LETTER TO THE MINISTER OF TRANSPORT, INFRASTRUCTURE AND COMMUNITIES

The Honourable Lawrence Cannon
Minister of Transport, Infrastructure and Communities, Ottawa

Dear Minister:

In accordance with the provisions of the *Financial Administration Act*, I am pleased to submit VIA Rail Canada Inc.'s Annual Report for the year ending December 31, 2007.

Donald A. Wright
Chairman of the Board

viarail.ca

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The Year at a Glance

The following key financial indicators and operating statistics summarize the performance of the Corporation for the year 2007 with comparative data for the years 2003 to 2006. They exclude the financial results of the variable interest entity.

	2007	2006	2005	2004	2003
KEY FINANCIAL INDICATORS (IN MILLIONS OF DOLLARS)					
Total passenger revenue	**268.8**	266.6	255.6	240.6	231.4
Total revenue	**285.6**	297.1	289.8	258.7	250.3
Cash operating expenses (1)	**486.2**	475.5	465.7	443.8	431.4
Operating deficit (1)	**200.6**	178.4	175.9	185.1	181.1
Capital expenditures	**12.4**	14.5	21.2	20.2	77.4
Government funding:					
Operating	**200.6**	169.0	169.0	177.4	181.1
Capital	**12.4**	0.0	0.7	20.2	82.4
Total Government funding (2)	**213.0**	169.0	169.7	197.6	263.5
KEY OPERATING STATISTICS (3)					
Revenue/Cash operating expenses ratio (%) (1)	**58.9**	62.8	62.4	58.8	58.5
Total passengers carried (IN THOUSANDS)	**4,181**	4,091	4,097	3,887	3,789
Total passenger-miles (IN MILLIONS)	**874**	874	888	851	857
Government operating funding per passenger-mile (IN CENTS)	**23.0**	19.3	19.0	20.8	21.1
Yield (CENTS PER PASSENGER-MILE)	**30.5**	30.3	28.6	28.0	26.8
Train-miles operated (IN THOUSANDS)	**6,658**	6,665	6,740	6,771	6,780
Car-miles operated (IN THOUSANDS)	**46,362**	47,625	48,614	48,396	48,682
Average passenger load factor (%)	**55**	55	55	53	53
Average number of passenger-miles per train-mile	**131**	131	132	126	126
On-time performance (%)	**77**	84	81	70	73
Number of employees at year-end	**3,017**	3,003	3,059	3,027	3,051

1. *Cash operating expenses used in the calculation of the Revenue/Cash operating expenses ratio, exclude amortization of Property, plant and equipment, reorganization charges, accounting accrual for compensation, unrealized gains and losses on derivative financial instruments, pension and employee future benefits.*
2. *Excludes internal funding from the Asset Renewal Fund of $23.9 million in 2006, $27.4 million in 2005 and $7.7 million in 2004 and includes a capital funding contribution to the Asset Renewal Fund of $5.0 million in 2001, 2002 and 2003.*
3. *Key operating statistics are unaudited.*

Corporate Overview

VIA Rail operates Canada's national passenger rail service on behalf of the Government of Canada. An independent Crown corporation established in 1977, we provide a safe, efficient and environmentally responsible service from coast to coast. We operate up to 503 trains weekly on 12,500 kilometres of track, connecting over 450 Canadian communities. With approximately 3,000 employees, VIA carried close to 4.2 million passengers in 2007.

VISION

At VIA, we will be the Canadian leader of service excellence in passenger transportation.

MISSION

We will work together to provide travel experiences that anticipate the needs and exceed the expectations of our customers.

CORE BUSINESS STRATEGY

Customer Intimacy

We will build on our expertise and distinctive competencies to provide the best total travel experience that will delight travellers, and nurture loyal customers.

VALUES

Customer Focus

We appreciate and listen to our customers, and we innovate to provide the best passenger transportation experience at the best value for money.

Respect

We are human – people who respond with integrity to the needs of our customers, to each other and to the people and communities we serve.

Passion

We are dedicated to and passionate about our business, as well as the role we play in Canada's development, and we will go the extra mile to ensure that VIA Rail continues to be successful.

SERVICES

In Western Canada, we provide year-round, all-weather transportation, including service to remote communities. The legendary Western transcontinental train the *Canadian®* provides service thrice weekly between Toronto and Vancouver.

In the Quebec City-Windsor corridor, our trains provide intercity passengers with fast, convenient, comfortable and affordable service, downtown-to-downtown, between Canada's largest business centres.

In Eastern Canada, the *Ocean™* offers intercity service six times a week between Montreal and Halifax, offering its friendly *Easterly™* class service during the summer peak season. The *Chaleur™* makes three trips each week from Montreal through the Gaspé Peninsula.

In rural and remote areas, we operate services designated by the government to meet regional transportation needs.

Left to right:

Alex Quinn
Machinist
(Montreal Maintenance Center)

Anick Cesaria
Senior Specialist, Communications
(Headquarters, Montreal)

Eddy Petracco
Station Service Agent
(Central Station, Montreal)

Message from the Chairman

VIA Rail reached a new milestone in 2007, following more than a decade of improving service and growing ridership. In October, the Government of Canada announced new funding for passenger rail, including a short-term increase in operating funding, and the largest capital investment program in VIA Rail's history.

The announcement is a welcome recognition of VIA's performance in managing the national service, and of the potential of passenger rail for the future.

VIA has earned this recognition, and the confidence of Canadians. It has achieved a record of solid results built on rigorous, responsible management, the dedication of its employees, and a passionate commitment to customer service. Since 1990 that commitment has transformed Canadian passenger rail, doubling both revenues and cost recovery, and raised the quality of service across the country, year after year.

The five-year, $516 million capital investment program will ensure that VIA's current network and service levels are sustainable into the future, while improving the reliability of VIA's trains and providing the capacity for more frequent service. VIA started work to refurbish and modernize its oldest locomotives in 2007. In 2008, VIA will begin a rebuild of passenger cars and a program of strategic improvements to the infrastructure shared with freight railways, eliminating bottlenecks which cause passenger train delays in the Quebec City-Windsor corridor.

The investment will also enhance VIA's environmental performance. Passenger rail is already one of the most environmentally sustainable modes of public transportation in Canada.

Passenger rail has the potential to play an increasingly valuable role in Canadian transportation. The capital investment plan now underway provides new opportunities to expand and build on that potential for the future. I am confident that, as the Corporation moves forward, VIA will continue to deliver on the promise of passenger rail – providing an efficient, cost-effective and environmentally responsible solution for the growing transportation needs of Canadians.

DA Wright

Donald A. Wright
Chairman of the Board

Message from the President

VIA's people achieved something remarkable in 2007. We knew from the start that it would not be easy to hold on to the gains achieved in recent years. Slow markets, new competitive pressures, and problems with infrastructure and equipment were just some the realities we faced. But once again, the VIA team came through.

In terms of ridership, we kept the numbers above the record four-million mark reached in the last two years. Total passenger-miles and yield – what we earned per passenger-mile – stayed firm. Costs were tightly contained across the company. And while total revenues and on-time performance are a real concern, everyone kept their eye on the ball – the customer focus that drives the success of passenger rail.

In 2007 we developed more precise tools for listening to our customers, understanding their expectations, and delivering a travel experience that matches and exceeds those expectations. We examined the elements that build a memorable experience for our customers, and identified new ways to measure how well we are doing.

This focus translated into better services – including Wi-Fi access in major stations from coast to coast, better on-board products and station services, the new Edmonton-Jasper Snow Train, an improved Hudson Bay tourism service, new specialty trains in the Corridor, and a very good year for our Montreal-Halifax *Easterly* class service. VIA also laid the foundations for a renewed relationship with CN, who owns most of the track our trains run on.

Thanks to the leadership of the Board of Directors and the solid performance of VIA's employees, the Corporation secured the funding it needs to invest in equipment and infrastructure. We appreciate this vote of confidence from the Government of Canada. The investment will dramatically improve on-time performance, and secure the foundations for a more reliable, financially sustainable service in the years ahead.

The investment represents an enormous opportunity to sustain the progress we have achieved for more than a decade. With this opportunity comes a high expectation for even better performance – and we know that we will meet that expectation by continuing to go the extra mile, providing the best travel experience to every customer who boards our trains.

Paul Côté

Paul Côté
President and Chief Executive Officer

THE YEAR IN
REVIEW

FACING THE CHALLENGES OF 2007

VIA's ridership increased in 2007, and the company saw a slight increase in passenger revenues, as well as earnings per passenger-mile. Rigorous management kept operating costs under control throughout the year. As a result, VIA ended the year better than its operating budget.

While this improvement compared to budget is modest, it is a significant achievement. Travel and tourism markets remained flat or declined throughout 2007, while the high value of the Canadian dollar further depressed demand from US travellers and encouraged Canadian vacationers to travel abroad. Competitors adopted discounts for bulk ticket purchases, and low-cost air carriers, including a new service to Toronto's downtown airport, affected VIA's Toronto-Ottawa and Toronto-Montreal services. VIA's products in these markets remained strong, but poor on-time performance threatened to undermine the appeal of passenger rail for travellers. Several freight derailments and blockades caused delays for passenger trains and real inconvenience for travellers. Increasing freight traffic and slower freight trains caused erratic on-time performance in Western and central Canada. VIA's own equipment, including aging passenger cars and locomotives, continued to make it difficult to provide a reliable, consistent service to customers.

VIA reacted quickly to these challenges, protecting its ridership and market share while positioning rail for future growth. The Corporation reinforced its *Moving Forward* management plan to strengthen its core competitive advantage, customer intimacy, as the foundation for VIA's business strategy. Employees became more adept at translating this strategy into concrete action. As a result, VIA developed new and enhanced services to deliver on the promise of a unique, high-value travel experience for its customers.

VIA'S LONG-TERM PERFORMANCE TRENDS REMAINED STRONG IN 2007

Since 1990 VIA has:

- Reduced reliance on government operating funding by 51%
- Increased revenues by 100%
- Increased passenger miles by 14%
- Increased cost recovery by 104%

THE CAPITAL INVESTMENT PLAN

VIA'S TRACK RECORD was recognized and rewarded in October, when the Government of Canada announced new funding totalling $691.9 million for the national passenger rail service.

This funding includes the largest capital investment plan in VIA's history ($516 million), designed to maintain and improve the reliability of the service, and ensure that passenger rail remains both cost-effective and sustainable in the future. It also includes new, short-term operating funding ($175.9 million over 5 years) which will sustain the national network until the benefits of the capital program can be realized.

Left to right:

Matthew McKernan
Senior Manager, Management Systems
(Montreal Maintenance Center)

Robert Rivest
Senior Advisor, Security Management
System and Operating Regulatory Affairs
(Headquarters, Montreal)

A great deal of planning and preparation occurred in 2007 and in years previous to prepare for such an investment. Following the October announcement, VIA was able to move ahead immediately with its capital investment plan. Here is how the money will be spent:

MODERNIZING LOCOMOTIVES

VIA's fleet includes 54 General Motors F-40 locomotives, which are used across Canada. More than twenty years old, the F-40s are nearing the end of their normal life cycle. Since 2004 VIA has been exploring options for revitalizing this fleet, an exercise that included the design and creation of a prototype demonstrating how the F-40 could be rebuilt to as-new condition. At the end of 2007, VIA contracted with a Canadian supplier to rebuild and modernize the entire fleet, extending their service life by 15–20 years at less than half the cost of buying new equipment.

Rebuilding will not only bring the F-40s back to as-new condition, but will upgrade the locomotives to meet current environmental, safety and operating standards. Once the project is complete the rebuilt equipment will provide more reliable train service and reduce maintenance costs by up to 15 per cent. It will also reduce operating costs and emissions by saving up to five million litres of fuel annually.

RENEWING PASSENGER CARS

In the Quebec City-Windsor corridor VIA currently uses 98 Light, Rapid, Comfortable (LRC) passenger cars built by Bombardier. These cars have been in service for more than 25 years. In 2007, one LRC car was used as a platform to test modern on-board systems, and early in 2008, VIA began the tendering process for a rebuild of the entire fleet.

As with the F-40 locomotives, the rebuild of the LRC cars will extend their service life by another 15-20 years. This investment will also reduce maintenance costs and improve reliability, while upgrading passenger comfort and amenities to meet current market standards. New technologies will reduce energy consumption and also make the operation of this equipment more environmentally sustainable.

