BRITISH COLUMBIA
FERRY COMMISSION

ORDER
NUMBER: 12-04

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IN THE MATTER OF
Section 55 of the *Coastal Ferry Act*,
and
An Order to Establish the Criteria to Determine When a Capital Expenditure is Deemed to be a Major Capital Expenditure for Purposes of Section 55

BEFORE: Gordon Macatee, BC Ferries Commissioner
Sheldon Stoilen, BC Ferries Deputy Commissioner

O R D E R

WHEREAS:

A. Section 55(2) of the *Coastal Ferry Act* (the “Act”) created a requirement that the ferry operator must first obtain the commissioner’s approval before incurring a major capital expenditure;

B. Section 55(5) of the Act provides that a capital expenditure of a ferry operator is a major capital expenditure if it meets the criteria

(1) established by the commissioner from time to time; and

(2) most recently provided by the commissioner to the ferry operator.

C. The Board of Directors of BC Ferry Services Inc. (“BC Ferries”) has a policy in place requiring board approval of all capital expenditures greater than $15 million;

D. The commissioner’s capital expenditure oversight is intended to ensure that major capital expenditures are reasonable, prudent, and consistent with the current Coastal Ferry Services Contract, any long-term capital plan established by the ferry operator and a government approved long-term vision for the future evolution of marine ferry services;

E. The Province has announced its intention to develop and approve a long-term vision for the future evolution of marine ferry services to provide a framework for capital planning purposes;

F. BC Ferries has elected to adopt new International Financial Reporting Standards (IFRS) accounting standards as of April 1, 2012, and the change will have a direct impact on how capital expenditures are reported in the financial statements. Information on BC Ferries new IFRS accounting standards is in Appendix A to this order;

G. The Province will terminate the Harmonized Sales Tax (HST) on April 1, 2013, restore the Goods and Services Tax (GST) and introduce a Provincial Sales Tax (PST). These tax changes will have an effect on the capital costs going forward;

H. The commissioner's report to the Minister of Transportation and Infrastructure in January 2012 recommended that BC Ferries begin a process of transitioning to liquefied natural gas (LNG) fuel on vessels as soon as possible;

I. The same report recommended that BC Ferries move quickly to upgrade reservation and ticketing systems to allow for transition to an expanded use of reservations across the system.

NOW THEREFORE the commissioners order that:

1. For purposes of section 55(5), a major capital expenditure is defined as any capital expenditure which exceeds $30 million, inclusive of component programs and interest during construction, and irrespective of the level of expenditure, any new vessel or terminal, and any vessel life extension which extends the life of the vessel by more than five years.

2. In addition, upgrades to information technology (IT) systems in excess of $5 million which support ticketing and reservations, are considered a major capital expenditure.

3. The commissioner accepts BC Ferries' intention to transition to the new IFRS accounting standards on the timetable noted above.

4. Any additional capital costs or capital savings which result from the transition to IFRS or to a new PST / GST tax arrangement are to result in adjustments to the capital plan, and not result in any unplanned, additional capital expenditure.

5. BC Ferries is permitted to bring forward applications for Section 55(1) for commissioner review and pre-authorization of projects which are not deemed to be major capital projects at its discretion.

6. In addition to a 10-year capital plan which is required to be submitted by the ferry operator to the commissioner prior to commencement of the next performance term, the ferry operator shall submit annually to the commissioner its rolling five-year capital plan and any updates thereto which have been approved by its Board of Directors.

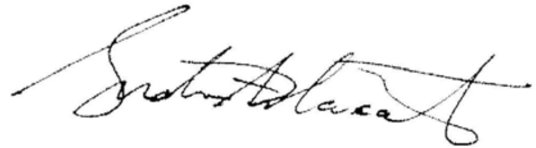
7. The commissioner's review and approval or disapproval of a major capital expenditure will be based solely on a determination that the project is or is not: reasonable, affordable, prudent, consistent with the approved and current five-year

capital plan as submitted to the commissioner; consistent with the current Coastal Ferry Services Contract; and consistent with any government approved long-term vision for the future evolution of marine ferry services.

8. All capital expenditure plans for new vessels and all vessel life extensions which involve engine replacement must include consideration of conversion to LNG fuel.

