Quarterly Financial Report

MARINE ATLANTIC INC.

September 30, 2011

MARINE ATLANTIC INC.
Table of Contents
September 30, 2011

MARINE ATLANTIC INC.
Quarterly Financial Report
September 30, 2011

The following Quarterly Financial Report of the financial results of Marine Atlantic Inc. ("the Corporation") is for the six months ended September 30, 2011. This report should be read in conjunction with the Corporation's 2011/12 – 2015/16 Corporate Plan Summary and the Corporation's 2010/2011 Annual Report which includes the audited annual financial statements for the year ended March 31, 2011. Information about the Corporation, including the Annual Report and the Corporate Plan Summary, can be found at www.marine-atlantic.ca.

The unaudited financial statements and the accompanying notes have been prepared in accordance with Public Sector Accounting Standards and are reported in Canadian dollars.

OVERVIEW OF THE CORPORATION

Marine Atlantic Inc. is a federal Crown Corporation responsible for operating the ferry service between the Island of Newfoundland and the Province of Nova Scotia. Its vessels carry people, vehicles, and commercial units that deliver goods and products to and from the Province of Newfoundland and Labrador. It is constitutionally mandated to perform its transportation service.

The Corporation reports annually to the Government of Canada through the Minister of Transport, Infrastructure and Communities and works closely with the Minister of State (Transport). A Bilateral Agreement with the Government of Canada sets out the principles that govern the Corporation's relationship with the shareholder. It also outlines the funding agreements under which the Corporation operates its ferry service. While the Corporation generates revenues from its operations, the majority of required funding is received from the federal government through Transport Canada.

Headquartered in St. John's, NL, Marine Atlantic Inc. operates terminals in the Newfoundland and Labrador ports of Port aux Basques and Argentia and the Nova Scotia port of North Sydney. The Corporation provides ferry services on two routes: a year-round 96 nautical mile daily ferry service between Port aux Basques and North Sydney and a seasonal 280 nautical mile tri-weekly ferry service between Argentia and North Sydney (which operates only during the higher traffic period between mid-June and late-September).

Marine Atlantic Inc. is a key employer in each of the three towns in which it operates. Its employees have stable employment opportunities that translate into significant direct and indirect benefits to these areas. Employment levels within the Corporation peak at more than 1,300 persons during the busy summer season. The workforce at Marine Atlantic Inc. is predominately unionized; approximately 96 per cent of employees are unionized and covered by six Collective Agreements. To fulfill its mandate, the Corporation operates a fleet of four ice-class ferries. The Corporation's fleet includes the MV *Blue Puttees*, MV *Highlanders*, MV *Atlantic Vision* and the MV *Leif Ericson*. The fleet of vessels is maintained to high standards and codes such as Transport Canada Marine Safety, American Bureau of Shipping, Lloyds Register and Det Norske Veritas Classification Societies, and complies with the International Safety Management (ISM) Code.

To ensure the safe operations of vessels at sea, Marine Atlantic Inc. is governed by various acts and regulations. These include: *Canada Labour Code*, *Marine Occupational Safety and Health Act* and Regulations, *Transportation of Dangerous Goods Act* and Regulations, *Marine Liability Act* and Regulations, *Canada Shipping Act* and Regulations, *Canada Marine Act*, *Coastal Trade Act*, Domestic Ferries Security Regulations (DFSR), and the Marine Transportation Security Regulations (MTSR) Part III.

The Corporation also falls under the umbrella of the International Convention for the Safety of Life at Sea (SOLAS), the pre-eminent of all international treaties concerning the safety of merchant ships.

QUARTERLY RESULTS

Financial Performance snapshot (in thousands)

	Three months ending September 30, 2011				Six months ending September 30, 2011			
	Actual	Budget	Variance $ [1]	Var %	Actual	Budget	Variance $ [1]	Var %
Revenue	$ 38,299	$ 38,285	$ 14	0%	$ 61,673	$ 61,214	$ 459	1%
Expenses	$ 65,539	$ 67,073	$ 1,534	2%	$ 129,152	$ 136,093	$ 6,941	5%

[1] Positive Variance indicates a favourable result compared to Budget

Statistics snapshot

	Three months ending September 30, 2011				Six months ending September 30, 2011			
	Actual	Forecast	Variance [2]	Var %	Actual	Forecast	Variance [2]	Var %
Passengers	197,255	221,192	(23,937)	-11%	275,400	303,951	(28,551)	-9%
Passenger Units	70,932	78,050	(7,118)	-9%	98,552	108,240	(9,688)	-9%
Commercial Units	27,603	27,604	(1)	0%	55,607	54,655	952	2%
Auto Equivalent Units [3]	193,094	201,615	(8,521)	-4%	339,307	346,374	(7,067)	-2%

[2] Positive Variance indicates a favourable result compared to Forecast
[3] Auto Equivalent Unit or AEU is the length of an average passenger automobile

Revenues

The Corporation's revenue in the second quarter was as forecasted in the Corporate Plan. This was due mainly to commercial traffic which continues to grow this year. Commercial traffic was as forecasted in the quarter and is two per cent higher than expected for the year to date (four per cent higher than the same period of the prior year).

In addition, onboard accommodation revenue continued to be higher than budgeted in the quarter and fuel surcharge revenue was higher due to the increase that became effective in July. These revenue gains are partially offset by passenger and passenger related vehicle traffic which continued to be below projections in the period. Passenger traffic is lower than forecasted by 11 per cent for the quarter and nine per cent for the year to date (six per cent lower than the same period of the prior year) while passenger related vehicle traffic is down from forecast by nine per cent for both the quarter and year to date (four per cent lower than the same period of the prior year).