THE 5-YEAR INVESTMENT PLAN (2007-2012):

Equipment	$232.0 million
Upgrade infrastructure	$237.5 million
Improve stations	$18.2 million
Investing for efficiency	$28.3 million
TOTAL	**$516.0 million**

IMPROVING ACCESSIBILITY

Equipment modifications undertaken as part of the capital investment plan will also make rail service more convenient and comfortable for travellers with restricted mobility. These include modifications to VIA's Renaissance equipment, such as more accessible sleeping accommodations on the eastern transcontinental service and larger accessible washrooms, improved tie-down areas for those with wheel-chairs, and accommodation for service animals.

INFRASTRUCTURE

Most of the rail infrastructure used by VIA Rail is owned by CN, and thus shared with freight trains. Beginning in 2008, VIA will work with the freight railways to upgrade strategic sections of this infrastructure, in order to improve passenger service between all major Corridor cities, including Quebec City, Montreal, Ottawa, Toronto, Kitchener, Brantford, London, and Windsor – as well as many smaller communities in between.

Work will include upgraded track, improved rail/public road crossings and upgraded crossing protection systems, new pedestrian crossings, improved signalling, and improved access control to prevent trespassing. Centralized Traffic Control (CTC) systems will be extended to cover all Corridor infrastructure on which VIA operates.

By eliminating many bottlenecks and creating new passing tracks, this work will eliminate many delays caused by rail traffic congestion, and allow passenger trains to operate at higher average speeds. As a result, capacity will increase for fast, frequent service throughout the Corridor. VIA projects that when these infrastructure improvements are complete the Corridor network will be able accommodate more than one million additional passengers – an increase in ridership of 32 per cent over 2006.

STATIONS

VIA will upgrade and modernize key passenger stations to serve customers more effectively, and to address operational and safety needs. Major station projects include improved platforms, lounges, lighting and boarding gates, interior and exterior renovations, and in some cases expansion or new facilities.

INVESTING FOR EFFICIENCY

The five-year investment plan also addresses the need to keep key facilities and business systems up to date. VIA will upgrade its maintenance facilities, including machinery and tools, and will upgrade information technology to improve the efficiency of functions such as ticketing and the management of customer information.


VIA Rail Canada
VIA Rail Canada

DRIVING SUCCESS THROUGH CUSTOMER INTIMACY

THE CAPITAL INVESTMENT PLAN will provide the tools VIA needs to build on the success of its proven customer-focused business strategy. However, it will take several years to realize the full effects of this investment. In the meantime, VIA continues to focus on providing consistently exceptional customer service.

Customer intimacy is not new at VIA Rail. VIA's people excel at offering personalized customer service, and the company has long been recognized as a leader in the field. Customer satisfaction ratings are consistently high. As competitive pressures increase and travel markets become more volatile, the Corporation is taking customer service further, identifying customer intimacy as its critical competitive advantage in the marketplace.

Left to right:

Vicky Breton
Senior Service Attendant
on the *Ocean* (based in Halifax)

Ken Cairns
Service Manager
on the *Ocean* (based in Halifax)

THE CUSTOMER INTIMACY STRATEGY

The 2007 *Moving Forward* management plan sharpened VIA's focus on the customer by identifying customer intimacy as VIA's core business strategy. This strategy serves to underline an important fact – that relationships with customers will drive the success of passenger rail. It defines a framework for all initiatives and business activities, providing the "how and why" behind the goals set out in the *Moving Forward* plan with respect to safety, service, business growth, engagement, entrepreneurship and environmental sustainability.

Customer intimacy builds on what VIA does best – providing consistent, high quality personal service to customers – with a new emphasis on the total customer experience. This means focusing attention on what the customer will remember about their trip, and how he or she feels about the experience of travelling with VIA Rail. The strategy also emphasizes strong relationships with customers over time – recognizing the value of existing customers as the starting point for future ridership and revenue growth.

MEASURING CUSTOMER VALUE

In support of customer intimacy, VIA adopted a new performance indicator in 2007, one that helps the company obtain a clearer image of the organization's performance from the customers' perspective. The net promoter score provides insight into how and when customers become promoters – the kind of people who recommend VIA to friends and relatives. As an alternative to traditional customer satisfaction ratings, the score assesses the quality of VIA's relationship with its customers, and customer loyalty. This new measurement is being adopted by many companies in the transportation, leisure and other service industries.

The net promoter score helps focus the organization on improving every customer's experience. Combined with two other key performance indicators – cost recovery and total passenger miles over the same time period – the net promoter score also makes a clear and direct connection between the quality of the customer experience, VIA's success as a business, and future opportunities for business growth.

ENGAGING OUR PEOPLE

The new customer intimacy business strategy was discussed with employees through the town hall process, which is an integral part of VIA Rail's consultative management approach. From Vancouver to Halifax, a series of meetings and face-to-face discussions engaged all employees in a dialogue on the Corporation's strategic challenges and the need to focus on the customer experience. The meetings were also a forum for informing people about progress in meeting corporate goals, and ensuring that all employees understand the business challenges facing the Corporation.

VIA's customer intimacy strategy depends upon and builds upon the engagement of every employee. A customer's experience is shaped at every touch point, or moment at which they interact with the company. Touch points occur not only on board our trains, but whenever a customer calls for schedule information, uses VIA's web site, enters a station, buys a ticket, or checks their luggage. They are influenced by the frontline employee present at that moment, and also by every "behind the scenes" employee who made that moment possible.

This is why during town halls, training, and in regular employee communications, all employees are reminded that their efforts are critical, and that they too can have an impact on the customer experience. They are encouraged to build partnerships within the organization to clarify and strengthen their connection with the customer. Developing this sensibility helps everyone to gain a better understanding of how the customer's experience is shaped by the entire organization as a whole, and each individual within it.

TAKING THE STRATEGY TO THE FRONTLINE

Frontline leaders were among the first to participate in workshops on the customer intimacy business strategy, and on creating customer intimacy through their interactions with passengers.

These workshops address the fact that, to achieve customer intimacy, frontline employees must deal with many different personalities, exercise judgment and discretion, solve problems creatively and 'on the spot', project a positive, helpful attitude – and do all of this all the time. This is not something one learns in a traditional class on service skills, but rather through modelling best practices and behaviour on the job. Thus, the new customer intimacy development program helps managers and team leaders to encourage and support their employees through better communication, by coaching behaviours that create a customer-intimate culture.

Moving forward

THE 2007 *MOVING FORWARD* PLAN

Our Business Strategy: Customer Intimacy

We will build on our expertise and distinctive competencies to provide the best possible total travel experience that will delight travellers, and nurture loyal customers.

Our Goals

- Ensuring everyone's safety and security
- Engaging our people
- Delivering our customer promise
- Growing our business
- Enhancing our entrepreneurial attitude
- Enhancing our environmental sustainability

Customer intimacy is about customer relationships, and the relationship that exists between employees and managers will be reflected in relationships with the customer. By modelling a positive emotional connection, personal recognition, care and attentiveness, managers demonstrate the qualities essential to creating customer intimacy.

These workshops also captured personal success stories of providing service that will ultimately be used in building a unique VIA service model.

CUSTOMER ADVOCACY TEAMS

VIA's regional service teams were restructured and renamed as Customer Advocacy Teams in 2007, reflecting the new customer intimacy business model.

When they were introduced in 2001, the service teams responsible for the East, the Quebec City-Toronto corridor, Southwestern Ontario and Western Canada represented a major innovation in cross-functional management and teamwork. This approach proved to be very successful, bringing accountability for service results closer to the markets and customers being served.

The teams support greater synergy between regions and among individuals within the company. Each team has a mandate to champion the customer intimacy strategy, assuming responsibility for continuously improving the customer experience in the region, while also focusing on cost recovery. The two Corridor teams have been combined into a single Customer Advocacy Team, to ensure a more consistent customer experience in Corridor markets, where VIA offers similar products.

The cross-functional approach remains vitally important when managing issues which cut across organizational boundaries, requiring collaboration between all parts of the Corporation. In addition to the three Customer Advocacy Teams, there are several cross-functional teams at VIA, addressing everything from technology to environmental planning.

Left to right:

Teresa Beaulieu
Telephone Sales Agent
(Montreal Office)

Francine Devlin
Telephone Sales Agent
(Montreal Office)

THE NEW PEOPLE TEAM

VIA began a transformation of the Human Resources function in 2005, turning from a mainly administrative role to one that is more strategic and consultative. Now known as the People team, the group was further restructured in 2007 to establish a closer partnership with managers and employees, to provide more strategic support for VIA's customer intimacy strategy, and to ensure easier access to its services for all employees.

The new People team includes the Business Advisory Services group, which partners with managers throughout the Corporation to provide strategic and consultative services for all people-related needs. The Centres of Expertise, meanwhile, designs and delivers a range of talent management, learning and total rewards programs, and deals with all matters related to organizational effectiveness. The Shared Services and Recruitment group delivers transactional services in the areas of pension, benefits and employee data maintenance, and executes VIA's strategic hiring goals, and the Labour Relations group provides expertise in collective agreements and labour issues.

WELCOME ABOARD

New in 2007, the Welcome Aboard program provides new management employees a quick immersion into all aspects of VIA operations, and a first-hand look at what the customer intimacy strategy means in action. Designed to help retain new employees and to help existing employees share their knowledge, participants travel on VIA's trains and meet with people across the network – gaining a direct understanding of how VIA serves its customers, and how everyone contributes to the customer experience.

It's also a great tool for creating an inclusive culture at VIA. Participants welcome the opportunity to meet many new colleagues face-to-face, and gain a sense of belonging within the organization.


Isabel
VIA Rail Canada

DELIVERING THE PROMISE

AN INTEGRAL PART of VIA's customer intimacy strategy is "delivering the promise"– ensuring that customers' expectations regarding service match what customers actually experience on board the train. This requires a continuous effort to improve and enhance services – to deliver on VIA's brand promise as "the more human way to travel".

A variety of initiatives in 2007 focused on fine-tuning VIA's on-board products, station services and amenities. As just one example, early in the year VIA's Service Design team consulted service managers, frontline staff and customer surveys to improve on-board food selection. A new *Comfort* class menu was developed and standardized for all VIA trains across the system, featuring wider variety and more options for health-conscious travellers.

Left to right:

Diane Bell
Business Advisor, People
(Toronto)

Isabel Nahdee
In-charge
(Union Station)

In 2007 VIA made free Wi-Fi access available in major stations between Toronto and Vancouver as well as between Montreal and Halifax. This achievement is a first for transcontinental train routes in North America. By using the service during scheduled train stops in Vancouver, Jasper, Edmonton, Winnipeg, Moncton and Halifax, customers can connect with friends and family at least once each day of their trip.

THE METROPOLIS PROJECT

In 2007, VIA launched the first phase of the Metropolis Project, a comprehensive review of VIA's products and services on the Montreal-Toronto service, and throughout the Corridor. The project team is assessing how well the customer experience matches the promise made to customers through VIA's advertising, promotions and other channels.

Working groups have already introduced a number of initiatives to better match expectations and service delivery. For example, boarding times are now standardized at Windsor, Toronto, Ottawa, Montreal and Quebec City to provide consistency for customers no matter where they board our trains. Coaching for on-train employees encourages better contact with customers. And VIA is developing tools and procedures to ensure that sales agents have more timely and accurate information available to answer customer enquiries.

The second phase of the Metropolis project will reposition VIA's Corridor products, to ensure consistency between VIA's resources and the needs of today's markets and customers. Repositioning and updating VIA's Corridor brand promise is an essential part of the customer intimacy strategy to attract more customers, increase revenues, and further improve the bottom line performance of Corridor services.

NEW CUSTOMERS, NEW MARKETS

VIA's customer focus helped to identify and respond quickly to new market opportunities in 2007, attracting new customers and new revenues.

The Snow Train Express between Edmonton and Jasper started its first season in January 2007 and began its second in November of the same year. Developed in partnership with Marmot Basin and the town of Jasper, the service represents a new addition to VIA's tourism products. VIA also offered an enhanced sleeper service between Winnipeg and Churchill, Manitoba in October of 2007. This first class service included exclusive access to one of VIA's dome observation cars throughout the two day journey, allowing customers to take in the unspoiled landscape by day and the *aurora borealis* by night.

In Ontario, VIA added a seasonal departure to the Toronto-Niagara Falls service from

DELIVERING THE PROMISE FOR TIM HORTONS

In June, VIA carried out a large and very successful charter move for Tim Hortons Inc., in connection with the company's 2007 conference for franchisees. Involving almost 1,000 passengers and several dedicated trains on some of VIA's busiest routes (between Toronto and Quebec City), it was a massive undertaking. Preparations involved almost every function at VIA.

As a cultural icon and one of Canada's most recognizable brands, Tim Hortons has exacting standards, and VIA pulled out all the stops to make this charter move unforgettable. It represented important new revenues for the company and opened up a whole new customer base for VIA, since many of these franchise owners were first-time train travellers.