DATED at Victoria in the Province of British Columbia, this 30th day of September, 2012.

BY ORDER



Gordon Macatee
BC Ferries Commissioner

Sheldon Stoilen
BC Ferries Deputy Commissioner

APPENDIX A

Transition to International Financial Reporting Standards

Prepared by the British Columbia Ferry Services Inc.

British Columbia Ferry Services Inc.
Transition to International Financial Reporting Standards

At the request of the British Columbia Ferries Commissioner, we have prepared this document to address the following three questions:

- Why are we transitioning to International Financial Reporting Standards ("IFRS")?
- Why are we changing over to reporting under IFRS effective April 1, 2012?
- How does the transition to IFRS impact us?

1. Why are we transitioning to IFRS?

In 2006, the Canadian Accounting Standards Board (AcSB) published a strategic plan that significantly affected financial reporting requirements for Canadian companies. The AcSB strategic plan outlined the convergence of Canadian generally accepted accounting principles (CGAAP) with IFRS over an expected five year transitional period. The benefits identified in such a convergence included:

- Provision of better access to global capital markets
- A move to principles-based standards like IFRS and away from rules-based-standards (would be easier to apply)
- Would be more cost effective than maintaining a separate CGAAP

As part of the AcSB's plan, IFRS replaces existing CGAAP for Canadian Publicly Accountable Enterprises, including BC Ferries. Existing CGAAP ceases to exist for Canadian Publicly Accountable Enterprises upon changeover to IFRS.

2. Why is our *Changeover* date for reporting under IFRS April 1, 2012?

The required *changeover* date to IFRS for most Canadian Publicly Accountable Enterprises was for annual periods beginning on or after January 1, 2011. For us, this would have required a changeover to IFRS effective April 1, 2011. In October 2010, the AcSB amended Part 1 of the CICA Handbook – Accounting (Handbook) to permit qualifying entities with rate-regulated activities to defer the adoption of IFRS by one year to no later than annual periods beginning on or after January 1, 2012. We elected this option which deferred our *changeover* date for reporting under IFRS to April 1, 2012.

In March 2012, the AcSB announced its intention to extend the option for deferral of the mandatory IFRS changeover date for entities with qualifying rate-regulated activities by one more year, to annual periods beginning on or after January 1, 2013. The Handbook was amended in May 2012 to permit this further deferral of IFRS adoption. We have chosen not to defer the adoption of IFRS for this additional one year period. Accordingly, our *changeover* date for conversion to IFRS will remain as April 1, 2012. Since IFRS requires comparative figures prepared under the same basis of accounting to be shown in the financial statements, the effective date for *transitioning* to IFRS is April 1, 2011.

Although considered, we did not elect the additional one year deferral for the following reasons:

- At the time of the announcement, we had already embedded IFRS into our systems and processes, and resources necessary for changes were otherwise engaged. Considerable time and effort would have been required to change back and would have resulted in an unacceptably high level of risk of failing to meet our fiscal 2013 first quarter reporting deadlines.
- We would have incurred unnecessary costs if the additional deferral option was chosen. These costs would have arisen from such activities as removing and rebuilding a fixed asset sub ledger; cancelling and recreating project work orders; changing reporting and budgeting models; maintaining records under both CGAAP and IFRS for another year; obtaining additional actuarial valuations and additional external audit and review of duplicate (IFRS and CGAAP) reporting.
- Going forward with IFRS is projected to have a positive impact on our financial results over the third performance term, and removal of regulatory assets and/or liabilities has limited impact as these balances are not significant and can be managed.
- We will continue to maintain all records necessary to account for regulatory assets and/or liabilities (deferral accounts). Although IFRS does not permit these regulatory assets and/or liabilities to be shown on the Statement of Financial Position, they will be fully disclosed in the notes to our financial statements, our Management's Discussion & Analysis, and will continue to be used for purposes of setting future price caps and fuel surcharges or rebates.

3. What are the items that will have the most significant impact on us as we transition to IFRS?

There are a number of items of difference between CGAAP and IFRS which will impact our financial position and results of operations. Primarily, these represent differences as to when an item is recognized in net earnings and, over a period of time, retained earnings should not be significantly different. We project that the transition to IFRS will have a positive impact on our financial position and operating results over the five years ended March 31, 2016.