Expenses

The Corporation's expenses were two per cent under budget in the second quarter. This small positive variance was due mainly to further gains on settled fuel swap contracts and lower wages and benefits expense due to lower than expected staff complements in the period.

Vessel, Facilities, and Equipment

During the first two quarters of this year, the Corporation invested $5.3 million in its capital assets which includes $1.5 million for additional work required on the MV *Leif Ericson*. Planning continued for multi-year projects such as the development of the master plan for the terminal facilities. Over 50 per cent of anticipated spending in capital this year is associated with two major projects including the planned maintenance for the MV *Atlantic Vision* which is scheduled for the winter and renovations to the recently purchased administration and warehousing building in North Sydney which began during the second quarter.

Forecast

The second quarter was extremely busy within the Corporation as the focus centered on delivering a positive travel experience for our customer and moving forward with internal renewal. The Corporation's approved government funding for 2011/12 is $200.6 million. Based upon results of the first two quarters and the budget allocated for the remainder of the year, the Corporation is anticipating it will operate well within its approved funding allocation and its forecasted cost recovery. There have been no revisions in goals or objectives compared to the Corporate Plan Summary.

RISK ANALYSIS

The financial risks of the Corporation have previously been disclosed in the Corporation's 2011/12 – 2015/16 Corporate Plan Summary and the Corporation's annual report. There are no significant changes to the risks previously identified.

SIGNIFICANT EVENTS

Marine Atlantic continued to focus significant efforts on renewal of the organization. The following highlights a number of initiatives from the second quarter period.

Summer of Success

With the addition of the MV *Blue Puttees* and MV *Highlanders* to Marine Atlantic's service, and the introduction of a new fleet to our customers, a number of initiatives were launched in anticipation of the busy summer season. The "Summer of Success" initiative placed significant focus on a successful integration of the new fleet and an improved experience for Marine Atlantic's customers.

An analysis of our summer season data shows that all of the preparatory work that took place helped achieve significant positive results. Some of these highlights include substantial growth in fleet capacity, a significantly improved travel experience for customers, greater access to reservations, improved reliability and on-time performance, significant passenger growth on the Argentia service, higher usage and satisfaction levels with onboard amenities such as cabins, and continuing increases to commercial traffic volumes. Unfortunately, similar to trends throughout Atlantic Canada, passenger vehicle traffic was down due to a number of economic factors. Despite this decrease, the success of the summer season has generated renewed confidence in Marine Atlantic's service which offers the potential for additional growth in the months and years ahead.

Sale of MV Caribou *and MV* Joseph and Clara Smallwood

After an extensive global marketing campaign, Marine Atlantic's long-serving vessels, the MV *Caribou* and the MV *Joseph and Clara Smallwood*, were sold by public auction to international buyers. The MV *Caribou* was sold for $3.875 million, while the MV *Joseph and Clara Smallwood* was sold for $3.8 million. Both vessels left the North Sydney area in early September after serving our customers and employees with distinction over a 25-year period.

Human Resources

During the second quarter, Marine Atlantic continued with its active recruitment campaign to attract a new Chief Information Officer (CIO) to oversee the Corporation's information and technological services. This senior executive position is expected to be filled during the third quarter. In addition, at the time of drafting this report, the President and CEO announced his retirement date for mid-December.

Shore-based Upgrades

A number of shore-based upgrades and re-developments are taking place at all three of Marine Atlantic's terminal properties. The planning process for the terminal re-development projects began late in the quarter and will continue into the third quarter. It is anticipated that following the planning phases, significant construction activity will begin.

Goods and Services Tax/Harmonized Sales Tax (GST/HST)

In October, Marine Atlantic received an update from the Canada Revenue Agency (CRA) Appeals Division relating to Notice of Objections filed by the company. The Corporation does not agree with the proposal and will obtain advice on the next steps and respond to the letter in the prescribed time.

REPORTING ON USE OF APPROPRIATIONS

The Corporation received $89 million in appropriations from the Government of Canada during the six months ended September 30, 2011. Please refer to Note 2(b) to the unaudited interim financial statements for the Corporation's accounting policy for government appropriations. Note 4 to the unaudited interim financial statements reports on how the appropriations received were used during the period.

STATEMENT OF MANAGEMENT RESPONSIBILITY

Management is responsible for the preparation and fair presentation of these quarterly financial statements in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations, and for such internal controls as management determines is necessary to enable the preparation of quarterly financial statements that are free from material misstatement. Management is also responsible for ensuring all other information in this quarterly financial report is consistent, where appropriate, with the quarterly financial statements.

Based on our knowledge, these unaudited quarterly financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the Corporation, as at the date of and for the periods presented in the quarterly financial statements.

Wayne Follett, CGA	Shawn Leamon, CGA
President and CEO	Vice President of Finance

St. John’s, NL
November 24, 2011

MARINE ATLANTIC INC.
Unaudited Statement of Financial Position
As at September 30, 2011
(in thousands)