June to September, and once again offered unique wine-tasting events on select departures. Also between Toronto and Niagara Falls, VIA piloted a popular new Bike Train service. Developed in partnership with the Niagara-on-the-Lake Chamber of Commerce, the City of Toronto, and the Ontario government, the service encouraged cyclists to bring their bicycles when visiting the region. Throughout Southern Ontario VIA partnered with eighteen Premier Spas, offering packages that included return train travel and shuttle transportation to and from their nearest VIA Rail station.

In Eastern Canada, VIA's refined *Easterly* class service completed its third year with strong results, improving revenues and ridership for the transcontinental between Montreal and Halifax. Designed as a Maritime Learning Experience, *Easterly* class includes educational activities, entertainment and Maritime-themed meals, and consistently receives high ratings from customers.

CONNECTING WITH CUSTOMERS

VIA broke new ground with the use of online services to connect with individual and corporate customers in the 1990s. Today, VIA continues to enhance its web-based booking and reservation technologies – providing travellers and travel agencies with convenient, efficient access to passenger rail services. Every year web-based sales continue to grow as a portion of total sales.

In 2007, VIA took its online presence further with innovative e-marketing initiatives. For example, an interactive web contest invited young people to submit their own ad illustrating the benefits of passenger rail. VIA promoted the contest on the popular social networking site Facebook – a fast, cost-efficient way to connect with the target audience. As a pioneering example of e-marketing through social media, the contest caught the attention of the media, including the daily *Journal de Montréal*, the graphic communications magazine *Grafika*, the CBC News "Technology and Science" blog, and the online magazine *Design Edge Canada*.

TRAVEL INDUSTRY RECOGNIZES VIA AS BEST IN CLASS

In August, VIA won First Place for railway services in the 8th Annual Agent's Choice Awards. Some 4,000 travel agents picked VIA Rail over such internationally recognized names as Rocky Mountaineer, Rail Europe, British Rail, Orient Express, Japan Rail, and the Trans-Siberian Railway. Agents cited VIA's easy-to-use web site, informative staff and outstanding service as the main reasons VIA was awarded top place.

VIA's *Canadian* was also voted the top train in North America by the Society of International Railway Travelers, an organisation for people who love the comfort and romance of great trains. The *Canadian* ranked ahead of the *Sierra Madre Express* (Mexico) the *GrandLuxe Express* (US) and the *Rocky Mountaineer* (Canada).

And finally, VIA's *Easterly* class and its Maritime Learning Experience were singled out by National Geographic this year as one of the *100 Best Vacations To Enrich Your Life* (Pam Grout, 2007).


Arthur
VIA Rail Canada
VIA Rail Canada

SERVING WITH INTEGRITY

STRONG RELATIONSHIPS with customers are built on trust, and that trust has to be earned by providing service with integrity.

For VIA, this means conducting business honestly and transparently, and recognizing that passenger rail service has an impact on customers, employees, and communities. VIA makes it a priority to take this impact into account in its management decisions, responding with integrity and respect to all stakeholders who are affected by the Corporation.

Left to right:

Brigitte Ayotte
Senior Service Attendant
on the *Canadian* (based in Winnipeg)

Arthur Jurkowski
Assistant Service Coordinator
on the *Canadian* (based in Winnipeg)

RAISING THE BAR FOR SAFETY

With one of the best safety records in the industry, VIA's first and primary responsibility is to ensure the safety and security of its customers, its employees, and the communities where our trains operate.

VIA was the first railway in Canada to implement a comprehensive Safety Management System (SMS) in 2001, integrating all safety rules, procedures and responsibilities, and making safety part of the job for every employee. The SMS is regularly audited by Transport Canada. VIA completed a comprehensive assessment of its effectiveness, and conducted SMS refresher training in 2007.

VIA also received special recognition in 2007 from the Railway Association of Canada for improvements made to the Corporation's Hazardous Assessment and Risk Control Strategies (HARCS) process. An integral part of the SMS, HARCS allows the company to identify and address potential risks associated with workplace safety, security and the environment. The HARCS database, along with comprehensive training, a new Hazard Prevention Program, and new guidelines for Health and Safety Committees, have together created an internal network of employees who participate in cross-functional assessments of potential risks.

TAKING RESPONSIBILITY FOR SECURITY

Partnerships continue to be the foundation of security across the passenger rail network. In November the Railway Association of Canada and the Government of Canada signed a Memorandum of Understanding that provides a framework for cooperation on security matters throughout the industry.

VIA fully supported this agreement, and applies this partnership model by participating in joint security exercises and fostering cooperative relationships with relevant security-related authorities. In 2007, VIA signed letters of understanding with various municipal and regional law enforcement agencies across the country, giving them access to VIA premises and the authority to act on VIA's behalf in

A DECADE OF SAFE WORK PRACTICE IN ATLANTIC CANADA

In June 2007, VIA's Eastern region Equipment Maintenance team marked an impressive milestone. In the decade since June of 1997, not a single equipment maintenance employee in the Atlantic Provinces and the Gaspé has sustained a work-related injury resulting in time off work.

Team members say that workplace safety has become a state of mind – and the longer they go without an accident, the more motivated they are to maintain their winning streak.

security matters. At the end of the year VIA also reached agreements with several K-9 police units, allowing them to use VIA facilities for their training and routine patrols. Agreements such as this have advantages both for VIA and the agencies involved – by increasing the visibility of law enforcement across the passenger rail network while at the same time familiarizing those authorities with VIA's operations.

Security training is another important aspect of the 2007 Memorandum of Understanding on rail security. VIA is a leader in this area, having introduced in September 2007 an on-line Security Awareness Program that instils a sense of personal responsibility for security in all employees. The training package was presented to the Railway Association of Canada's Rail and Urban Transit Steering Committee and to Transport Canada's Emergency Preparedness group. Transport Canada has since recognized the training package as a best practice in the rail industry.

AN ENVIRONMENTALLY SUSTAINABLE SERVICE

VIA continually works to reduce the environmental impact of passenger rail, widely recognized as one of the most environmentally responsible modes of public transportation available today. Each year the company identifies initiatives to improve environmental performance, and no significant corporate project gets the green light without first passing an environmental assessment.

VIA has included explicit environmental goals in its strategic business planning since 2003, and drives continuous improvements in environmental performance through a comprehensive Environmental Management System. The corporate Environmental Policy was updated in 2007, and distributed to all employees as a guide for increasing environmental awareness in day-to-day activities. VIA's 11 employee-led Green Teams support initiatives at the local level in VIA facilities across the network, and encourage efforts to improve the Corporation's overall environmental performance. In 2007, Green Teams participated in many community

TECHNOLOGY ENHANCES WORKPLACE SAFETY

VIA installed locomotive remote control technology on two switching locomotives at the Montreal Maintenance Centre (MMC) in 2007. In conventional switching operations, one locomotive attendant is in the cab at the controls, while another on the ground transmits directions by radio. With the use of a remote control portable transmitter and a microprocessor receiver unit in the locomotive, all switching movements are conducted more efficiently and safer than conventional means, with a single attendant on the ground.

A recent study by the US Federal Railroad Administration showed that remote control locomotives reduced the number of train accidents in switching operations by 13.5 per cent, and the employee injury rate by 57 per cent.

Source: *Safety of Remote Control Locomotive Operations*, final report of the Federal Railroad Administration, US Department of Transportation, March 2006.

events, such as Earth Day, Car Free Day and Clean Air Day celebrations, and initiated numerous local initiatives that aimed to reduce their worksites' ecological footprint.

Another 2007 Memorandum of Understanding with the Government of Canada established guidelines for the railway industry with respect to reducing locomotive emissions. VIA is already an industry leader in this regard. Since 1990, VIA has cut fuel consumption by 25 per cent per passenger-kilometre, and greenhouse gas (GHG) emissions by 15 per cent. Under the capital investment plan announced by the Government of Canada in the fall of 2007, VIA is now rebuilding its older locomotives to ensure that they meet a higher environmental standard – when completed, the rebuilt locomotives will reduce fuel consumption by another five million litres per year, and eliminate another 15 thousand tons of GHG emissions annually. These efforts will continue in 2008, when VIA tests leading edge pollution control technology that will make VIA's locomotives among the cleanest in North America.

VIA has been particularly successful in reducing the environmental impact of train maintenance operations. VIA's maintenance centres in Montreal, Winnipeg, and Vancouver obtained ISO14001 certification beginning in 2001, and have successfully achieved their 3-year recertifications since then. The ISO14001 international standard encourages the continual improvement of environmental performance.

SERVING OUR COMMUNITIES

As a corporate citizen, VIA is a vital part of the more than 450 communities it serves. And VIA's involvement in those communities extends beyond the provision of rail services.

At the national level, VIA lends its support to Kids Help Phone, a charity that provides toll-free, 24-hour bilingual and anonymous counselling to young people in Canada. VIA also holds an employee-driven national charitable campaign every year, with funds going to the United Way and Healthpartners. And in small towns and big cities from coast to coast, VIA's people get involved in causes and activities

ENVIROEXPO

VIA Rail Canada

VIA united its environmental commitment and support for Canadian youth in 2007 with the launch of EnviroExpo – a new environmental innovation category of the Canada-Wide Science Fairs. Developed by VIA in partnership with the Youth Science Foundation Canada, the program challenges students in grades 7 to 12 and CEGEP to combine art and science to develop new solutions to significant environmental challenges. VIA will offer three post-secondary scholarships of $10,000 to the winners.

that are closer to home. With the creation of EnviroExpo in 2007, VIA is extending the reach of its environmental commitment and community involvement to high schools and CEGEPs from coast to coast.

As a federal institution, VIA plays an important role in promoting Canada's linguistic duality. The Corporation continues to demonstrate its daily commitment to providing clients with quality services, a commitment that includes serving each passenger in their official language of choice. In 2007, 98 per cent of passengers who responded to a customer satisfaction survey confirmed that they were served by VIA in the language of their choice, whether it was on the telephone, in a station, or on board our trains. All of VIA's internal and external communications are circulated in both English and French, and the Corporation conducts its commercial practices in both official languages.

SERVING CUSTOMERS WITH SPECIAL NEEDS

VIA is recognized for its leadership in advancing the cause of accessible public transportation for all Canadians. Over the past 25 years, VIA has established a constructive working relationship with a number of organizations representing disabled travellers.

A cooperative approach has helped VIA to make continuing improvements to its trains, stations and frontline services, ensuring that Canadian passenger rail remains at the forefront of accessible transportation. This is reflected in the special training VIA gives to staff, in on-line and telephone tools, as well as in the many physical changes VIA has made to equipment, stations and maintenance facilities to ensure better access for all Canadians. In 2007, VIA began a review of its installations and signage to bring them in line with the Canadian Transportation Agency's Code of Practice on removing communication barriers for travellers with disabilities. Web accessibility standards were also included in the mandate for a forthcoming redesign of VIA's web site.

A GREEN CHOICE

As part of a campaign to increase environmental awareness, both within the Corporation and with our customers, VIA introduced a new environmental logo in 2007. The logo appears in corporate literature, internal communications, and VIA's advertising campaigns – a symbol of VIA's environmental commitment in all its business decisions.

In the spring of 2007 the Supreme Court of Canada handed down a decision concerning the accessibility of Renaissance cars, following a complaint submitted by the Council of Canadians with Disabilities. The ruling requires that VIA modify certain Renaissance car facilities to improve existing on-board amenities for travellers with disabilities.

Throughout the rest of 2007 VIA worked with the Canadian Transportation Agency, with the aim of meeting these requirements as quickly as possible. By the end of the year VIA had submitted a detailed modification plan to the Canadian Transportation Agency. Approval is needed to proceed with the modifications.

ACCESS TO INFORMATION

VIA Rail operates its business in an open and transparent manner. While information must be shared in a manner that takes into account issues such as personal privacy and commercial confidentiality, openness and transparency are the starting point in building a trusted relationship with customers, and with the public in general.

In September 2007, legislation came into effect which made VIA subject to the Access to Information and the Privacy Acts (ATIP). These acts govern the legal and enforceable right of public access to records that are under the control of the federal government and its institutions.

VIA has developed a process to respond to information requests, managed by a unit created for that purpose. VIA received 53 requests for information under the legislation in 2007, and responded to 51 within the prescription period. Two of these requests, received late in December, were carried over into 2008.

ACCESSIBILITY AND EXCELLENCE IN THE CUSTOMER EXPERIENCE

VIA has built a reputation firmly based on positive customer testimonials from customers who turn to passenger rail for accessible transportation services.