The areas with the highest impact on our financial position and results of operations include the following:

I. Property, plant and equipment:

a) *Inspections and major overhauls*

Under IFRS, inspections and major overhauls of our vessels will be capitalized. Under CGAAP these items were expensed as incurred. The capitalization of inspections and major overhauls of our vessels is a significant change affecting us. A process to track these items has been finalized and necessary system configuration changes completed. We have defined, identified, and quantified inspection and major overhaul items for each class of vessel for reclassification at transition date and internal reporting solutions have been completed.

This change has the potential to cause significant fluctuations in earnings over the reporting periods due to the level of inspections and major overhauls in any one period and the number of periods over which each will be amortized.

Impact on transition: None

Expected future impact: Over the five years ending March 31, 2016, we estimate the net impact of this change to range from a decrease in annual net earnings of $1 million to an increase in annual net earnings of $14 million.

b) *Feasibility, research and training costs related to capital projects*

As a rate-regulated entity and prior to transitioning to IFRS, we capitalized some costs such as feasibility, research and training that directly related to a specific asset. Under IFRS these costs will no longer be capitalized.

Impact on transition: None

Expected future impact: Over the five years ending March 31, 2016, we estimate the net impact to be a decrease in earnings of up to $2 million annually. These decreases in earnings should be offset by increases in earnings in annual periods subsequent to March 31, 2016.

c) *Valuation at and subsequent to transition*

Upon transition to IFRS, we have a choice to value property, plant and equipment using either a historical cost model or a revaluation model. We have decided to use a historical cost model for all property, plant and equipment with the exception of land. We will use a revaluation model for land assets.

Impact on transition: The choice of a revaluation model for land assets has resulted in increases in land value and retained earnings of $12.2 million on the transition date of April 1, 2011.

Expected future impact: Earnings in annual periods subsequent to transition will reflect gains or losses as land values change from one year to the next.

II. *Rate-regulated operations:* IFRS does not currently provide specific guidance with respect to accounting for rate-regulated activities. We expect that issues regarding rate-regulated activities will remain unresolved for some time and as a result, regulatory assets and/or liabilities will not be shown on the IFRS Statement of Financial Position.

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

Expected future impact: Although future balances of regulatory accounts are uncertain, we expect that they will not have a material impact on our future financial position and results of operations. We also expect that net earnings over the five year period ended March 31, 2016 will increase by $2.1 million as we recover the net regulatory assets derecognized at April 1, 2011.

III. *Employee Benefits:* Upon transition to IFRS, we had a choice to either recognize all cumulative actuarial gains and losses of defined benefit plans through opening retained earnings or recalculate the actuarial gains and losses under IFRS from the

inception of the defined benefit plans. We elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2011.

Impact on transition: The actuarial loss recognized reduced opening retained earnings by $3.6 million.

Expected future impact: Under CGAAP, actuarial gains and losses would have been reflected in future earnings over the expected average remaining service period of active employees. Accordingly, annual net earnings over that future period are expected to increase by a total of $3.6 million.

Summary of Impact:

Impact on transition: The impact on our opening retained earnings at April 1, 2011 resulting from the transition to IFRS is as follows:

Impact on opening retained earnings	($ millions)
Land revaluation (I c))	12.2
De-recognition of regulatory assets and liabilities (II)	(2.1)
Cumulative actuarial loss on defined benefit plans (III)	(3.6)
Increase in opening retained earnings	6.5

Expected future impact: We estimate that the transition to IFRS will result in an increase in net earnings for the five year period ended March 31, 2016 of approximately $23 million. This increase includes the recovery of $2.1 million in net regulatory assets which were derecognized and charged to retained earnings upon transition to IFRS at April 1, 2011. We must, however, comply with regulatory orders which create regulatory assets and liabilities and accordingly, for the purposes of setting price caps and monitoring our compliance with them, the Commissioner should recognize them when reviewing our financial position and results of operations. When adjusted downwards to remove the recovery of the net regulatory assets, the increase in net earnings over the five year period is expected to be approximately $21 million.