	September 30, 2011	March 31, 2011 (Restated - Note 3)	April 1, 2010 (Restated - Note 3)
Financial assets			
Cash (Note 5)	**$ 23,865**	$ 9,580	$ 11,054
Accounts receivable	**11,149**	9,035	9,505
Receivable from Government of Canada (Note 4)	**-**	3,396	-
Inventories for resale	**350**	341	508
Derivative financial instruments	**2,756**	4,008	156
Accrued pension asset	**50,942**	49,501	34,674
Assets held for sale	**-**	7,200	-
	$ 89,062	$ 83,061	$ 55,897
Liabilities			
Accounts payable and accrued liabilities	**$ 16,255**	$ 29,211	$ 18,830
Derivative financial instruments	**966**	275	1,865
Deferred revenue	**1,461**	2,628	3,841
Payable to Government of Canada (Note 4)	**8,219**	-	1,234
Accrued vacation pay	**6,042**	5,860	5,617
Accrued pension liability	**1,882**	1,857	1,921
Accrued liability for other non-pension post-retirement benefits	**34,166**	32,826	30,839
Accrued liability for post-employment benefits	**12,083**	12,415	13,172
	81,074	85,072	77,319
Net financial assets (debt)	**$ 7,988**	$ (2,011)	$ (21,422)
Non-financial assets			
Prepaid expenses	**2,868**	3,202	480
Inventories held for consumption	**12,869**	11,390	13,615
Vessel, facilities, and equipment	**177,145**	179,886	130,047
	192,882	194,478	144,142
Accumulated surplus (deficit)	**$ 200,870**	$ 192,467	$ 122,720
Accumulated surplus is comprised of:			
Accumulated operating surplus	**202,589**	192,467	122,720
Accumulated remeasurement gains (losses)	**(1,719)**	-	-
	$ 200,870	$ 192,467	$ 122,720

Contingencies (Note 8)

The accompanying notes are an integral part of these financial statements.

MARINE ATLANTIC INC.
Unaudited Statement of Operations and Accumulated Surplus
Period ended September 30, 2011
(in thousands)

	3 month period ended September 30, 2011	6 month period ended September 30, 2011	12 month period ended March 31, 2011
			(Restated - Note 3)
Revenues			
Commercial	$ 33,321	$ 54,100	$ 83,920
Fuel surcharge	4,901	7,460	11,662
Other income	77	113	181
	38,299	61,673	95,763
Expenditures			
Wages and benefits	23,152	44,285	79,407
Fuel	11,415	18,545	32,512
Charter fees	11,123	22,207	25,818
Charter importation taxes	-	7,876	13,832
Repairs and maintenance	3,716	6,404	12,352
Materials, supplies and services	5,102	7,680	13,372
Insurance, rent and utilities	1,579	2,695	5,405
Fleet renewal costs	48	1,211	10,001
Other	1,293	2,316	9,078
Employee future benefits (Note 6)	4,018	8,036	8,279
Decommissioning of vessels	648	2,507	3,118
Foreign currency exchange loss	17	46	66
Unrealized (gain) loss on derivative financial instruments	-	-	(5,442)
Realized (gain) loss on derivative financial instruments	(529)	(1,853)	2,761
(Gain) Loss on disposal of vessel, facilities and equipment	-	-	(14)
Loss on write down of assets held for sale	-	-	8,322
(Gain) Loss on disposal of assets held for sale	(872)	(872)	-
Amortization	4,829	8,069	12,476
	65,539	129,152	231,343
Surplus (deficit) before government funding	(27,240)	(67,479)	(135,580)
Government funding			
Operations	24,955	69,766	124,370
Capital	1,432	5,328	77,839
Recovery of vessel decommissioning costs	648	2,507	3,118
	27,035	77,601	205,327
Surplus (deficit)	(205)	10,122	69,747
Accumulated surplus (deficit), beginning of period as originally stated	199,060	192,467	(219,580)
Change in accounting policy (Note 3)	-	-	342,300
Accumulated surplus, beginning of period as restated	199,060	192,467	122,720
Accumulated surplus, end of period	$ 198,855	$ 202,589	$ 192,467

The accompanying notes are an integral part of these financial statements.

MARINE ATLANTIC INC.
Unaudited Statement of Remeasurement Gains and Losses

Period ended September 30, 2011
(in thousands)

	3 month period ended September 30, 2011	6 month period ended September 30, 2011	12 month period ended March 31, 2011
Accumulated remeasurement gains (losses) on derivative financial instruments, beginning of period	**$ (670)**	**$ -**	$ -
Remeasurement gains (losses) arising during the period			
Unrealized gain (loss) on foreign exchange of cash	**92**	**225**	-
Unrealized gain (loss) on derivatives	**(612)**	**(91)**	-
Reclassifications to the statement of operations			
Realized gain (loss) on derivatives	**(529)**	**(1,853)**	-
Net remeasurement gains (losses) for the period	**(1,049)**	**(1,719)**	-
Accumulated remeasurement gains (losses) on derivative financial instruments, end of period	**$ (1,719)**	**$ (1,719)**	$ -

The accompanying notes are an integral part of these financial statements.

MARINE ATLANTIC INC.
Unaudited Statement of Change in Net Financial Assets (Debt)
Period ended September 30, 2011
(in thousands)

	3 month period ended September 30, 2011	6 month period ended September 30, 2011	12 month period ended March 31, 2011 (Note 3)
Surplus (deficit)	**$ (205)**	**$ 10,122**	$ 69,747
Change in tangible capital assets			
Acquisition of vessel, facilities and equipment	**(1,432)**	**(5,328)**	(77,838)
Amortization of vessel, facilities and equipment	**4,829**	**8,069**	12,476
Loss on disposal of vessel, facilities and equipment	**-**	**-**	(14)
Loss on write down of assets held for sale	**-**	**-**	8,322
Reclassification of assets held for sale to financial assets	**-**	**-**	7,200
Proceeds on disposal of vessel, facilities and equipment	**-**	**-**	15
Decrease (increase) in tangible capital assets	**3,397**	**2,741**	(49,839)
Change in other non-financial assets			
Net change in inventories held for consumption	**3,843**	**(1,479)**	2,225
Net change in prepaid expenses	**4**	**334**	(2,722)
Decrease (increase) in other non-financial assets	**3,847**	**(1,145)**	(497)
Remeasurement gains (losses)	**(1,049)**	**(1,719)**	-
Decrease (increase) in net debt	**5,990**	**9,999**	19,411
Net financial assets (debt), beginning of period	**1,998**	**(2,011)**	(21,422)
Net financial assets (debt), end of period	**$ 7,988**	**$ 7,988**	$ (2,011)

The accompanying notes are an integral part of these financial statements.