In June, VIA was invited to describe its efforts and expertise with respect to accessible passenger services at the International Conference on Mobility and Transport for Elderly and Disabled Persons (TRANSED) in Montreal. It was an excellent opportunity for VIA to share successes, as well as to learn from other companies.

Corporate Governance

VIA's Board of Directors is responsible for overseeing the strategic direction and management of the Corporation, and reports on VIA's operations to Parliament. Her Excellency the Governor General in Council, on the recommendation of the Minister of Transport, approves the appointment of members of the Board. In 2007, eight new members were appointed to the Board.

The Corporation and its Board of Directors are committed to principles of good governance, and have fully implemented a new governance program over the past few years that clearly defines the Board's roles with respect to strategic planning and direction of the Corporation, performance management of Executives and Directors, succession planning, risk management and financial oversight.

All members of the board sign a code of ethics reflecting the spirit and intent of the *Accountability Act*, which sets out standards of transparency and accountability for the officers of Crown corporations.

BOARD COMMITTEES

Audit and Risk Committee
Provides oversight and monitoring of the Corporation's

- standards of integrity and behaviour;
- financial information reporting and disclosure, and the annual report;
- internal control practices; and
- risk management policies and procedures.

Corporate Governance Committee
Examines governance practices observed within VIA Rail and makes recommendations with respect to such matters to the Board of Directors.

Human Resources Committee
Reviews and makes recommendations to the Board of Directors on the appointment, compensation, performance and succession of officers, and reviews organizational structure.

Investment Committee
Makes recommendations to the Board of Directors on the Pension Fund and the Asset Renewal Fund investment performance, policies and related matters.

Nominating Committee
Makes recommendations to the full Board of Directors, which in turn makes recommendations to the Minister of Transport, regarding appointments and re-appointments to the positions of Chief Executive Officer and the Chair of the Board of Directors.

Planning and Finance Committee
Oversees and monitors the Corporation's Strategic Plan, five-year Corporate Plan, and annual operating and capital budgets.

Management Discussion and Analysis

MANAGEMENT DISCUSSION AND ANALYSIS

This discussion and analysis presents data and comments on the Corporation's financial position and results of operations for the year 2007, excluding the financial results of VIA's variable interest entity.[1] It should be read in conjunction with the Consolidated Financial Statements that follow, and the Year at a Glance on page 1.

OVERVIEW OF FINANCIAL RESULTS

EXCLUDING FINANCIAL RESULTS OF VIA'S VARIABLE INTEREST ENTITY

	2007	vs Budget		vs 2006	
(IN MILLIONS OF DOLLARS)	$	$	%	$	%
PASSENGER REVENUES	**268.8**	(9.9)	(4)	2.2	1
TOTAL REVENUES	**285.6**	(7.8)	(3)	(11.4)	(4)
OPERATING EXPENSES	**486.2**	21.3	4	(10.7)	(2)
OPERATING DEFICIT	**(200.6)**	13.5	6	22.2	(12)
RIDERSHIP (thousands of passengers)	**4,181**	7	0.2	90	2

Despite a difficult operating environment that had a serious impact on revenues, VIA achieved good financial results in 2007. The Corporation realized substantial operating savings to offset a revenue shortfall, and improved its financial performance as compared to budget.

Passenger revenues got off to a strong start after the 2006/07 winter holiday season. That trend reversed after the first quarter of 2007, due to increased competition from other modes, the negative effects of a strong Canadian dollar on tourism spending, service disruptions, and on-time performance challenges. This downward pressure on revenues continued throughout the remainder of 2007, until winter storms boosted December revenues and passenger volumes to record levels for the month.

With the recovery in December, total revenues at year end were $285.6 million. This represents a decline of $11.4 million (4 per cent) from the previous year, and is $7.8 million (3 per cent) less than budget for 2007. Revenues in 2006 included $11.7 million of exceptional capital gains.

1. *In April 2006, as part of its mandate to provide passenger rail service in Canada, the Corporation entered into an operating agreement with the Keewatin Railway Company (KRC) to provide a financial contribution to KRC for the purposes of operating passenger rail services and essential freight to the communities in Northern Manitoba served by KRC. KRC is a Variable Interest Entity (VIE) to the Corporation given that the Corporation is the primary beneficiary exposed to a majority of the risk of loss from KRC's activities. The Corporation has therefore consolidated the financial statements of KRC. In 2007, the financial contribution provided by the Corporation to KRC amounted to $1.9 million. (See note 13 in the consolidated financial statements.)*

In 2007 total operating expenses ended at $486.2 million. Expenses increased by only $10.7 million (2 per cent) over 2006, and were $21.3 million (more than 4 per cent) below budget.

The shortfall in revenues was more than offset by savings in expenses. These savings enabled the Corporation to end its financial year with an operating deficit of $200.6 million. After adjusting the 2006 results to exclude the impact of exceptional capital gains ($11.7 million) that year, the deficit would have increased by only $10.5 million or 6 per cent. The deficit was $13.5 million (6 per cent) below budget.

PASSENGER REVENUE AND RIDERSHIP

Despite pressures on revenues and ridership, VIA achieved a moderate increase on both counts. Passenger revenues increased $2.2 million over 2006, a 1 per cent increase that, while positive, fell 4 per cent short of budget targets. Ridership also gained moderately, increasing over 2 per cent versus last year to 4.2 million trips.

This was achieved in the face of VIA's greatest challenge: to retain its core customer base in the midst of difficulties with on-time performance, depressed markets, generally lower fares from competitors, and improvements to competing services.

Severe disruptions affected VIA's network throughout the spring and summer, forcing many travellers to forego the train for alternative air, or even bus, service. These last factors had their greatest impact on VIA's two most important Corridor services: Montreal-Toronto and Ottawa-Toronto. At the same time, a rising Canadian dollar encouraged record numbers of Canadians to vacation outside the country in 2007. With the addition of a third air carrier, competition intensified in central Canada's intercity markets, as business travellers were offered exceptionally low air fares, more frequent departures and a downtown Toronto airport location.

In response to this situation VIA boosted the promotion of its first class *VIA 1* product to frequent business travellers in both Montreal-Toronto and Ottawa-Toronto markets. To counter price resistance, VIA introduced a new *Comfort* class fare plan in these markets, which matched airlines' low fares and focused on last-minute 'price-shopping' travellers.

These factors also affected VIA's western transcontinental train service – another major source of revenue weakness in 2007. An expected recovery after a strong fall tourism season in 2006 did not materialize, and equipment reliability problems persisted. The high value of the Canadian dollar also coincided with weak demand for long-distance travel, all of which had a negative impact on this service.

Despite weak passenger revenue growth, online sales continued to perform well in 2007. Throughout the year VIA continued to enhance on-line access to its services, increasing convenience for customers and reducing its distribution costs. By year end, VIA had successfully transferred all travel agencies to its web booking portal. As a result, on-line sales increased for the sixth consecutive year and accounted for 42 per cent of total sales.

OPERATING COSTS

EXCLUDING FINANCIAL RESULTS OF VIA'S VARIABLE INTEREST ENTITY

Effective management, along with a number of favourable one-time factors, helped VIA to achieve substantial savings in 2007, and to minimize the impact of rising costs. Operating costs rose just $10.7 million or 2 per cent over 2006, and were below budget by $21.3 million or 4 per cent. There were three major sources of rising costs: train operating expenses, major equipment overhauls, and compensation. Expenses for train operations were affected by costs due to problems with equipment reliability and poor on-time performance, soaring fuel costs, as well as inflation-induced increases in labour and utilities. The Corporation also provided for potential loss on Asset-Backed Commercial Paper (ABCP). The Corporation holds an $8.7 million exposure to ABCP in its Asset Renewal Fund, which has been illiquid since August 2007. Management took the prudent step of estimating a fair value for its non-bank ABCP holdings as of December 31, 2007 (as described in note 6), based on information available at the time.

The hedging program and the value of the Canadian dollar limited the impact of higher fuel prices. VIA also benefited from a recovery of prior year capital taxes and the revaluation of a legal action.

CAPITAL EXPENDITURES

EXCLUDING FINANCIAL RESULTS OF VIA'S VARIABLE INTEREST ENTITY

New government funding was announced in 2007 to address the Corporation's future capital needs. This significant investment of $516 million was announced by the government in October.

Capital spending for 2007 totalled $12.4 million, $2.1 million less than the previous year and $4.3 million less than planned, mainly due to uncertainty about the timing and amount of government funding during the first half of the year. Almost three quarters of 2007 capital spending was devoted to equipment, station upgrading, and information technology projects.

2007 saw the completion of two key capital projects – construction and testing of a prototype rebuilt F-40 locomotive and a rebuilt Light, Rapid, Comfortable (LRC) car that tests modern on-board systems. These will serve as the basis for the rebuild of the entire F-40 locomotive and LRC car fleets. The two rebuild programs form a major part of the $516 million capital investment program.

ON-TIME PERFORMANCE

VIA recognizes that on-time performance is a critical issue for customers, and for the success of passenger rail. Delayed service undermines customer satisfaction and loyalty, particularly in the Quebec City-Windsor corridor, where travellers are especially time sensitive.

On-time performance and service reliability represented a major challenge in 2007. This critical issue has had a compounded negative impact on the financial performance of the Corporation. Growth in freight traffic and longer freight trains continue to affect VIA operations. In addition, work programs for infrastructure improvements across Canada were extended over the summer period, and were a major source of train delays. System-wide, overall on-time performance dropped to 77 per cent, a 7 percentage point decrease from 2006 and 11 percentage points below target.

Of increasing concern were VIA controllable delays – delay minutes caused by problems with VIA operations, such as equipment breakdowns, as opposed to delays attributed to infrastructure owners or other third parties. In the Quebec City-Windsor corridor, equipment maintenance delays increased by 141 per cent in 2007, partly due to cold weather conditions. Higher passenger volumes also contributed to increased VIA controllable delays. Overall on-time performance for the Corridor was 78 per cent in 2007, a 7 percentage point drop from 2006.

For the Eastern transcontinental service, overall on-time performance was 73 per cent, just 1 percentage point down from 2006. However, the length of delays on this service – the number of minutes a train is late in arriving – increased by 179 per cent. On the Western transcontinental, direct control delays increased by 25 per cent, while freight traffic in the region continued to grow. On-time performance for the year on this service was 24 per cent, a drop of 26 percentage points from 2006.

Persistent problems with on-time performance have forced VIA to adopt a new approach to the issue of scheduling, and to renew its working relationship with CN, the owner of most of the infrastructure used by passenger rail. In 2007, both companies agreed to a new train schedule in the Corridor that should allow VIA to deliver on-time service more consistently in this important market. At the same time, a VIA team analyzed every aspect of the Western transcontinental schedule in order to address on-time performance issues.

OUTLOOK FOR 2008

The federal government's welcome announcement of investment in passenger rail at the end of 2007 will modernize a significant percentage of VIA's equipment and upgrade strategic parts of the infrastructure on which VIA operates. It will contribute to more efficient and reliable service across the country, and will allow for more frequent services in the Quebec City-Windsor corridor. Once completed, this investment will substantially improve the reliability, efficiency, and financial sustainability of passenger rail.

However, it will take time to realize the benefits of the five-year investment program. In 2008, VIA will continue to face significant challenges. The travel and tourism industry foresees little growth in key markets for the year, and competition is expected to remain high. For VIA, the ability to maintain high-yield business and tourism services, retain existing customers, and strengthen customer loyalty will be critical.

VIA's *Moving Forward* plan will continue to keep the company focused on the customer. Customer intimacy – the company's core business strategy – has already produced results over the past year, with improved service delivery and enhancements on trains and in stations. Continuing on this path in 2008 will enable the Corporation to better deliver on the promise of passenger rail for customers, with greater consistency. VIA will continue to build on key customer relationships and strengthen its customer loyalty program.

Improvements in on-time performance will be a priority in 2008. Marketing, pricing and revenue management strategies will continue to strengthen the position of rail as the 'value-for-money' travel option. The role of the travel trade within VIA's distribution network will also be reinforced.

At the same time, VIA will continue to contain rising costs with rigorous cost controls. Efforts to increase productivity will focus on enhancing the talents of VIA's people, developing innovative applications of technology, and exploring new entrepreneurial initiatives to further improve cost recovery.

CONSOLIDATED FINANCIAL STATEMENTS

Management's Responsibility Statement

Year ended December 31, 2007

Management of the Corporation is responsible for the preparation and integrity of the consolidated financial statements contained in the Annual Report. These consolidated statements have been prepared in accordance with Canadian generally accepted accounting principles and necessarily include certain amounts that are based on management's best estimates and judgement. Financial information contained throughout the Annual Report is consistent with that in the consolidated financial statements. Management considers that the consolidated statements present fairly the financial position of the Corporation, the results of its operations and its cash flows.

