

Quarterly Financial Report

MARINE ATLANTIC INC.

June 30, 2011

MARINE ATLANTIC INC.

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MARINE ATLANTIC INC.

Quarterly Financial Report

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The following Quarterly Financial Report of the financial results of Marine Atlantic Inc. (“the Corporation”) is for the first quarter ended June 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 once approved by the federal government.

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.

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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)

	Actual	Budget	Variance \$ ¹	Variance %
Revenue	\$ 23,374	\$ 22,929	\$ 445	2%
Expenses	\$ 63,612	\$ 69,020	\$ 5,408	8%

¹ Positive Variance indicates a favourable result compared to Budget

Revenues

The Corporation's revenue for the first quarter was two per cent higher than forecasted in the Corporate Plan. This has been driven by the increase in commercial traffic due to the continued growth of the Newfoundland and Labrador economy.

The Corporation's two new vessels, the MV *Blue Puttees* and the MV *Highlanders*, are equipped with more than double the cabins than the vessels they replaced. The actual occupancy ratio of these additional onboard accommodations was higher than anticipated resulting in more revenue than budgeted. Passenger and passenger related vehicle traffic was below projections partially offsetting overall revenue gains.

The Corporation's operating plan provided for a third vessel dedicated to the transportation of commercial traffic during the period. A delay in the completion of the MV *Leif Ericson* life extension resulted in two vessels providing the ferry service for the first two months of the year. While the two vessels were able to transport the traffic, commercial customers did experience an increase in wait time for transportation. As a result of the decrease in capacity, the Corporation provided a fare discount to all commercial traffic traveling during the month of May thereby reducing the commercial revenue surplus for the quarter.

Expenses

Overall the Corporation's expenses were eight per cent under budget during the quarter. The reduced vessel operating schedule created savings in fuel consumption. There were 80 fewer crossings than planned in the period due to the delay in the MV *Leif Ericson* returning to service. While the market price for fuel was trending higher than forecasted, the Corporation recognized gains on settled fuel swap contracts for the period.

Some of the savings are temporary as they can be attributed to delayed corporate initiatives. For instance, the Corporation's annual maintenance plan was updated due to the delay in completion of the MV *Leif Ericson* life extension. This resulted in an abbreviated spring maintenance session for the MV *Atlantic Vision* with the remaining work to be completed this fall following the completion of the Argentinia-North Sydney ferry service. Maintenance costs for the newest additions to the fleet, the MV *Blue Puttees* and the MV *Highlanders*, were lower than budgeted during the quarter.

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During the maintenance period the Corporation reflagged the MV *Atlantic Vision*. The vessel now flies the Canadian flag. The Corporation recognized \$7.9 million in charter importation taxes as an expense in the quarter associated with this process. The MV *Highlanders* entered service on target in late April, therefore fleet integration costs were incurred as planned. The MV *Caribou* and MV *Joseph and Clara Smallwood* were retired from service during the 2010/2011 fiscal year and are currently being held for sale. As of June 30, the Corporation recognized \$1.9 million in recoverable decommissioning costs. The sale of the vessels was completed in August.

Statistics snapshot

	Actual	Forecast	Variance ¹	Variance %
Passengers	78,145	82,759	(4,614)	-6%
Passenger Units	27,620	30,190	(2,570)	-9%
Commercial Units	28,004	27,051	953	4%
Auto Equivalent Units ²	146,213	144,759	1,454	1%

¹ Positive Variance indicates a favourable result compared to Budget

² Auto Equivalent Unit or AEU is the length of an average passenger automobile

Vessel, Facilities, and Equipment

The Corporation is undergoing a revitalization of its infrastructure in which the most visible changes were related to the vessel fleet. During the first quarter of this year, the Corporation invested \$3.9 million in its capital assets. Planning continued for multi-year projects such as the development of the master plan for the terminal facilities. Over 50% of anticipated spending in capital this year is associated with two major projects: 1) the dry docking of the MV *Atlantic Vision* which is scheduled for the winter; and 2) renovations to the recently purchased administration and warehousing building which is set to begin during the second quarter to coincide with the traditional construction season.

Forecast

The Corporation's approved government funding for 2011/12 is \$200.6 million. Based upon results of the first quarter and the budget allocated for the remainder of the year, the Corporation is anticipating it will operate within its approved funding allocation and achieve its cost recovery targets. There have been no revisions in goals or objectives compared to the Corporate Plan Summary. The Corporation has identified opportunities in its approved funding which may be utilized in future years. The Corporation is currently working with the Board of Directors and Transport Canada regarding these revised estimates through a reprofiling process.

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.