MARINE ATLANTIC INC.
Unaudited Statement of Cash Flows
Period ended September 30, 2011
(in thousands)

	3 month period ended September 30, 2011	6 month period ended September 30, 2011	12 month period ended March 31, 2011
			(Restated - Note 3)
Operating transactions			
Cash receipts from customers	**$ 31,878**	**$ 59,212**	$ 94,538
Other income received	**116**	**129**	77
Government funding	**35,350**	**73,116**	133,629
Cash paid to suppliers and employees	**(52,974)**	**(109,893)**	(207,832)
Cash paid for pension, workers' compensation and other non-pension employee future benefits	**(3,975)**	**(8,442)**	(21,940)
	10,395	**14,122**	(1,528)
Capital transactions			
Purchase of vessel, facilities and equipment	**(1,432)**	**(16,100)**	(67,067)
Proceeds on disposal of vessel, facilities and equipment	**-**	**-**	15
	(1,432)	**(16,100)**	(67,052)
Financing transactions			
Interest and foreign exchange on cash	**36**	**163**	39
Government capital funding	**1,432**	**16,100**	67,067
	1,468	**16,263**	67,106
Net increase (decrease) in cash	**10,431**	**14,285**	(1,474)
Cash, beginning of period as originally stated	**13,434**	**9,580**	2,517
Change in accounting policy (Note 3)	**-**	**-**	8,537
Cash, end of period	**$ 23,865**	**$ 23,865**	$ 9,580

The accompanying notes are an integral part of these financial statements.

1. BASIS OF PRESENTATION

Marine Atlantic Inc. ("the Corporation") is incorporated under the *Canada Business Corporations Act.* The *Marine Atlantic Inc. Acquisition Authorization Act* of 1986 established the Corporation as a parent Crown corporation. As a result of the *National Marine Policy (1995)*, the mandate of the Corporation was narrowed to the operation of a ferry system.

The Corporation operates a ferry service between Nova Scotia and Newfoundland and Labrador. Marine Atlantic Inc.'s business is seasonal in nature, with the highest activity in the summer (second quarter) and the lowest activity in the winter (fourth quarter), due to the high number of leisure travellers and their preference to travel during the summer months. The Corporation 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.

These unaudited interim financial statements have been prepared by management in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations. The basis of accounting used is Canadian generally accepted accounting principles for government agencies as recommended by the Public Sector Accounting Board ("PSAB") of the Canadian Institute of Chartered Accountants. The Corporation has received an exemption from the requirement that quarter-to-quarter comparatives be provided in these interim financial statements. These interim financial statements do not include all of the disclosures provided in Marine Atlantic Inc.'s annual audited financial statements. The disclosures provided below are incremental to those included with the annual financial statements. The interim financial statements should be read in conjunction with the financial statements and the notes thereto for the year ended March 31, 2011.

The accounting policies and methods of application followed in the preparation of these interim financial statements differ from those followed in the company's 2011 annual audited financial statements, and are disclosed in note 2 below. See note 3 to these interim financial statements for an explanation of the changes in accounting policies from those followed in the 2011 annual audited financial statements and the effect of these changes.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of accounting

The financial statements are prepared in accordance with Canadian generally accepted accounting principles for government agencies as recommended by the Public Sector Accounting Board ("PSAB") of the Canadian Institute of Chartered Accountants.

The Corporation reports all revenues and expenses on an accrual basis. Assets are carried at the lower of cost and net recoverable value. Liabilities and financial obligations to outside organizations are recorded at the estimated amount ultimately payable.

Both financial and non-financial assets are reported on the Statement of Financial Position. Non-financial assets can be used to provide services in future periods and are charged to expense through amortization or upon utilization. These assets do not normally provide resources to discharge the liabilities of the Corporation unless they are sold. As a result, non-financial assets are not taken into consideration when determining the net debt of the Corporation, but rather are deducted from the net debt to determine the accumulated surplus.

Intangible assets are not recognized in the Corporation's financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Parliamentary appropriations

Parliamentary appropriations to fund the current cash requirements, related to operating expenses in excess of commercial revenues, are included in income for the period when funding has been agreed and all requirements are met by the Corporation. Any difference between amounts provided and amounts required represents a receivable from (payable to) the Government of Canada.

Amounts related to vessel, facilities and equipment are recorded as income in the period in which the related vessel, facilities and equipment are acquired.

The Corporation recognizes a gain or loss on the disposal of assets. Net proceeds are applied against the operating funding requirements in the period of disposition.

(c) Financial instruments

Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit and short term investments with maturities of less than three months. Cash and cash equivalents are measured at fair value.

Accounts receivable

Accounts receivable and receivables from the Government of Canada are measured at amortized cost using the effective interest method.

Derivative financial instruments

Derivative financial instruments are measured at fair value with changes in fair value being recognized in the statement of remeasurement gains and losses until the derivative financial instrument is derecognized, at which point the accumulated remeasurement gain or loss is reversed and reclassified to the statement of operations.

Accounts payable, accrued liabilities, Payable to the Government of Canada and deferred revenue

Accounts payable, accrued liabilities, payable to the Government of Canada, and deferred revenue are measured at amortized cost using the effective interest method.

(d) Inventory

Inventories consisting primarily of items used for consumption onboard vessels are valued at the lower of cost and net realizable value. Cost is determined on a weighted-average basis.