To fulfill its responsibility, the Corporation maintains systems of internal controls, policies and procedures to ensure the reliability of financial information and the safeguarding of assets. The internal control systems are subject to periodic reviews by Samson Bélair/Deloitte & Touche, s.e.n.c.r.l., as internal auditors. The external auditor, the Auditor General of Canada, has audited the Corporation's consolidated financial statements for the year ended December 31, 2007, and her report indicates the scope of her audit and her opinion on the consolidated financial statements.

The Audit and Risk Committee of the Board of Directors, consisting primarily of independent Directors, meets periodically with the internal and external auditors and with management, to review the scope of their audits and to assess reports on audit work performed. The consolidated financial statements have been reviewed and approved by the Board of Directors on the recommendation of the Audit and Risk Committee.

Paul Côté

Paul Côté
President and Chief Executive Officer

Robert St-Jean

Robert St-Jean, CA
Chief Financial and Administration Officer

Montreal, Canada
February 8, 2008

Auditor's Report

TO THE MINISTER OF TRANSPORT, INFRASTRUCTURE AND COMMUNITIES

I have audited the consolidated balance sheet of VIA Rail Canada Inc. as at December 31, 2007 and the consolidated statement of operations, comprehensive income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, I report that, except for the changes in accounting policies adopted in the current year as explained in Note 2 to the consolidated financial statements, these principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of the Corporation that have come to my notice during my audit of the financial statements have, in all significant respects, been in accordance with Part X of the *Financial Administration Act* and regulations, the *Canada Business Corporations Act* and articles and the by-laws of the Corporation.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Montreal, Canada
February 8, 2008

CONSOLIDATED BALANCE SHEET

AS AT DECEMBER 31
(IN THOUSANDS)

	2007	2006
CURRENT ASSETS		
Cash and cash equivalents	$ 5,147	$ 4,250
Accounts receivable, trade	7,445	5,805
Accounts receivable, prepaid and other	4,575	2,080
Receivable from the Government of Canada	303	-
Derivative financial instruments (Note 15)	6,262	5,759
Materials	20,629	19,968
Asset renewal fund (Note 6)	17,700	22,000
	62,061	59,862
LONG-TERM ASSETS		
Property, plant and equipment (Note 5)	$ 487,905	533,123
Asset renewal fund (Note 6)	56,826	55,141
Accrued benefit asset (Note 8)	286,621	230,878
Derivative financial instruments (Note 15)	553	1,206
Other	-	220
	831,905	820,568
	$ 893,966	$ 880,430
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (Notes 7 and 15)	$ 99,738	$ 94,687
Deferred revenues	11,812	11,524
	111,550	106,211
LONG-TERM LIABILITIES		
Accrued benefit liability (Note 8)	25,216	24,477
Future corporate taxes (Note 9)	41,042	35,871
Deferred investment tax credits	1,950	2,292
Other	1,346	778
	69,554	63,418
DEFERRED CAPITAL FUNDING (Note 10)	488,763	530,242
SHAREHOLDER'S EQUITY		
Share capital (Note 11)	9,300	9,300
Contributed surplus	4,963	4,963
Retained earnings	209,836	166,296
	224,099	180,559
	$ 893,966	$ 880,430

Commitments and Contingencies (Notes 12 and 18 respectively)

The notes are an integral part of the consolidated financial statements

On behalf of the Board,

Eric Stefanson, FCA
Director and Chairman of the Audit and Risk Committee

Donald A. Wright
Director and Chairman of the Board

CONSOLIDATED STATEMENT OF OPERATIONS, COMPREHENSIVE INCOME AND RETAINED EARNINGS

YEAR ENDED DECEMBER 31
(IN THOUSANDS)

	2007	2006
REVENUES		
Passenger	**$ 268,959**	$ 266 609
Investment income	**2,733**	17 987
Other	**15,607**	13 219
	287,299	297,815
EXPENSES		
Compensation and benefits	**218,141**	210,140
Train operations and fuel (Note 15)	**119,450**	118,033
Stations and property	**30,592**	28,533
Marketing and sales	**29,265**	29,887
Maintenance material	**30,753**	28,324
On-train product costs	**17,875**	17,969
Operating taxes	**7,066**	6,159
Employee future benefits (Note 8)	**(35,633)**	(29,594)
Amortization and losses on write-down and disposal of property, plant and equipment	**55,396**	58,956
Other	**18,859**	20,065
	491,764	488,472
OPERATING LOSS BEFORE FUNDING FROM THE GOVERNMENT OF CANADA AND CORPORATE TAXES	**204,465**	190,657
Operating funding from the Government of Canada	**200,596**	169,001
Amortization of deferred capital funding (Note 10)	**53,617**	55,851
Income before corporate taxes	**49,748**	34,195
Corporate tax expense (Note 9)	**6,208**	463
NET INCOME AND COMPREHENSIVE INCOME FOR THE YEAR (Note 2)	**43,540**	33,732
Retained earnings, beginning of year	**166,296**	132,564
RETAINED EARNINGS, END OF YEAR	**$ 209,836**	$ 166,296

The notes are an integral part of the consolidated financial statements

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31
(IN THOUSANDS)

	2007	2006
OPERATING ACTIVITIES		
Net income and comprehensive income for the year	$ **43,540**	$ 33,732
Adjustments to determine net cash from (used in) operating activities:		
Amortization of property, plant and equipment	**57,283**	58,956
(Gains) losses on write-down and disposal of property, plant and equipment	**(1,545)**	347
Gain on disposal of Asset Renewal Fund investments	**-**	(13,645)
Amortization of premium and discount on purchase of bonds in the Asset Renewal Fund	**-**	23
Amortization of investment tax credits	**(342)**	(347)
Amortization of deferred capital funding	**(53,617)**	(55,851)
Future corporate taxes	**5,171**	463
Change in fair value of financial instruments	**1,300**	-
Unrealized net loss on derivative financial instruments	**1,349**	4,429
Change in non-cash working capital	**(319)**	(5,326)
Change in other long-term assets	**220**	766
Change in accrued benefit asset	**(55,743)**	(53,633)
Change in accrued benefit liability	**739**	2,672
Change in other long-term liabilities	**(72)**	427
	(2,036)	(26,987)
FINANCING ACTIVITIES		
Capital funding	**12,138**	7,360
	12,138	7,360
INVESTING ACTIVITIES		
Acquisition of investments in the Asset Renewal Fund	**(526,086)**	(636,575)
Proceeds from sale and maturity of investments in the Asset Renewal Fund	**527,401**	679,245
Acquisition of property, plant and equipment	**(12,438)**	(22,012)
Proceeds from disposal of property, plant and equipment	**1,918**	598
	(9,205)	21,256
CASH AND CASH EQUIVALENTS		
Increase during the year	**897**	1,629
Balance, beginning of year	**4,250**	2,621
BALANCE, END OF YEAR	$ **5,147**	$ 4,250
REPRESENTED BY:		
Cash	**2,265**	393
Short-term investments, 4.44%, maturing in January 2008 (2006: 4.30%)	**2,882**	3,857
	$ **5,147**	$ 4,250

The notes are an integral part of the consolidated financial statements

Notes to Consolidated Financial Statements

AS AT DECEMBER 31, 2007

1. AUTHORITY AND OBJECTIVES

VIA Rail Canada Inc. is a Crown corporation named in Part I of Schedule III to the *Financial Administration Act*. It was incorporated in 1977, under the *Canada Business Corporations Act*. The Corporation's vision is to be the Canadian leader in service excellence in passenger transportation with a mission to work together to provide travel experiences that anticipate the needs and exceed the expectations of our customers. The Corporation uses the roadway infrastructure of other railway companies and relies on them to control train operations.

The Corporation is not an agent of Her Majesty and is subject to income taxes.

The Corporation has one operating segment, passenger transportation and related services.

2. CHANGES IN ACCOUNTING POLICIES

On January 1, 2007, the Corporation adopted CICA accounting handbook section 3855, *Financial Instruments – Recognition and Measurement*, section 3861, *Financial Instruments – Disclosure Presentation*, section 1530, *Comprehensive Income* and 3251, *Equity*.

A | FINANCIAL INSTRUMENTS

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities, including non-financial derivatives, be recognized on the Consolidated Balance Sheet when the Corporation becomes a party to the contractual provisions of the financial instrument or non-financial derivative.

Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependant upon the classification of the financial instrument as held-for-trading (HFT), held-to-maturity (HTM), available-for-sale (AFS), loans and receivables (L&R), or other financial liabilities.

The HFT classification is applied when an entity has the objective of generating a profit from the short-term fluctuation in price of an instrument or alternatively, the standard permits that any financial instrument be irrevocably designated as HFT. The HTM classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. An asset can be classified as AFS when it has not been classified as HFT or HTM.

Financial assets and financial liabilities classified as HFT are measured at fair value with changes in those fair values recognized in income. Financial instruments classified as HTM, L&R, or other liabilities are measured at amortized cost using the effective interest method of amortization. Financial assets classified as AFS are measured at fair value with the unrealized gains and losses, including changes in foreign exchange rates, being recognized in Other Comprehensive Income (OCI) as described below.

The fair value is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The fair value is determined by reference to quoted bid or asked prices, as appropriate, in the most advantageous active market for that instrument to which the Corporation has immediate access. When the bid and ask prices are not available, the Corporation uses the closing price of the most recent transaction of that instrument.

Derivative financial instruments are recorded on the Consolidated Balance Sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair value of derivative financial instruments are recognized in income.

Transaction costs for financial instruments classified or designated as HFT are expensed as incurred. For the other financial instruments, transaction costs are capitalized on initial recognition. Interest expense is recorded using the effective interest method.

The Corporation has implemented the following classifications.

All financial instruments are measured at fair value on initial recognition. Subsequent measurement and classification is as follows:

- Cash and cash equivalents and the Asset Renewal Fund are classified as HFT and any period change in fair value is recorded as investment income.

- Derivative financial instruments are classified as HFT and any period change in fair value is recorded in the train operations and fuel expense and other expenses.

- Accounts receivable are classified as L&R. These financial assets are measured at amortized cost using the effective interest method, less any impairment. Where the time value of money is not material due to their short-term nature, accounts receivable are carried at the original invoice amount less allowance for doubtful receivables.

- Accounts payable and accrued liabilities are classified as Other liabilities and are measured at amortized cost using the effective interest method. Where the time value of money is not material due to their short-term nature, accounts payable are carried at the original invoice amount.

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. The purpose of the section is to enhance financial statement users' understanding of the significance of financial instruments to the Corporation's financial position, performance and cash flows.

B | COMPREHENSIVE INCOME

Section 1530 introduces Comprehensive income, which consists of net income and OCI. Comprehensive Income represents changes in Shareholders' equity during a period arising from transactions and other events with non-owner sources that are recognized in OCI, but excluded from net income. Upon adoption of Section 1530, the Corporation revised its "Consolidated Statement of Operations, Comprehensive Income and Retained Earnings" to include the newly required statement of comprehensive income by creating a combined statement. No amounts have been reclassified to accumulated other comprehensive income. Currently, the Corporation has no OCI.

C | EQUITY

Section 3251 establishes standards for the presentation of equity and the changes in equity during the year.

D | IMPACT UPON ADOPTION

In accordance with the transitional provisions of the standards, prior periods have not been restated for the adoption of these new accounting standards.

The adoption of these new accounting standards had no impact on the opening retained earnings.

3. ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The significant accounting policies followed by the Corporation are summarized as follows:

A | VARIABLE INTEREST ENTITIES

These consolidated financial statements include the financial statements of the Corporation and as required by Accounting Guideline 15 "Consolidation of Variable Interest Entities" ("AcG-15"), the financial statements of the Keewatin Railway Company ("KRC"), a variable interest entity (VIE). AcG-15 requires the consolidation of VIEs if a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is exposed to a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party is exposed to a majority of the VIE's losses), or both (the primary beneficiary). Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and non-controlling interests at fair value at the date the enterprise became the primary beneficiary (See note 13). The Corporation revises its initial determination of the accounting for VIEs when certain events occur, such as changes in governing documents or contractual arrangements.

B | FUNDING FROM THE GOVERNMENT OF CANADA

Operating funding, which pertains to services, activities and other undertakings of the Corporation for the management and operation of railway passenger services in Canada, is recorded as a reduction of the operating loss. The amounts are determined on the basis of operating expenses less commercial revenues excluding unrealized gains and losses on derivative financial instruments, employee future benefits and non-cash transactions relating to property, plant and equipment and future corporate taxes, and are based on the operating budget approved by the Government of Canada for each year.

