fiscal 2012. BC Ferries then eliminated the short term incentive plan and replaced with the holdback program. These changes were retroactive to April 1, 2013 and for senior managers and April 1, 2014 for others qualifying.

Exempt Salary Adjustments

On an annual basis, BC Ferries reviews possible general salary adjustments for its exempt staff. Any increase is contingent on numerous factors including the financial performance of BC Ferries in the preceding year. From an external labour market perspective, the Company will consider the results of an annual external compensation survey, collective agreement adjustments, and public sector wage adjustments particularly for the British Columbia Government, BC Hydro, ICBC and TransLink. BC Ferries reviews this information with the Board of Directors for consideration and approval of any resulting general salary adjustments.

Relationship with Union

Management's relationship with its union has improved since BC Ferries was reorganized as an independent company. Labour stability has been in place since 2003. BC Ferries also have a strong employee engagement process and management has obtained a high degree of cooperation with its safety programs. That has resulted in significant improvements in safety and reductions in absenteeism.

Addressing Skill Gaps

The most significant skill gaps are with deck and engineering offices. Strategies to address these gaps include attraction programs, efforts to exclude these skilled positions from the bargaining unit in order to facilitate hiring and extensive training that involves:

- Operational and management programs
- Simulations
- Two levels of management training: shore and off-shore
- Linkages with training programs offered at BCIT, Camosun College and the University of Victoria.

Outsourcing Initiatives

BC Ferries have outsourced certain functions and examined others in order to increase efficiency:

- IT technical support was outsourced from the late 1990's to 2007, but this was repatriated due to high costs.
- During the 2001-2007 period, some of the ERP responsibilities were contracted out but these were also repatriated.
- Some banking functions have been outsourced but these may be repatriated with new systems.

It has examined the merits of outsourcing payroll administration and accounts payable. At this stage outsourcing remains very limited.

Awards

BC Ferries has received the following efficiency-related awards since the beginning of PT2:

- SailSafe – A joint initiative between BC Ferries and the BC Ferry & Marine Workers' Union which focuses on injury prevention and employee wellness. The initiative has resulted in safer, healthier employees and financial savings in WorkSafe BC compensation costs.
- WorkSafeBC Certificate of Recognition – Awarded by WorkSafeBC in 2014 as a result of safety initiatives implemented by BC Ferries. The award resulted in a rebate of $600,000 in WorkSafeBC premiums.
- Lloyd's List North America Safety Award – Awarded in the training category for improvements in navigation safety as a result of the new Bridge Simulation Training program.
- Latitude Productions UK International Safety Award – Awarded for motivating and inspiring employees to reach for world-class safety performance.
- Power Smart Excellence Award – Power Smart Leader – Awarded in by BC Hydro in 2014 to customers who continuously demonstrate a best-in-class approach to strategic energy management and an ongoing commitment to energy conservation in British Columbia.

Finance Expense

Figure 18 illustrates the rate of the most recent debt issuances for BC Ferries and comparable organizations. Credit rating information is included for each organization. With recent performance, BC Ferries has the third lowest debt issuance rate amount the comparable companies despite the fact they are rated "A" while the comparables are rated "AA".