(e) Tangible capital assets

Vessel, facilities and equipment are carried at cost less accumulated amortization. Major spare parts that are included in the Corporation's vessel spare parts inventory are accounted for as vessel, facilities and equipment. For this purpose, major spare parts are those that are expected to

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Tangible capital assets (continued)

be used for more than one fiscal period in connection with an item of vessel, facilities and equipment.

The cost of work in progress includes materials, direct labour and overhead. Amounts included in work in progress are transferred to the appropriate vessel, facilities and equipment classification when available and ready for use and are then amortized.

Amortization is calculated at rates sufficient to write off the cost, less any residual value, of vessel, facilities and equipment over their estimated useful lives on a straight-line basis. The cost, less any residual value, of projects onboard the vessel are amortized over the lesser of the useful life of the asset or the useful life of the vessel. Leasehold improvements are amortized over the shorter of the term of the lease agreement or the asset's useful life.

Estimated useful lives and amortization methods are reviewed at the end of each year. The rates for significant classes of vessel, facilities and equipment are as follows:

Vessel	5% to 10%
Shore facilities	2.5% to 5%
Equipment (includes vessel projects)	10% to 25%
Leasehold improvements	Term of lease agreement

When conditions indicate that an item of vessel, facilities, and equipment no longer contributes to the Corporation's ability to provide goods and services, the cost of the asset is written down to residual value, if any. Write-downs are not reversed.

(f) Employee future benefits

The Corporation accrues its obligations under employee benefit plans and the related costs, net of plan assets, as the benefits accrue to employees. The Corporation has adopted the following policies:

- The Corporation maintains, through a trustee, a registered defined benefit pension plan covering substantially all of its employees, an unfunded supplementary retirement arrangement for senior managers hired prior to March 1, 2001, and an unfunded supplementary retirement arrangement adopted in 2006 for designated positions providing benefits for service since 2004. Eligibility under the latter supplementary arrangement was extended to benefits accrued for service since 2009 for all members of the registered defined benefit pension plan who are affected by the maximum pension payable by the registered plan. Benefits generally are based on employees' length of service and final or best average earnings for all benefits.

  The cost of pensions is actuarially determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, salary escalation, inflation and retirement ages of employees. The discount rate used to calculate the interest cost on the pension obligations is based on its expected return on plan assets for the registered pension plan and a proxy of the cost of borrowing for the other plans. The expected long-term rate of return on plan assets is based on estimated returns, consistent with market conditions applicable on the measurement date, for each major asset class and the target asset

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Employee future benefits (continued)

mix specified in the plan's investment policy. A market-related value of plan assets is used for purposes of the financial statements, and the expected return on plan assets is based thereon. The market-related value of plan assets is determined using a method which amortizes gains or losses relative to the expected return over five years.

Actuarial gains or losses arise from the difference between the actual rate of return and the expected long-term rate of return on plan assets and from changes in the pension obligations due to changes in actuarial assumptions used or actual experience differing from that which is expected based on the assumptions. Actuarial gains and losses for registered pension plan members, and members for the supplementary retirement arrangement adopted in 2006 are amortized over the estimated average remaining service period of the members. Actuarial gains and losses for the members of the former supplementary retirement arrangements are amortized over the average life expectancy of plan members.

Adjustments for plan amendments, net of offsetting unamortized actuarial gain/losses, related to prior period employee services are recognized in the statement of operations in the period of plan amendment.

The estimated average remaining service period of the members covered by the registered pension plan and the supplementary retirement arrangement adopted in 2006 is 11.3 years (2011 – N/A). For the former supplementary retirement arrangements, the average life expectancy of plan members is 17.7 years (2011 – N/A).

- For certain employees and former employees, the Corporation is a self-insured employer and is accountable for workers' compensation liabilities incurred. The cost of workers' compensation liabilities is actuarially determined using the net present value of liabilities for work-related injuries of current and former employees when awards are approved by the Workplace Health, Safety and Compensation Commission of Newfoundland and Labrador; Workplace Health, Safety and Compensation Commission of New Brunswick; or Workers' Compensation Commission of Prince Edward Island; or legislative amendments are made and the anticipated future costs can be reasonably calculated. This plan is a post-employment benefit plan. Other post-employment benefits valued are the income replacement for employees on short-term disability and group benefit continuation for employees on long term disability.

  Management recognizes changes in the net present value of the liability, based on updated actuarial estimates of future costs as a result of actual experience and changes in actuarial assumptions. Adjustments arising from actuarial gains and losses are amortized over the average expected period over which benefits will be paid of 10 years (2011 – N/A).

- The cost of non-pension post-retirement benefits is actuarially determined using management's best estimates of future participation rate in the retiree health and dental plan, average health care cost per covered individual, health care trend rates and utilization, salary escalation and mortality rates. Adjustments arising from actuarial gains and losses are amortized over the estimated average remaining service period of the related employee group. The estimated average remaining service period of members covered by non-pension employee future benefit plans expected to receive benefits is 13.4 years (2011 – N/A). Adjustments for plan amendments, net of offsetting unamortized actuarial gain/losses, related to prior period employee services are recognized in the statement of operations in the period of plan amendment.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Employee future benefits (continued)

- Current and retired employees of Marine Atlantic Inc. have travel benefits for the Corporation's vessels. No liability has been recognized on the statement of financial position for this benefit because it is not material.

(g) Revenue recognition

The Corporation recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable and collection is reasonably assured. Commercial and fuel surcharge are recorded when ferry services are provided. The Corporation requires customers to pay in advance when booking a reservation. These amounts received are recorded as deferred revenue and are recognized as revenue when ferry services are provided.

Interest income is recorded as it is earned and collection is reasonably assured.