Funding for depreciable property, plant and equipment is recorded as deferred capital funding on the Consolidated Balance Sheet and is amortized from the acquisition date on the same basis and over the same periods as the related property, plant and equipment. Upon disposition of the funded depreciable property, plant and equipment, the Corporation recognizes into income all remaining deferred capital funding related to the property, plant and equipment. Funding for non-depreciable property, plant and equipment is recorded as contributed surplus.

C | CASH EQUIVALENTS

Cash equivalents investments include bankers' discount notes and bankers' acceptances which may be liquidated promptly and have original maturities of three months or less.

D | ASSET RENEWAL FUND

Asset Renewal Fund investments include bankers' discount notes, bankers' acceptances and commercial paper which may be liquidated promptly and have original maturities of three months or less. Changes in fair value are recorded in investment income.

E | REVENUE RECOGNITION

Revenues earned from passenger transportation are recorded as services are rendered. Amounts received for train travel not yet rendered are included in current liabilities as deferred revenues. Investment income and other revenues which includes third party revenues are recorded as they are earned. The change in fair value of the financial instruments held for trading other than derivative financial instruments is recorded in Investment income.

F | FOREIGN CURRENCY TRANSLATION

Accounts in foreign currencies are translated using the temporal method. Under this method, monetary Balance Sheet items are translated at the exchange rates in effect at year-end. Gains and losses resulting from the changes in exchange rates are reflected in the Consolidated Statement of Operations, Comprehensive Income and Retained Earnings.

Non-monetary Balance Sheet items as well as foreign currency revenues and expenses are translated at the exchange rate in effect on the dates of the related transactions.

G | MATERIALS

Materials, consisting primarily of items used for the maintenance of rolling stock, are valued at the lower of weighted average cost and replacement cost and at net realizable value for obsolete materials.

H | PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment acquired from Canadian National Railway and Canadian Pacific Limited at the start of operations in 1978 were recorded at their net transfer values while subsequent acquisitions are recorded at cost.

The costs of refurbishing and rebuilding rolling stock and costs associated with other upgrading of property, plant and equipment are capitalized if they are incurred to improve the service value or extend the useful lives of the property, plant and equipment concerned; otherwise, such costs are expensed as incurred.

Retired property, plant and equipment are written down to their net realizable value.

Amortization of property, plant and equipment is calculated on a straight-line basis at rates sufficient to amortize the cost of property, plant and equipment, less their residual value, over their estimated useful lives, as follows:

Rolling stock	**12 to 30 years**
Maintenance buildings	**25 years**
Stations and facilities	**20 years**
Infrastructure improvements	**5 to 40 years**
Leasehold improvements	**2 to 20 years**
Machinery and equipment	**4 to 15 years**
Information systems	**3 to 7 years**
Other property, plant and equipment	**3 to 10 years**

No amortization is provided for projects in progress and retired property, plant and equipment.

I | CORPORATE TAXES

The Corporation utilizes the liability method of accounting for corporate taxes under which future corporate tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future corporate tax assets and liabilities are measured using substantively enacted rates that are expected to apply for the year in which those temporary differences are expected to be recovered or settled. The effect on future corporate tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date. Future corporate tax assets are recognized to the extent that realization is considered more likely than not.

J | INVESTMENT TAX CREDITS

Investment tax credits are recognized when qualifying expenditures have been made, provided there is reasonable assurance that the credits will be realized. They are amortized over the estimated useful lives of the related property, plant and equipment. The amortization of deferred investment tax credits is recorded as a reduction of the amortization of property, plant and equipment. These credits are included in other long-term liabilities.

K | EMPLOYEE FUTURE BENEFITS

The Corporation accrues obligations under its employee future benefit plans.

The cost of pension and other employee future benefits earned by employees is actuarially determined using the projected benefit method prorated on services and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.

For the purpose of calculating the expected return on plan assets, those assets are valued at market value.

On January 1, 2000, the Corporation adopted the new accounting standard on employee future benefits using the prospective application method. The Corporation is amortizing the transitional asset on a straight-line basis over 13 to 14 years, which was the average remaining service lives of the active employee groups at the time.

Past service costs are amortized on a straight-line basis over the expected average remaining service lives of the active employee groups which was, in most cases, estimated to be 11 years at the time.

For the pension plans, the excess of the accumulated net actuarial gain or loss over 10 per cent of the greater of the accumulated benefit obligation and the fair value of plan assets is amortized on a straight-line basis over the average remaining service lives of the active employee groups which is, in most cases, estimated to be 12 years.

The Corporation's obligations for worker's compensation benefits are based on known awarded disability and survivor pensions and other potential future awards with respect to accidents that occurred up to the fiscal year-end. The Corporation is self-insured. The actuarial determination of these accrued benefit obligations uses the projected benefit method. This method incorporates management's best estimate of cost escalation as well as demographic and other financial assumptions. Management's best estimate also takes into account the experience and assumptions of provincial workers' compensation boards. The actuarial gains or losses are amortized over a seven-year period, the average duration of these obligations.

L | DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments such as swaps and certain forward foreign exchange contracts, are utilized by the Corporation in the management of its exposure to changes in fuel prices and the value of the US dollar of at least 50 per cent and up to 80 per cent of its consumption. The Corporation does not enter into derivative financial instruments for trading or speculative purposes. The Corporation does not currently apply hedge accounting on these derivative financial instruments.

Forward foreign exchange contracts are also utilized by the Corporation in the management of its exposure to the changes in value of the US dollar related to the purchase of materials from the US as part of a major capital project to refurbish some of its locomotive fleet.

Derivative financial instruments are recognized on the Consolidated Balance Sheet and removed when they expire or are terminated. Each derivative is recognized at fair value as either an asset or a liability on the Consolidated Balance Sheet. Changes in fair value of derivative financial instruments related to fuel are recognized in the train operations and fuel expenses. The change in fair value of derivative financial instruments related to the purchase of materials from the US are recorded as other expenses. Derivative financial instruments with a positive fair value are reported as derivative financial instrument assets and derivatives with a negative fair value are reported as part of accounts payable and accrued liabilities or other long-term liabilities.

M | MEASUREMENT UNCERTAINTY

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as revenues and expenses and the disclosure of contingent assets and liabilities. The most significant estimates involve the recognition of liabilities and other claims against the Corporation, the fair value of financial instruments, employee future benefits, future corporate taxes as well as the useful life of property, plant and equipment. Actual results could differ from these estimates and such differences could be material.

N | *VIA PRÉFÉRENCE* PROGRAM

The incremental costs of providing travel awards under the Corporation's *VIA Préférence* frequent traveller reward program are accrued as the entitlements to such awards are earned and are included in accounts payable and accrued liabilities.

O | NON-MONETARY TRANSACTIONS

Non-monetary transactions are recorded at the estimated fair value of the goods or services received or the estimated fair value of the services given, whichever is more reliably determinable. Revenues from non-monetary transactions are recognized when the related services are rendered. Expenses resulting from non-monetary transactions are recognized during the period when goods or services are provided by third parties.

4. FUTURE ACCOUNTING CHANGES

A | FINANCIAL INSTRUMENTS – PRESENTATION AND DISCLOSURE

The CICA issued two new accounting standards: section 3862, *Financial Instruments – Disclosures*, and section 3863, *Financial Instruments – Presentation*. The new standards will be in effect for fiscal years beginning after October 1, 2007 and the Corporation will adopt them on January 1, 2008. The Corporation is in the process of evaluating the disclosure and presentation requirements of the new standards, however, it is not anticipated that the results of the Corporation will be affected.

Section 3862 and 3863 will replace section 3861, *Financial Instruments – Disclosure and Presentation* revising and enhancing its disclosure requirements and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosure about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

B | INVENTORIES

The CICA issued section 3031, *Inventories*, which will replace section 3030, *Inventories*. The new standard is effective for fiscal years beginning on or after January 1, 2008, and the Corporation will adopt this section on January 1, 2008. Section 3031 will affect the measurement and disclosure of inventory. The measurement changes include: the requirement to measure inventories at the lower of cost and net realizable value; the use of the specific cost method for inventories that are not ordinarily interchangeable or goods and services produced for specific purposes; the requirement for the Corporation to use a consistent cost formula for inventory of a similar nature and use; and the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. Disclosure of inventories will also be enhanced. Inventory policies, carrying amounts, amounts recognized as an expense, write-downs and the reversals of write-downs are required to be disclosed. The Corporation is assessing the requirement to reclassify some of inventory of spare parts as Property plant and equipment.

C | CAPITAL

Section 1535, Capital disclosure establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the Financial Statements to evaluate the Corporation's objectives, policies and processes for managing capital.

5. PROPERTY, PLANT AND EQUIPMENT

(IN MILLIONS OF DOLLARS)

	2007			2006		
	COST	ACCUMULATED AMORTIZATION	NET	COST	ACCUMULATED AMORTIZATION	NET
Land	**5.7**	**-**	**5.7**	5.7	-	5.7
Rolling stock	**777.2**	**484.7**	**292.5**	772.0	448.5	323.5
Maintenance buildings	**181.8**	**141.5**	**40.3**	181.8	133.0	48.8
Stations and facilities	**45.3**	**30.4**	**14.9**	45.1	28.6	16.5
Infrastructure improvements	**148.5**	**57.9**	**90.6**	147.8	53.9	93.9
Leasehold improvements	**116.4**	**93.0**	**23.4**	114.2	90.2	24.0
Machinery and equipment	**36.3**	**30.3**	**6.0**	35.5	29.5	6.0
Information systems	**51.1**	**45.9**	**5.2**	46.2	43.0	3.2
Other property, plant and equipment	**20.5**	**19.6**	**0.9**	20.4	19.4	1.0
	1,382.8	**903.3**	**479.5**	1,368.7	846.1	522.6
Projects in progress			**8.1**			10.1
Retired property, plant and equipment (at net realizable value)			**0.3**			0.4
			487.9			533.1

Projects in progress as at December 31, 2007, primarily consist of rolling stock, improvements to infrastructure and information systems for $6.0 million (2006: $8.7 million).

6. ASSET RENEWAL FUND

A | ASSET RENEWAL FUND

The Corporation has been authorized by the Treasury Board of Canada Secretariat to segregate proceeds from the sale or lease of surplus assets in a manner which ensures that these funds are retained for future capital projects. However, the Treasury Board of Canada Secretariat could approve the use of the Asset Renewal Fund to finance operating deficits.

The short term investments in the Asset Renewal Fund include the following:

(IN MILLIONS OF DOLLARS)

	2007	2006
	CARRYING VALUE AND FAIR VALUE	CARRYING VALUE AND FAIR VALUE
Cash on hand	**-**	0.1
Bankers' discount notes	**-**	0.1
Bankers' acceptances	**33.3**	-
Commercial Paper	**41.2**	76.9
Balance at end of year	**74.5**	77.1
Less: Short-term	**17.7**	22.0
Long-term portion	**56.8**	55.1

During the year ended December 31, 2007, the Treasury Board of Canada Secretariat approved the use of the Asset Renewal Fund to fund a maximum of $6.0 million of the 2007 operating deficit and a maximum of $3.5 million of the 2007 capital expenditures.

Of the December 31, 2007 total balance in the Asset Renewal Fund, the Corporation has received approval by the Treasury Board of Canada Secretariat to use up to $17.7 million (2006: $22 million) to fund future working capital requirements. This amount is presented in the short-term portion of the Asset Renewal Fund.

The weighted average effective rate of return on short-term investments as at December 31, 2007, was 4.74 per cent (2006: 4.38 per cent) except for non-bank sponsored Asset-Backed Commercial Paper. The weighted average term to maturity as at December 31, 2007, is two months (2006: one month) excluding non-bank sponsored Asset-Backed Commercial Paper.

The fair value of short-term investments is based on the current bid price at the Consolidated Balance Sheet date except for the Asset-Backed Commercial Paper as described bellow.

The Asset Renewal Fund is invested in 20 short-term money market funds (2006: 21) that have a rating of “R-1 low” or higher. The diversification in short term securities is provided by limiting to 10 per cent or less the percentage of the market value of the Asset Renewal Fund assets invested in securities of a single issuer.

The Corporation is subject to credit risk from its holdings of the Asset Renewal Fund. The Corporation minimizes its credit risks by adhering to the *Minister of Finance of Canada Financial Risk Management Guidelines for Crown Corporations* and the Corporate Investment Policy and by investing in high quality financial instruments.