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SIGNIFICANT EVENTS

Summer of Success Campaign

To achieve the goal of successfully integrating the new fleet and gaining recognition from its customers that the service has improved, a working group was formed with representatives from a variety of Marine Atlantic Inc. departments to identify, examine and resolve issues that could potentially create barriers to a successful summer travel season. This group analyzed issues, defined problems and challenges, explored and identified possible solutions, developed implementation plans, and designed goals, monitoring tools and measures to prevent complaints, mitigate traffic backlogs, decrease negative publicity and improve difficult working conditions for front line employees. Everything from reservations and ticketing, traffic allocations on each sailing, security, marshalling of commercial units on the terminal property, traffic management, and loading of the vessels was reviewed. The smoothness of the first two weeks of the summer schedule suggests the plans put in place by the working group have made a positive contribution to a summer of success.

Upgrades to Argentina Ferry Service

With the start of the summer schedule on June 17, the MV *Atlantic Vision* made her inaugural voyage to Argentina. This change has been enthusiastically welcomed by the Corporation's customers, in terms of usage and satisfaction. Bookings are up over last year, as are onboard accommodation sales. In addition, positive customer feedback has been directed to both Marine Atlantic Inc. and to the regional media. While only six round trips were completed by the end of the first quarter, early indications suggest a successful season.

MV Leif Ericson's Return to Service

The MV *Leif Ericson* was scheduled to return to service in early April after a major life extension project during the winter of 2010/11. The completion of the project was delayed due to gear box problems discovered during sea trials. The MV *Leif Ericson* returned to service in early June prior to the start of the summer season.

Commercial Discount

For the month of May, the Corporation instituted a 15 per cent discount on all commercial fares. For the previous several months, Marine Atlantic Inc. had been working hard to renew its fleet and offer greater capacity, better amenities and improved service, and its commercial partners had been very patient and co-operative during this time. The fleet transition process had been delayed due to the extended refit of the MV *Leif Ericson* which was not expected to be completed until June. Commercial customers had been adversely affected by the decreased capacity throughout April and could anticipate a continued impact on their businesses for several more weeks. As a result, the Corporation implemented the discount until the transition was complete.

Update on Sale of MV Caribou and MV Joseph and Clara Smallwood

In April, through an international Request For Proposals, the Corporation selected ICAP Shipping Limited, an international publicly traded company that specializes in the sale and purchase of ships, to find buyers for the ships. ICAP Shipping Limited coordinated the bidding process to find owners for the MV *Caribou*

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and MV *Joseph and Clara Smallwood*. There were several bids received and the sale of the ship to the successful bidder was finalized in August.

Fuel Surcharge

The Corporation's vessels consume in excess of 40 million litres of fuel annually. In recent months, the Corporation has experienced a continued increase in the cost of fuel. Therefore, on June 22, the Corporation raised the fuel surcharge from 16 per cent to 21 per cent effective July 8. Current and expected fuel prices, current traffic demand and operating profile were considered in the decision to make this adjustment.

Pension Changes

In accordance with Bill C-9 issued March 25, 2011, the Corporation has elected to treat letters of credit as assets for valuation purposes and to cease application of the existing relief regulations (Solvency Funding Relief Regulations and Solvency Funding Relief Regulations, 2009). This has the potential to substantially reduce the required solvency payments for this fiscal year. The Board of Directors will make a final recommendation on the amount of solvency payments later in the year. The Corporation received the latest actuarial valuation of the pension plan for funding purposes in June. Based on this report the employer pension current service payments as a percentage of employee pensionable earnings will increase.

Strategic Review

In 2010, Marine Atlantic Inc. was selected to conduct a Strategic Review of its operations. The Corporation used this opportunity to identify ways to improve business processes thereby increasing efficiencies and ensuring customers and taxpayers receive good value for their money.

Strategic Review initiatives will be implemented during the same time period in which the Corporation's five-year, \$521 million investment plan is underway. This plan will see the integration of modern, reliable, and efficient vessels into the fleet and significant upgrades to the shore based infrastructure as well as improvements to business processes.

In total, the Corporation will achieve \$5.4 million in savings over a three year period. The efficiencies will be in two categories: operational efficiency (60%) and improved sourcing of goods and services (40%).

Deficit Reduction Action Plan

The federal budget tabled on June 6, 2011, outlined the Government's plan to return to a balanced budget by 2014/15. This plan includes the launch of a comprehensive one-year strategic and operating review, which is a review of the cost of programs delivered by the federal government and their operations. The review will examine direct program spending covering about 67 organizations.

Marine Atlantic Inc. is part of this exercise and is conducting a review of the efficiency and effectiveness of its programs and operations to ensure value for money. Proposals will be developed and submitted for review by a special committee of ministers chaired by the President of the Treasury Board. The final results of the Deficit Reduction Action Plan for the Corporation will be announced in Budget 2012.