(h) Foreign currency translation

Monetary assets and liabilities denominated in a foreign currency are translated at exchange rates in effect at the financial statement date. Non-monetary assets and liabilities, revenues and expenses are translated using exchange rates in effect at the date of the transaction. Commitments and contingencies denominated in foreign currencies are translated at exchange rates in effect at the financial statement date. Exchange gains and losses, with the exception of gains or losses relating to long-term foreign currency denominated monetary items, are included in the statement of operations for the period. Exchange gains or losses relating to long-term foreign currency denominated monetary items are recognized in the statement of remeasurement gains and losses until the item matures at which time all gains and losses would be recognized in the statement of operations.

3. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS

In previous fiscal years, the Corporation classified itself as a Government Business-Type Organization ("GBTO") and followed the recommendations of the Canadian Institute of Chartered Accountants (CICA) Accounting Handbook - Part V. In October 2009, the PSAB determined that the category will cease to exist for fiscal years ending on or after January 1, 2011, and GBTOs are required to reclassify themselves in accordance with Public Sector Accounting Standards (“PSAS”). In accordance with recommendations of the PSA Handbook, the Corporation has determined that it is an other government organization (“OGO”) and has determined that PSAS is the most appropriate framework for reporting purposes.

The adoption of PSAS is accounted for by retroactive application with restatement of prior periods. Although minor quantitative balances have changed, the following is a summary of the main qualitative differences for the Corporation between its previous and current financial statements:

- The March 31, 2011 Balance Sheet has been replaced by the Statement of Financial Position, segregating financial and non-financial assets as well as the net debt (liabilities less financial assets) of the Corporation; and accumulated surplus/deficit at the Statement of Financial Position date.
- The Statement of Income and Accumulated Deficit for the year ended March 31, 2011 has been replaced by the Statement of Operations and Accumulated Deficit, reporting both revenue and expenses.
- A Statement of Change in Net Debt has been presented, which represents the expenditures of a public sector reporting entity less revenue, as well as acquisitions of tangible capital assets and other items explaining the difference between the surplus/deficit of the period and the change in net debt for the period.
- A Statement of Remeasurement Gains and Losses has been presented, which represents the unrealized gains and losses in financial assets and liabilities due to the revaluation of balances denominated in foreign exchange and/or the unrealized gains and losses as a result of recording certain financial assets and liabilities at fair value.

The Corporation has elected to use the following exemptions under PS 2125, *First Time Adoption by Government Organizations:*

<u>Pension and non-pension post-retirement and post-employment benefits</u>

Under Section PS 3250 for pension and non-pension post-retirement benefits, and PS 3255 for post-employment benefits, a government organization amortizes actuarial gains and losses to the liability or asset, and the related expense in a systematic and rational manner over the expected average remaining service life of the related employee group or a reasonable future period for plans with no active members. Retroactive application of this approach requires a government organization to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to PSA Standards into a recognized portion and an unrecognized portion. However, a first-time adopter may elect to recognize all cumulative actuarial gains and losses as the date of transition to PSA Standards directly in accumulated surplus/deficit. Marine Atlantic Inc. has elected to do this.

<u>Tangible capital asset impairment</u>

Section PS 3150, indicates the conditions when a write-down of a tangible capital asset should be accounted for. A first-time adopter need not comply with those requirements for write-downs of tangible capital assets that were incurred prior to the date of transition to PSA Standards. If a first-time adopter uses this exemption, the conditions for a write-down of a tangible capital asset in Section PS 3150 are applied on a prospective basis from the date of transition. Marine Atlantic Inc. is using this exemption.

(in thousands)

3. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

The following tables present the reconciliation of account balances and transactions from the previous reporting framework to PSA standards:

a) Reconciliation of the April 1, 2010 Statement of Financial Position:

	Footnotes	CICA Accounting Handbook Part V	Adjustments	PSA Standards
Assets				
Cash	**A**	**$ 2,517**	**$ 8,537**	**$ 11,054**
Accounts receivable		**9,505**	**-**	**9,505**
Receivable from the Government of Canada		**-**	**-**	**-**
Inventories		**14,123**	**-**	**14,123**
Derivative financial instruments		**156**	**-**	**156**
Prepaid expenses		**480**	**-**	**480**
Restricted cash	**A**	**8,537**	**(8,537)**	**-**
Vessels, facilities, and equipment	**B**	**128,890**	**1,157**	**130,047**
Intangible assets	**B**	**1,157**	**(1,157)**	**-**
Accrued pension asset	**D, E**	**68,654**	**(33,980)**	**34,674**
Total assets		**$ 234,019**	**$ (33,980)**	**$ 200,039**
Liabilities				
Accounts payable and accrued liabilities		**$ 18,830**	**$ -**	**$ 18,830**
Derivative financial instruments		**1,865**	**-**	**1,865**
Deferred revenue		**3,841**	**-**	**3,841**
Payable to Government of Canada		**1,234**	**-**	**1,234**
Accrued vacation pay		**5,617**	**-**	**5,617**
Accrued pension liability	**D, E**	**1,264**	**657**	**1,921**
Accrued liability for other non-pension post-retirement benefits	**C, D, E**	**23,263**	**7,576**	**30,839**
Accrued liability for post-employment benefits	**C, D, E**	**9,108**	**4,064**	**13,172**
Deferred capital funding	**I**	**130,047**	**(130,047)**	**-**
Total liabilities		**$ 195,069**	**$ (117,750)**	**$ 77,319**
Accumulated surplus	**H**	**$ 38,950**	**$ 83,770**	**$ 122,720**

(in thousands)

3. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

b) Reconciliation of the March 31, 2011 Statement of Financial Position:

	Footnotes	CICA Accounting Handbook Part V	Adjustments	PSA Standards
Assets				
Cash	A	$ 1,005	$ 8,575	$ 9,580
Accounts receivable		9,035	-	9,035
Receivable from the Government of Canada		3,396	-	3,396
Inventories		11,731	-	11,731
Derivative financial instruments		4,008	-	4,008
Prepaid expenses		3,202	-	3,202
Restricted cash	A	8,575	(8,575)	-
Vessel, facilities, and equipment	B	178,637	1,249	179,886
Intangible assets	B	15,081	(15,081)	-
Assets held for sale		7,200	-	7,200
Accrued pension asset	F, G	78,409	(28,908)	49,501
Total assets		$ 320,279	$ (42,740)	$ 277,539
Liabilities				
Accounts payable and accrued liabilities		$ 29,211	$ -	$ 29,211
Derivative financial instruments		275	-	275
Deferred revenue		2,628	-	2,628
Accrued vacation pay		5,860	-	5,860
Accrued pension liability	F, G	1,245	612	1,857
Accrued liability for other non-pension post-retirement benefits	C, F, G	24,601	8,225	32,826
Accrued liability for post-employment benefits	C, F, G	8,826	3,589	12,415
Deferred capital funding	I	187,086	(187,086)	-
Total liabilities		$ 259,732	$ (174,660)	$ 85,072
Accumulated surplus	H	$ 60,547	$ 131,920	$ 192,467

(in thousands)

3. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

c) Reconciliation of the Statement of Operations and Accumulated Deficit for the year ended March 31, 2011:

	Footnotes	CICA Accounting Handbook Part V	Adjustments	PSA Standards
Revenue				
Commercial revenue		$ 83,920	$ -	$ 83,920
Fuel surcharge revenue		11,662	-	11,662
Other income		181	-	181
		95,763	-	95,763
Operating expenses				
Wages and benefits		79,407	-	79,407
Fuel		32,512	-	32,512
Charter fees		25,818	-	25,818
Charter importation taxes	B	-	13,832	13,832
Repairs and maintenance		12,352	-	12,352
Materials, supplies and services		13,372		13,372
Insurance, rent and utilities		5,405	-	5,405
Other		9,078	-	9,078
Employee future benefits	F, G	13,222	(4,943)	8,279
Fleet renewal costs		10,001	-	10,001
Decommissioning of vessels		3,118	-	3,118
Foreign currency exchange loss (gain)		66	-	66
Unrealized loss on derivative financial instruments		(5,442)	-	(5,442)
Realized loss on derivative financial instruments		2,761	-	2,761
(Gain) loss on disposal of vessels, facilities and equipment		(14)	-	(14)
Loss on write down of assets held for sale		8,322	-	8,322
Amortization		12,476	-	12,476
		222,454	8,889	231,343
Deficit before government funding		(126,691)	(8,889)	(135,580)
Government funding				
Operations	I	124,370	77,839	202,209
Recovery of vessel decommissioning costs		3,118	-	3,118
Amortization of deferred capital funding	I	20,800	(20,800)	-
Surplus		$ 21,597	$ 48,150	$ 69,747

Notes to the reconciliation of CICA Accounting Handbook – Part V to PSA standards:

A) Reclassification of “restricted cash” to “cash”

PSA Standards require information about designated assets to be disclosed in the notes, and not on the statement of financial position. Therefore, restricted cash was reclassified to “cash and cash equivalents” on the face of the consolidated statement of financial position and note disclosure was made with respect to restricted cash (See Note 5).

(in thousands)

3. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

B) Reclassification of "intangible assets"

Under PSA Standards, computer hardware and software falls under the scope of PS 3150 *Tangible Capital Assets*. Therefore, an "intangible assets" balance of $1,157 was reclassified to "vessels, facilities, and equipment" at the date of transition.

Under PSA costs related to the importation of vessels that were previously recognized as an intangible asset are required to be expensed in the period incurred. Therefore, a balance of $13,832 has been recognized on the statement of operations as "Charter importation taxes".

C) Reclassification of current portion of long-term accrued obligations

Current assets and liabilities are not presented under PSA. Therefore, the current portion of long-term accrued obligations was reclassified to the appropriate accrued obligation balances.

D) Amendments to employee benefit plans

Under the Corporation's previous accounting framework, the cost of amendments to employee benefit plans was recognized on a deferred basis. Under PSA, the cost of plan amendments is to be recognized immediately in the statement of operations.

The unamortized balances related to plan amendments as of April 1, 2010 for each benefit plan were as follows:

Costs (credits)	
Pension benefits	$6,390
Other non-pension post-retirement benefits	($188)
Post-employment benefits	-

Therefore, the adjustment required as of April 1, 2010 was to decrease the accrued pension asset by $6,366, increase the accrued pension liability by $24 and decrease the accrued liability for other non-pension post-retirement benefits by $188, with corresponding adjustments to accumulated surplus/deficit.

E) Unamortized actuarial gains/losses and impact of remeasurement at the date of transition

The Corporation has decided to take the election under PS 2125 *First time adoption by Government* Organizations and recognize all unamortized actuarial gains/losses directly in accumulated surplus/deficit.

The unamortized actuarial gains/losses as of the date of transition for each benefit plan were as follows:

Losses (gains)	
Pension benefits	$26,177
Other non-pension post-retirement benefits	($2,890)
Post-employment benefits	$1,979

(in thousands)

3. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

E) Unamortized actuarial gains/losses and impact of remeasurement at the date of transition (Continued)

The Corporation has elected not to defer the change in the discount rates required under the PSA Standards.