B | CHANGES IN THE ASSET RENEWAL FUND

The Asset Renewal Fund includes the following changes during the year:

(IN MILLIONS OF DOLLARS)

	2007	2006
Balance at beginning of year	**77.1**	106.2
Proceeds from sale or lease of surplus assets	**1.5**	1.1
Investment Income	**3.2**	17.6
Change in fair value	**(1.3)**	-
Less: Cash drawdown during the year	**(6.0)**	(47.8)
Balance at end of year	**74.5**	77.1

C | ASSET-BACKED COMMERCIAL PAPER (ABCP)

The Corporation holds $8.7 million (face value) in non-bank sponsored Asset-Backed Commercial Paper (ABCP) in the Asset Renewal Fund. These investments matured in August, September and October 2007 but, as a result of liquidity issues in ABCP market, they did not settle on maturity. The Corporation's non-bank sponsored ABCP notes have not traded in the market since August 2007 and there is currently no market quote available.

The Corporation has recorded an unrealized loss based on an estimated change in fair value of $1.3 million as a reduction of Investment Income in the Consolidated Statement of Operations, Comprehensive Income and Retained Earnings.

The Corporation's estimate of the fair value of its investment in ABCP was based on a valuation model developed internally from information provided by the Pan-Canadian investors' committee and market information on similar structures that were still pricing at year-end, to reflect credit spread deterioration that occurred in the market place in 2007. Other assumptions were used to adjust for the lack of liquidity of the non-bank ABCP holdings, increased default potential on some of the structure receivables and to reflect a potential drop in expected yield resulting from the restructuring effort.

The Corporation's estimate of the fair value of its non-bank sponsored ABCP notes is subject to significant risks and uncertainties, including the timing and amount of future cash flows, the outcome of the Montreal Proposal and any other restructuring process, market liquidity and the quality of the underlying assets and financial instruments. Accordingly, there can be no assurance that the Corporation's assessment of the fair value of its ABCP holdings will not change materially in subsequent periods. The Corporation has sufficient cash to fund all its ongoing liquidity and capital expenditure requirements.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The Accounts payable and accrued liabilities include the following:

(IN MILLIONS OF DOLLARS)

	2007	2006
Accrued liabilities	**22.9**	27.8
Wages payable and accrued	**32.5**	31.9
Trade payables	**33.3**	25.5
Capital tax, income tax and other taxes payable	**9.3**	8.2
Derivative financial instruments (Note 15)	**1.2**	0.5
Current portion of network restructuring and reorganization accrual	**0.4**	0.6
Other	**0.1**	0.2
	99.7	94.7

8. EMPLOYEE FUTURE BENEFITS

The Corporation provides a number of funded defined benefit pension plans as well as unfunded post retirement and post-employment benefits that include life insurance, health coverage and self insured Workers' Compensation benefits, to all its permanent employees. The actuarial valuations for employee future benefits are carried out by external actuaries who are members of the Canadian Institute of Actuaries.

The defined benefit pension plans are based on years of service and final average salary.

Pension benefits increase annually by 50 per cent of the increase in the Consumer Price Index in the 12 months ending in December subject to a maximum increase of 3 per cent in any year.

The latest actuarial valuation for the post-retirement unfunded plan was carried out as at July 31, 2007. The next actuarial valuation will be carried out as at July 31, 2010.

The latest actuarial valuation for the post-employment unfunded plan was carried out as at July 31, 2007. The next actuarial valuation will be carried out as at July 31, 2010.

The latest actuarial valuation for the self-insured workers' compensation benefits was carried out as at December 31, 2006. The next actuarial valuation will be carried out as at December 31, 2009, and will be available in September 2010.

The latest actuarial valuations of the pension plans were carried out as at December 31, 2006. The next actuarial valuation will be carried out as at December 31, 2009, and will be available in June 2010.

The actuarial valuation of the Supplemental Executive Retirement Plan is carried out annually. The last actuarial valuation was carried out as at December 31, 2007.

The actuarial valuation of the Supplemental retirement plan for management employees, (SRP), with respect to retired members is carried out annually. The latest actuarial valuation was carried out December 31, 2007. The latest actuarial valuation for active members of the SRP was carried out December 31, 2006, and the next actuarial valuation will be carried out no later than December 31, 2009.

Based on these actuarial valuations and projections to December 31, the summary of the principal valuation results, in aggregate, is as follows:

(IN MILLIONS OF DOLLARS)

	PENSION PLANS		OTHER BENEFIT PLANS	
	2007	2006	**2007**	2006
ACCRUED BENEFIT OBLIGATION:				
Balance at beginning of year	**1,532.8**	1,511.4	**29.7**	29.8
Current service cost	**25.5**	26.0	**4.4**	4.7
Employee contributions	**9.7**	9.6	**-**	-
Interest cost	**78.5**	74.8	**1.5**	1.5
Benefits paid	**(97.0)**	(90.0)	**(5.6)**	(6.0)
Net transfer in	**12.6**	0.2	**-**	-
Actuarial (gains) losses	**(82.8)**	0.8	**1.8**	(0.3)
Balance at end of year	**1,479.3**	1,532.8	**31.8**	29.7
FAIR VALUE OF PLAN ASSETS:				
Balance at beginning of year	**1,777.2**	1,659.0	**-**	-
Actual return on plan assets	**45.9**	183.3	**-**	-
Employer contributions	**13.6**	15.1	**5.6**	6.0
Employee contributions	**9.7**	9.6	**-**	-
Net transfer in	**12.6**	0.2	**-**	-
Benefits paid	**(97.0)**	(90.0)	**(5.6)**	(6.0)
Balance at end of year	**1,762.0**	1,777.2	**-**	-

The percentage of the fair value of the total pension plan assets by major category as at December 31 was as follows:

Asset categories:	**2007**	2006
Equity securities (public market)	**53.4%**	57.3%
Fixed income securities (public market)	**34.0%**	32.6%
Private equity, hedge funds and other	**12.6%**	10.0%
Real estate	**-**	0.1%
	100.0%	100.0%

(IN MILLIONS OF DOLLARS)

	PENSION PLANS		OTHER BENEFIT PLANS	
	2007	2006	**2007**	2006
RECONCILIATION OF THE FUNDED STATUS:				
Fair value of plan assets	**1,762.0**	1,777.2	**-**	-
Accrued benefit obligation	**1,479.3**	1,532.8	**31.8**	29.7
Funded status of plans - surplus (deficit)	**282.7**	244.4	**(31.8)**	(29.7)
Unamortized net actuarial losses	**187.3**	201.7	**3.1**	1.2
Unamortized past service costs	**2.2**	2.7	**0.4**	0.5
Unamortized transitional (asset) obligation	**(185.6)**	(217.9)	**3.7**	4.3
	286.6	230.9	**(24.6)**	(23.7)
Network restructuring long-term liability	**-**	-	**(0.6)**	(0.8)
Accrued benefit asset (liability)	**286.6**	230.9	**(25.2)**	(24.5)

(IN MILLIONS OF DOLLARS)

	PENSION PLANS		OTHER BENEFIT PLANS	
	2007	2006	**2007**	2006
ELEMENTS OF DEFINED BENEFIT COSTS RECOGNIZED IN THE YEAR:				
Current service cost	**25.5**	26.0	**4.4**	4.7
Interest cost	**78.5**	74.8	**1.5**	1.5
Actual return on plan assets	**(45.9)**	(183.3)	**-**	-
Actuarial (gains) losses	**(82.8)**	0.8	**1.8**	(0.3)
Elements of employee future benefits (income) costs before adjustment to recognize the long-term nature of these costs	**(24.7)**	(81.7)	**7.7**	5.9
ADJUSTMENTS TO RECOGNIZE THE LONG-TERM NATURE OF EMPLOYEE FUTURE BENEFITS COSTS:				
Differences between:				
• Expected return and actual return on plan assets for the year	**(75.3)**	66.1	**-**	-
• Actuarial loss (gain) recognized for the year and the actual actuarial loss on accrued benefit obligation for the year	**89.7**	9.0	**(1.8)**	0.4
• Amortization of past service costs for the year and the actual plan amendments for the year	**0.5**	0.4	**-**	0.1
• Amortization of transitional (asset) obligation	**(32.4)**	(32.4)	**0.7**	2.4
Defined benefit (income) costs recognized	**(42.2)**	(38.6)	**6.6**	8.8

The employee future benefits expense in the Consolidated Statement of Operations, Comprehensive income and Retained Earnings includes the pension plans net income and the other benefit plans net costs.

	PENSION PLANS		OTHER BENEFIT PLANS	
	2007	2006	**2007**	2006
WEIGHTED-AVERAGE OF SIGNIFICANT ASSUMPTIONS:				
Accrued benefit obligation as at December 31:				
Discount rate	**5.50%**	5.00%	**5.50%**	5.00%
Rate of compensation increase	**3.00%**	3.25%	**3.00%**	3.25%
Benefit costs for the year ended December 31:				
Discount rate	**5.00%**	5.00%	**5.00%**	5.00%
Expected long-term rate of return on plan assets	**7.00%**	7.25%	-	-
Rate of compensation increase	**3.25%**	3.25%	**3.25%**	3.25%
Assumed health care cost trend rates as at December 31:				
Initial health care cost trend rate	-	-	**7.78%**	5.88%
Cost trend rate declines to	-	-	**3.66%**	3.37%
Year ultimate rate is reached	-	-	**2014**	2011

Sensitivity analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2007:

(IN THOUSANDS OF DOLLARS)

	INCREASE	DECREASE
Total service and interest cost	25	(23)
Accrued benefit obligation	214	(189)

9. CORPORATE TAXES

The corporate tax expense of the Corporation consists of the following:

(IN MILLIONS OF DOLLARS)

	2007	2006
Current tax expense	**1.0**	-
Future corporate tax expense	**5.2**	0.5
Corporate tax expense	**6.2**	0.5

Corporate tax expense on net income for the year differs from the amount that would be computed by applying the combined Federal and provincial statutory income tax rates of 32.4 per cent (2006: 32.4 per cent) to income before corporate taxes. The reasons for the differences are as follows:

(IN MILLIONS OF DOLLARS)

	2007	2006
Computed tax expense - statutory rates	**16.1**	11.0
Permanent difference:		
Large corporate tax expense (recovery)	**(0.5)**	-
Non-taxable portion of capital and accounting gains	**(0.2)**	(2.2)
Change in valuation allowance	**1.9**	(4.4)
Effect of statutory tax rate substantively enacted during the year	**(4.8)**	(3.9)
Effect of tax rate changes on future income taxes	**(4.0)**	(0.9)
Future income tax expense (recovery) relating to changes in temporary differences	**(4.1)**	1.1
Ontario corporate minimum tax expense	**1.5**	-
Other	**0.3**	(0.2)
	6.2	0.5

Future corporate income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Significant components of the future corporate tax (assets) and liabilities of the Corporation are as follows:

(IN MILLIONS OF DOLLARS)

	2007	2006
Future corporate tax assets:		
Property, plant and equipment	**(23.1)**	(19.2)
Contingencies, other liabilities and net amounts	**(4.3)**	(4.0)
Accrued benefit liability	**(6.4)**	(7.6)
Loss carry-forward	**(10.3)**	(11.9)
	(44.1)	(42.7)
Less the valuation allowance	**9.7**	7.8
	(34.4)	(34.9)
Future corporate tax liabilities:		
Accrued benefit asset	**74.0**	68.8
Unrealized gain on derivative financial instruments	**1.5**	2.0
	75.5	70.8
Net future corporate tax liabilities	**41.1**	35.9

The Corporation has $41.1 million of unused federal non-capital tax losses carried forward and their related year of expiry are as follows:

(IN MILLIONS OF DOLLARS)

2008	**3.9**
2010	**0.7**
2014	**3.3**
2015	**14.4**
2026	**18.8**
	41.1

10. DEFERRED CAPITAL FUNDING

Deferred capital funding represents the unamortized portion of the funding used to purchase property, plant and equipment.

(IN MILLIONS OF DOLLARS)

	2007	2006
Balance, beginning of year	**530.2**	578.7
Government funding for depreciable property, plant and equipment	**12.1**	7.3
Amortization of deferred capital funding	**(53.6)**	(55.8)
Balance, end of year	**488.7**	530.2

11. SHARE CAPITAL

The authorized share capital of the Corporation is comprised of an unlimited number of common shares with no par value. As at December 31, 2007 and 2006, 93,000 shares at $100 per share are issued and fully paid.

12. COMMITMENTS

A| The future minimum payments relating to operating leases mainly for real estate, maintenance of way and computer equipment are as follows:

(IN MILLIONS OF DOLLARS)

2008	**18.2**
2009	**12.8**
2010	**9.2**
2011	**8.8**
2012	**9.0**
Subsequent years proportionately to 2049	**180.8**
	238.8

B| As at December 31, 2007, the Corporation has outstanding purchase commitments amounting to $108.4 million (2006: $5.6 million) consisting mainly of advertising as well as the maintenance and completion of rolling stock projects. The Corporation expects to make payments under these commitments over the next 7 years.