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Reprofiling

The Corporation revisited the approved capital plan for the next four years and several changes were recommended to ensure success going forward. These changes were based upon updated estimates, realistic timelines, changing priorities and emerging opportunities. The Corporation anticipates that the changes will not require any additional funds, but will require a reallocation of approved funding between years.

The Corporation has informed Transport Canada of the desire to reprofile funds and has begun the prescribed process of detailing the sources of the funding and the scope of the changes.

Human Resources

In July, a member of the Corporation's Executive left the organization. The position was subsequently filled internally by a current Executive member.

REPORTING ON USE OF APPROPRIATIONS

The Corporation received \$52 million in appropriations from the Government of Canada during the quarter. 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.

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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
President and CEO



Shawn Leamon, CGA
Vice President of Finance

St. John's, NL
August 25, 2011

MARINE ATLANTIC INC.
Unaudited Statement of Financial Position

As at June 30, 2011
(in thousands)

	June 30, 2011	March 31, 2011	April 1, 2010
		(Restated - Note 3)	(Restated - Note 3)
Financial assets			
Cash (Note 5)	\$ 13,434	\$ 9,580	\$ 11,054
Accounts receivable	11,392	9,035	9,505
Receivable from Government of Canada (Note 4)	1,528	3,396	-
Inventories for resale	327	341	508
Derivative financial instruments	3,460	4,008	156
Accrued pension asset	50,562	49,501	34,674
Assets held for sale	7,200	7,200	-
	\$ 87,903	\$ 83,061	\$ 55,897
Liabilities			
Accounts payable and accrued liabilities	\$ 22,964	\$ 29,211	\$ 18,830
Derivative financial instruments	530	275	1,865
Deferred revenue	8,320	2,628	3,841
Payable to Government of Canada (Note 4)	-	-	1,234
Accrued vacation pay	6,382	5,860	5,617
Accrued pension liability	1,863	1,857	1,921
Accrued liability for other non-pension post-retirement benefits	33,516	32,826	30,839
Accrued liability for post-employment benefits	12,330	12,415	13,172
	85,905	85,072	77,319
Net financial assets (debt)	\$ 1,998	\$ (2,011)	\$ (21,422)
Non-financial assets			
Prepaid expenses	2,872	3,202	480
Inventories held for consumption	16,712	11,390	13,615
Vessel, facilities, and equipment	180,542	179,886	130,047
	200,126	194,478	144,142
Accumulated surplus (deficit)	\$ 202,124	\$ 192,467	\$ 122,720
Accumulated surplus is comprised of:			
Accumulated operating surplus	202,794	192,467	122,720
Accumulated remeasurement gains (losses)	(670)	-	-
	\$ 202,124	\$ 192,467	\$ 122,720

Contingencies (Note 8)

MARINE ATLANTIC INC.
Unaudited Statement of Operations and Accumulated Surplus

Three months ended June 30, 2011
(in thousands)

	June 30, 2011 (3 months)	March 31, 2011 (12 months) (Restated - Note 3)
Revenues		
Commercial	\$ 20,779	\$ 83,920
Fuel surcharge	2,559	11,662
Other income	36	181
	23,374	95,763
Expenditures		
Wages and benefits	21,133	79,407
Fuel	7,130	32,512
Charter fees	11,084	25,818
Charter importation taxes	7,876	13,832
Repairs and maintenance	2,688	12,352
Materials, supplies and services	2,578	13,372
Insurance, rent and utilities	1,116	5,405
Fleet renewal costs	1,163	10,001
Other	1,023	9,078
Employee future benefits (Note 6)	4,018	8,279
Decommissioning of vessels	1,859	3,118
Foreign currency exchange loss	29	66
Unrealized (gain) loss on derivative financial instruments	-	(5,442)
Realized (gain) loss on derivative financial instruments	(1,324)	2,761
(Gain) Loss on disposal of vessel, facilities and equipment	-	(14)
Loss on write down of assets held for sale	-	8,322
Amortization	3,240	12,476
	63,613	231,343
Surplus (deficit) before government funding	(40,239)	(135,580)
Government funding		
Operations	44,811	124,370
Capital	3,896	77,839
Recovery of vessel decommissioning costs	1,859	3,118
	50,566	205,327
Surplus (deficit)	10,327	69,747
Accumulated surplus (deficit), beginning of period as originally stated	192,467	(219,580)
Change in accounting policy (Note 3)	-	342,300
Accumulated surplus, beginning of period as restated	192,467	122,720
Accumulated surplus, end of period	\$ 202,794	\$ 192,467

MARINE ATLANTIC INC.
Unaudited Statement of Remeasurement Gains and Losses

Three months ended June 30, 2011
(in thousands)