Therefore, in addition to gains and losses mentioned above, changes to the asset valuation and assumptions due to the adoption of the PSA Standards, as well as changes in the value of the pension obligation due to the availability of a new actuarial valuation have resulted in the following additional gains or losses at the time of adoption of the PSA Standards:

Losses (gains)	
Pension benefits	$2,070
Other non-pension post-retirement benefits	$10,654
Post-employment benefits	$2,085

Therefore, an adjustment was made to decrease the accrued pension asset by $27,614, increase the accrued pension liability by $633, increase the accrued liability for other non-pension post-retirement benefits by $7,764, and increase the accrued liability for post-employment benefits by $4,064, with corresponding adjustments to accumulated surplus/deficit.

F) Resulting adjustment to accumulated surplus/deficit at March 31, 2011

The adjustment to accumulated surplus/deficit at March 31, 2011 is determined as follows:

Initial April 1, 2010 increase in accumulated deficit

Pension benefits	$34,637
Other non-pension post-retirement benefits	$7,576
Post-employment benefits	$4,064
Total initial adjustment	$46,277

Additional increase (decrease) in accumulated deficit due to differences in expenses recognized in the Statement of Operations for the year ending March 31, 2011

Pension benefits	($5,117)
Other non-pension post-retirement benefits	$649
Post-employment benefits	($475)
Total additional adjustment	($4,943)

Total increase (decrease) in accumulated deficit as at March 31, 2011

Pension benefits	$29,520
Other non-pension post-retirement benefits	$8,225
Post-employment benefits	$3,589
Total increase in accumulated deficit	$41,334

3. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

G) Actuarial gains/losses arising subsequent to the date of transition

Under the Corporation's previous accounting framework, actuarial gains and losses for pension benefits, and other non-pension post-retirement and post-employment benefits were amortized over the average remaining service period of active employees expected to receive benefits under the plan or over the average remaining life expectancy of employees in the case when all, or almost all of the employees are no longer active.

However, under PSA Standards, actuarial gains and losses are to be amortized over the expected average remaining service life of the related employee group expected to receive benefits under the plan or another reasonable future period. Under Section PS 3255, actuarial gains and losses may be amortized over a period linked to the type of benefit.

For pension and other non-pension post-retirement benefit plans in which the related employee group is no longer active, actuarial gains and losses are amortized over the average life expectancy of the plan members.

H) Share Capital

Under PSA Standards the Corporation's share capital shall be classified along with accumulated surplus (deficit). On transition an adjustment was made to classify $258,530 from share capital to accumulated surplus.

I) Deferred capital funding

Under the Corporation's previous framework, government transfers received for the purpose of purchases of capital assets were deferred and amortized to income at the same rate the asset was amortized.

However, under PSA Standards, government transfers for the purpose of purchases of capital assets are recognized as revenue when the related assets are acquired. As a result, an adjustment of $130,047 was made to de-recognize the deferred capital funding liability, with an offsetting adjustment to accumulated surplus/deficit.

The balance of the deferred capital funding liability as of March 31, 2011 was $187,086. Therefore, an adjustment was made as at and for the year ended March 31, 2011 to decrease this balance by $187,086, increase revenue by $57,039 and increase accumulated surplus by $130,047.

(in thousands)

4. (PAYABLE TO) RECEIVABLE FROM GOVERNMENT OF CANADA

The Corporation receives its funding from the Government of Canada based primarily on cash flow requirements. Items recognized in the statement of operations and accumulated surplus in one year may be funded by the Government of Canada in different years. Accordingly, the Corporation has different net results of operations for the year on a government funding basis than on a generally accepted accounting principles basis.

	September 30, 2011 (6 months)	March 31, 2011 (12 months)	April 1, 2010 (12 months)
Receivable from (payable to) Government of Canada, beginning of period	**$ 278**	$ (1,234)	$ 795
Parliamentary appropriations received during the period	**(89,216)**	(200,696)	(123,493)
Recognized during the period:			
Operations	**69,766**	124,370	106,596
Vessel, facilities and equipment	**5,328**	77,838	14,868
Government funding (deficit) surplus	**14,122**	(1,512)	2,029
(Payable to) receivable from Government of Canada, end of period	**(13,844)**	278	(1,234)
Recoverable vessel decommissioning costs	**5,625**	3,118	-
Total	**$ (8,219)**	$ 3,396	$ (1,234)

5. RESTRICTED CASH

Cash includes restricted cash consisting of cash denominated in Euros plus accumulated interest held in an escrow account. The total balance denominated in Euros is $6,223 (March 31, 2011 – $6,221), which translates to $8,738 Canadian dollars at September 30, 2011 (March 31, 2011 – $8,575).

6. EMPLOYEE FUTURE BENEFITS

During the six months ended September 30, 2011, the net employee future benefit expense was $8,036 (March 31, 2011 (12 months) – $8,279). The expense included costs for the Corporation's defined benefit pension plan, life insurance and health and dental care benefits to retirees and Workers' Compensation.

7. RELATED PARTY TRANSACTIONS

The Corporation is related in terms of common ownership to all Government of Canada created departments, agencies and Crown corporations. The Corporation enters into transactions with these entities in the normal course of business under the same terms and conditions that apply to unrelated parties. During the period, the Corporation incurred expenses of $653 (2011 – $1,410) with other federal Crown corporations, departments and agencies. In addition to these transactions, the Government of Canada provides funding to the Corporation as described in notes 2(b) and 4. The Corporation is given the right to use the crown land on which the terminals sit free of charge by Transport Canada. No amount was recorded since the fair value of the service received for free is not reliably measurable.

8. CONTINGENCIES

There have been no changes in the existence, likelihood or amount of contingencies since the end of the most recently completed fiscal year.