Figure 18

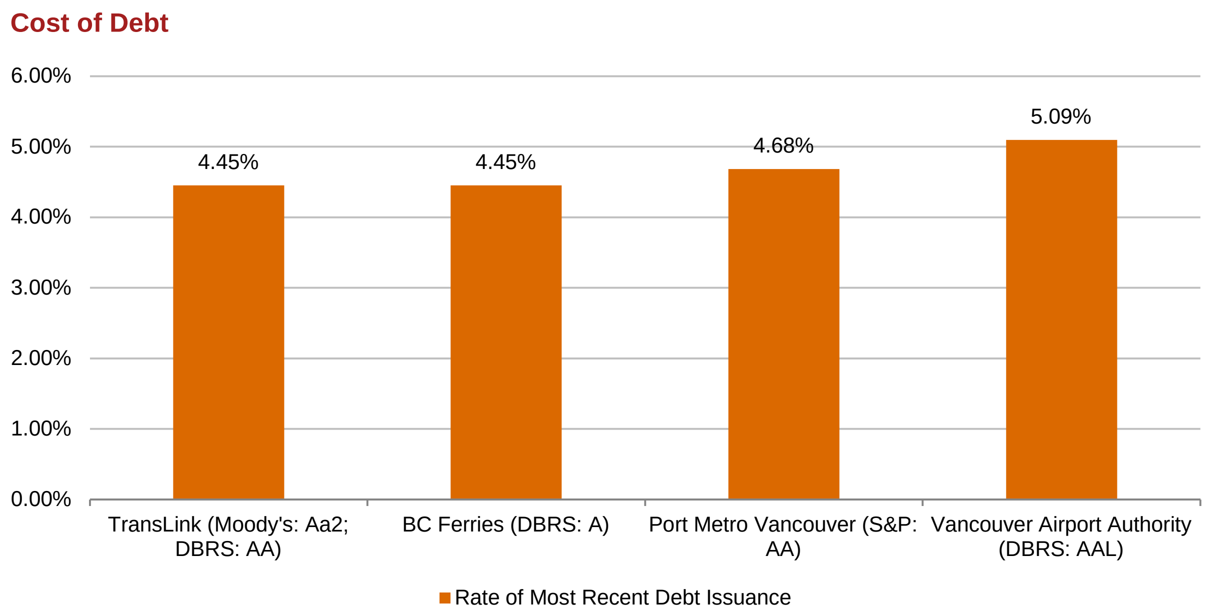
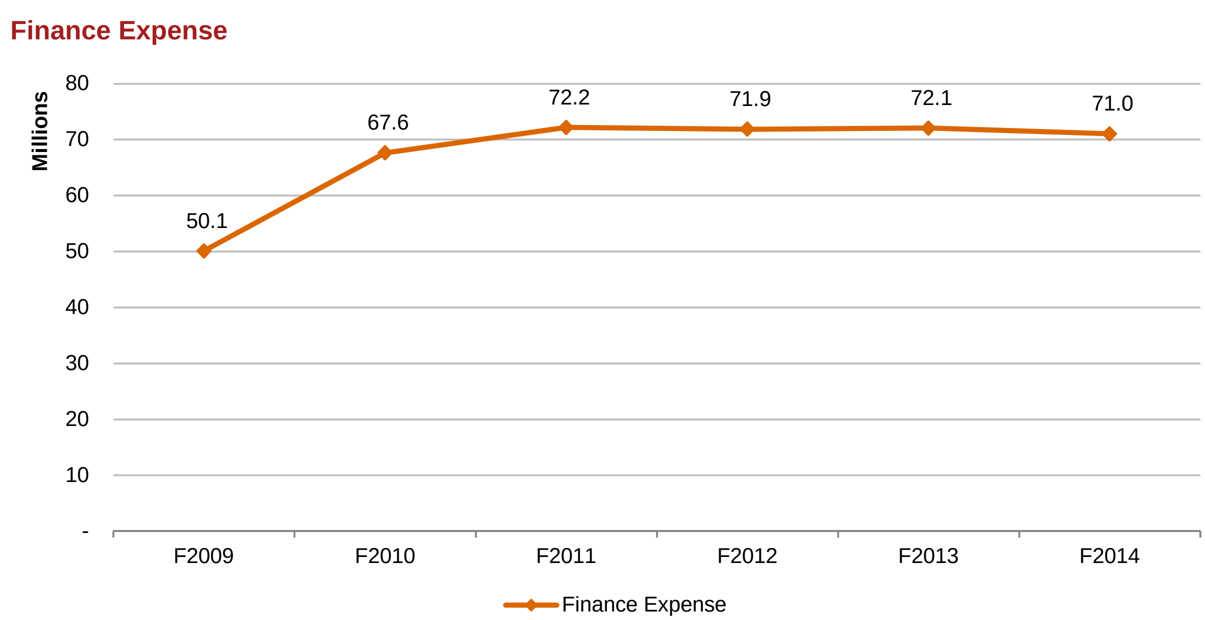


Figure 19 illustrates the finance expense incurred by BC Ferries between fiscal 2009 and fiscal 2014. Based on the chart, interest costs have been relatively consistent over the period from fiscal 2011 to fiscal 2013 and have decreased slightly in fiscal 2014. Accordingly, debt costs are reasonable and debt management appears appropriate.

Figure 19



Conclusions

The significant findings of our report are as follows:

- BC Ferries is demonstrating good cost control, especially in the area of Administrative expenses. Overall Administrative expenses have been reduced as a result of lower executive compensation and reduced head count. Lower scheduled and unscheduled overtime hours have also assisted in moderating overall labour cost increases.

- Cost control has been achieved while obtaining good outcomes with customer satisfaction and passenger and employee safety.

- The assessment of financial and management controls and processes addressed planning, budgeting, reporting and internal controls has been conducted at a high level. The assessment determined that these controls and processes appear to be appropriate.

- BC Ferries appear to have a strong culture of efficiency, based on its sound budgeting process, and alignment of performance pay with corporate objectives.

- BC Ferries' executive compensation compares well against that of several provincial Crown corporations. BC Ferries' executive compensation policies and procedures appear appropriate for an organization of its size and complexity.

- BC Ferries complies with PSEC guidelines for at-risk compensation, organizational layers and direct reports to the CEO. The number of managers does not appear to be excessive.