	June 30, 2011 (3 months)	March 31, 2011 (12 months)
Accumulated remeasurement gains (losses) on derivative financial instruments, beginning of period	\$ -	\$ -
Remeasurement gains (losses) arising during the period		
Unrealized gain (loss) on foreign exchange of cash	133	-
Unrealized gain (loss) on derivatives	(803)	-
	-	-
Reclassifications to the statement of operations		
	-	-
	-	-
	-	-
Net remeasurement gains (losses) for the period	(670)	-
Accumulated remeasurement gains (losses) on derivative financial instruments, end of period	\$ (670)	\$ -

MARINE ATLANTIC INC.
Unaudited Statement of Change in Net Financial Assets (Debt)

Three months ended June 30, 2011
(in thousands)

	June 30, 2011 (3 months)	March 31, 2011 (12 months) (Note 3)
Surplus (deficit)	\$ 10,327	\$ 69,747
Change in tangible capital assets		
Acquisition of vessel, facilities and equipment	(3,896)	(77,838)
Amortization of vessel, facilities and equipment	3,240	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	(656)	(49,839)
Change in other non-financial assets		
Net change in inventories held for consumption	(5,322)	2,225
Net change in prepaid expenses	330	(2,722)
Decrease (increase) in other non-financial assets	(4,992)	(497)
Remeasurement gains (losses)	(670)	-
Decrease (increase) in net debt	4,009	19,411
Net financial assets (debt), beginning of period	(2,011)	(21,422)
Net financial assets (debt), end of period	\$ 1,998	\$ (2,011)

MARINE ATLANTIC INC.
Unaudited Statement of Cash Flows

Three months ended June 30, 2011
(in thousands)

	June 30, 2011 (3 months)	March 31, 2011 (12 months) (Restated - Note 3)
Operating transactions		
Cash receipts from customers	\$ 27,334	\$ 94,538
Other income received	13	77
Government funding	37,766	133,629
Cash paid to suppliers and employees	(56,919)	(207,832)
Cash paid for pension, workers' compensation and other non-pension employee future benefits	(4,467)	(21,940)
	3,727	(1,528)
Capital transactions		
Purchase of vessel, facilities and equipment	(14,668)	(67,067)
Proceeds on disposal of vessel, facilities and equipment	-	15
	(14,668)	(67,052)
Financing transactions		
Interest and foreign exchange on cash	127	39
Government capital funding	14,668	67,067
	14,795	67,106
Net increase (decrease) in cash	3,854	(1,474)
Cash, beginning of period as originally stated	9,580	2,517
Change in accounting policy (Note 3)	-	8,537
Cash, end of period	\$ 13,434	\$ 9,580

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011
(in thousands)

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 deficit.

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

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Notes to the Unaudited Interim Financial Statements
June 30, 2011
(in thousands)

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

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(in thousands)

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

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Notes to the Unaudited Interim Financial Statements

June 30, 2011
(in thousands)

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.

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011
(in thousands)

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.

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011

(in thousands)

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*:

Pension and non-pension post-retirement and post-employment benefits

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.

Tangible capital asset impairment

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.

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011

(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

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011

(in thousands)

3. TRANSITION TO PUBLIC SECTOR ACCOUNTING STANDARDS (Continued)

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

		CICA Accounting Handbook Part V	Adjustments	PSA Standards
	Footnotes			
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

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011

(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
		<u>95,763</u>	<u>-</u>	<u>95,763</u>
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
		<u>222,454</u>	<u>8,889</u>	<u>231,343</u>
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		<u>\$ 21,597</u>	<u>\$ 48,150</u>	<u>\$ 69,747</u>

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).

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011

(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:

<u>Costs (credits)</u>	
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:

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

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011

(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

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011
(in thousands)

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.

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011

(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.

	June 30, 2011 (3 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	(52,434)	(200,696)	(123,493)
Recognized during the period:			
Operations	44,811	124,370	106,596
Vessel, facilities and equipment	3,896	77,838	14,868
Government funding (deficit) surplus	3,727	(1,512)	2,029
(Payable to) receivable from Government of Canada, end of period	(3,449)	278	(1,234)
Recoverable vessel decommissioning costs	4,977	3,118	-
Total	\$ 1,528	\$ 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 \$6,221 (March 31, 2011 – \$6,221), which translates to \$8,702 Canadian dollars at June 30, 2011 (March 31, 2011 – \$8,575).

6. EMPLOYEE FUTURE BENEFITS

During the 3 months ended June 30, 2011, the net employee future benefit expense was \$4,018 (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 \$397 (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.

MARINE ATLANTIC INC.

Notes to the Unaudited Interim Financial Statements

June 30, 2011

(in thousands)

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.