C| The Corporation has entered into train service agreements for the use of tracks and control of train operations expiring on December 31, 2008.

D| The Corporation has issued letters of credit totalling approximately $20.0 million (2006: $17.7 million) to various provincial government workers' compensation boards as security for future payment streams.

13. VARIABLE INTEREST ENTITIES

In April 2006, as part of its mandate to provide passenger rail service in Canada, the Corporation entered into an operating agreement with the Keewatin Railway Company ("KRC") to provide a financial contribution to KRC for the purposes of operating passenger rail services and essential freight to the communities in Northern Manitoba served by KRC. The Corporation will contribute an annual amount to KRC to fund a significant portion of KRC's operating expenditures and is at risk of increasing the level of contributions if net operating costs were to increase. KRC is a Variable Interest Entity (VIE) to the Corporation given that the Corporation is the primary beneficiary exposed to a majority of the risk of loss from KRC's activities.

In 2007, the financial contribution provided by the Corporation to KRC amounted to $1.9 million (2006: $2.0 million).

KRC received $0.4 million for the maintenance of their infrastructure from the Government of Canada in 2007 (2006: $1.2 million).

The liabilities recognized as a result of consolidating KRC do not represent additional claims on the Corporation's assets; rather, they represent claims against the specific assets of KRC. Conversely, assets having a net book value of $8.4 million (2006: $7.9 million) recognized as a result of consolidating KRC do not represent additional assets that could be used to satisfy claims against the Corporation's assets. Additionally, the consolidation of the KRC VIE did not result in any change in the underlying tax, legal or credit exposure of the Corporation.

14. FINANCIAL INSTRUMENTS

The classification of Financial instruments under the new accounting standards effective January 1, 2007, and their carrying amounts were as follows:

(IN MILLIONS OF DOLLARS)

	December 31, 2007		December 31, 2006 [1]	
	CARRYING VALUE		CARRYING VALUE	
	HFT	L&R	HFT	L&R
FINANCIAL ASSETS:				
Cash and cash equivalent	**5.1**	**-**	4.2	-
Accounts Receivables	**-**	**6.5** [2]	-	5.6 [2]
Derivative Financial Instruments	**6.8** [3]	**-**	7.0 [3]	-
Asset renewal fund	**74.5** [4]	**-**	77.1 [4]	-
	HFT	OTHER LIABILITY	HFT	OTHER LIABILITY
FINANCIAL LIABILITIES:				
Accounts Payable and Accrued Liabilities	**1.2** [3]	**70.0** [5]	0.5 [3]	59.1 [5]
Other	**0.6** [3]	**-**	0.1 [3]	-

[1] Financial Instruments classified January 1, 2007.
[2] Comprised of trade receivables.
[3] Comprised of derivative financial instruments not designated in a hedge relationship.
[4] Comprised of short-term investments.
[5] Comprised of trade accounts payable, accrued liabilities and accrued wages.

The estimated fair value of the recognized financial instruments other than financial instruments HFT and derivative financial instruments approximates their carrying value due to their current nature.

15. DERIVATIVE FINANCIAL INSTRUMENTS

The derivative financial instruments used by the Corporation include swaps which are typically a commodity or price swap where parties exchange payments in cash based on changes in the price of the commodity (heating oil) or a market index while fixing the price they effectively pay for fuel. The foreign exchange forwards are contractual agreements to either buy or sell US dollars at a specified price and date in the future related to fuel swaps and a future capital project.

At year-end, the Corporation had the following derivative financial instruments with positive fair values:

DESCRIPTION	PERIOD	FIXED PRICE PER US GALLON (USD)	NOTIONAL QUANTITY (000'S OF US GALLONS)	FAIR VALUE CAD (000'S)	
	(Note 1)			**2007**	2006
Crude swap	January to December 2007	0.800	4,536	**-**	5,036
Crude swap	January to December 2007	1.498	2,016	**-**	648
Crude swap	January to December 2007	1.780	1,008	**-**	2
Crude swap	January to December 2008	1.860	1,008	**690**	39
Crude swap	January to December 2008	1.799	1,008	**749**	105
Crude swap	January to December 2008	1.457	2,016	**2,167**	952
Crude swap	January to December 2008	1.945	1,008	**607**	**
Crude swap	January to December 2008	1.787	1,008	**761**	-
Crude swap	January to December 2008	1.988	1,008	**564**	-
Crude swap	January to December 2008	2.036	1,008	**518**	-
Crude swap	January to December 2008	2.411	1,008	**152**	-
Crude swap	May to October 2008	2.481	1,008	**52**	-
Crude swap	May to October 2009	2.368	504	**27**	-
Crude swap	January to December 2009	2.092	1,512	**524**	-
				6,811	6,782

** This financial instrument had a negative fair value in 2006.
[1] These financial instruments have a monthly settlement schedule.

DESCRIPTION	PERIOD	FORWARD RATE CAD / USD	NOTIONAL AMOUNT (USD) (000'S)	FAIR VALUE CAD (000'S)	
	(NOTE 1)			**2007**	2006
Foreign Exchange	January to December 2007	1.148	1,794	**-**	20
Foreign Exchange	January to December 2007	1.147	1,859	**-**	22
Foreign Exchange	January to December 2007	1.142	1,885	**-**	31
Foreign Exchange	January to December 2008	1.110	2,936	**	110
Foreign Exchange	May to October 2008	0.991	2,501	**2**	-
Foreign Exchange	May to October 2009	0.995	1,193	**2**	-
				4	183
				6,815	6,965

** This financial instrument has a negative fair value in 2007.
[1] These financial instruments have a monthly settlement schedule.

At year-end, the Corporation had the following derivative financial instruments with negative fair values:

DESCRIPTION	PERIOD	FORWARD RATE CAD / USD	NOTIONAL AMOUNT (USD) (000'S)	FAIR VALUE CAD (000'S)	
	(NOTE 1)			**2007**	2006
Foreign Exchange	January to December 2007	1.179	9,369	**-**	(178)
Foreign Exchange	January to December 2008	1.110	2,936	**(337)**	**
Foreign Exchange	January to December 2008	1.150	1,813	**(279)**	-
Foreign Exchange	January to December 2008	1.140	1,875	**(270)**	-
Foreign Exchange	January to December 2008	1.099	1,960	**(205)**	-
Foreign Exchange	January to December 2008	1.000	1,801	**(14)**	-
Foreign Exchange	January to December 2008	0.992	6,478	**(1)**	-
Foreign Exchange	April to December 2008	1.021	1,714	**(47)**	-
Foreign Exchange	January to December 2009	1.061	791	**(47)**	-
Foreign Exchange	January to December 2009	1.009	791	**(9)**	-
Foreign Exchange	January to December 2009	1.027	4,363	**(122)**	-
Foreign Exchange	January to December 2009	0.994	1,582	**(3)**	-
Foreign Exchange	January to December 2010	1.033	5,609	**(157)**	-
Foreign Exchange	January to December 2011	1.036	7,479	**(209)**	-
Foreign Exchange	January to December 2012	1.036	5,609	**(147)**	-
				(1,847)	(178)

** This financial instrument has a positive fair value in 2006.
[1] These financial instruments have a monthly settlement schedule.

DESCRIPTION	PERIOD	FIXED PRICE PER US GALLON (USD)	NOTIONAL QUANTITY (000'S OF US GALLONS)	FAIR VALUE CAD (000'S)	
	(NOTE 1)			**2007**	2006
Crude swap	January to December 2007	1.844	1,008	**-**	(71)
Crude swap	January to December 2007	1.870	1,008	**-**	(101)
Crude swap	January to December 2007	1.996	1,008	**-**	(244)
Crude swap	January to December 2008	1.945	1,008	**	(53)
				-	(469)
				(1,847)	(647)

** This financial instrument has a positive fair value in 2007.
[1] These financial instruments have a monthly settlement schedule.

The fair value of the positive balance of the above derivative financial instruments at December 31, 2007 is $6.8 million (2006: $7.0 million) of which $6.3 million is recorded as Current assets (2006: $5.8 million) and $0.5 million as Long-term assets (2006: $1.2 million). The negative balance is $1.8 million (2006: $0.6 million) of which $1.2 million (2006: $0.5 million) is included in "Account payable and accrued liabilities" as a short-term derivative financial instrument liability and $0.6 million (2006: $0.1 million) is included in "Other" as a long-term derivative financial instrument liability.

Included in the "Train operations and fuel" expense is a realized and unrealized net gain of $6.0 million related to fuel (2006: net loss of $0.1 million). An unrealized loss related to future capital projects of $0.6 million is recorded in other expenses.

The majority of the Corporation's derivative financial instruments are with one counterparty. The Corporation is exposed to minimal credit risk in the event of non-performance as the counterparty is of high credit quality.

The fair value of the derivative financial instruments is estimated as the discounted unrealized gain or loss calculated based on the market price at December 31, 2007, which generally reflects the estimated amount that the Corporation would receive or pay to terminate the contracts at the consolidated balance sheet date. The fair value of the derivative financial instruments is provided to the Corporation by the chartered banks that are the counterparties to the transactions.

It is determined using well established proprietary valuation models, such as a modified Black-Scholes model, that incorporate prevailing market rates and prices on underlying instruments. The fair values provided have been verified to provide the Corporation with the appropriate level of comfort in the numbers reported.

The discounting of the fair value of transactions is based on the boot-strapping method incorporating a set of bond yields over the term of the instruments in order to provide discount factors.

16. RELATED PARTY TRANSACTIONS

The Corporation is related in terms of common ownership to all Government of Canada created departments and agencies. The Corporation enters into transactions with these entities in the normal course of business on trade terms applicable to all individuals and enterprises and these transactions are recorded at exchange value. Other than disclosed elsewhere in these consolidated financial statements, related party transactions are not significant.

17. NON-MONETARY TRANSACTIONS

The Corporation recorded a revenue from non-monetary transactions of approximately $1.2 million (2006: $1.6 million) as "Passenger revenue" in the Consolidated Statements of Operations, Comprehensive Income and Retained Earnings for the year ended December 31, 2007. The Corporation also recorded non-monetary expenses of $1.3 million (2006: $1.5 million) in the Consolidated Statement of Operations, Comprehensive Income and Retained Earnings, mainly as "Marketing and sales" and other expenses resulting from non-monetary transactions. The nature of non-monetary transactions is mainly related to advertising exposure.

18. CONTINGENCIES

A| The Canadian Transportation Agency (CTA) rendered a decision in October 2003 against the Corporation in favour of the Council for Canadians with Disabilities (CCD). The Corporation was directed to re-design and re-construct its Renaissance rail cars to remove certain undue obstacles to persons with disabilities.

On March 2, 2005, the Corporation was successful in overturning the earlier CTA decision by a judgment of the Federal Court of Appeal. That appeal decision has been further appealed to the Supreme Court of Canada by the CCD. The Supreme Court heard the case on May 19, 2006 and upheld the CTA decision.

The Corporation has estimated the cost of removing the undue obstacles identified by the CTA to be between $8 million and $10 million, the Corporate Plan has provided for these costs. The modifications to the equipment will be started in 2008 and are schedule to be completed in 2010.

B| The Corporation began a restructuring of its labour force in 1997 which resulted in the elimination of a number of positions. The changes became subject to various Canadian Industrial Relations Board (CIRB) decisions, mediations and arbitrations.

In May 2003, the CIRB rendered a decision directing the Corporation to pay back wages under certain circumstances to former conductors. The Supreme Court decided not to grant the Corporation leave to appeal a Federal Court of Appeal ruling supporting the decision of the CIRB.

The Corporation is waiting for the final ruling from the arbitrator.

The Corporation has made a provision in its consolidated financial statements.

C| The Corporation's operations are subject to numerous federal, provincial, and municipal environmental laws and regulations concerning among other things, the management of air emissions, wastewater, hazardous materials, wastes and soil contamination as well as the management and decommissioning of underground and aboveground storage tanks. A risk of environmental liability is inherent in railroad and related transportation operations, real estate ownership and other activities of the Corporation with respect to both current and past operations.

The Corporation has performed a review of all of its operations and of all of its sites and facilities at risk in order to determine the potential environmental risks. The sites and the facilities for which environmental risks were identified were or will be the subject of thorough studies and corrective actions were or will be taken if necessary in order to eliminate or to attenuate these risks. The continuous risk management process that is in place allows the Corporation to monitor its activities and properties under normal operating conditions as well as monitor accidents that occur. The activities or properties likely to be contaminated or to cause a contamination are addressed, at the moment of their observation, by the development of an action plan according to the nature and the importance of the impact and the applicable requirements.

The Corporation's ongoing efforts to identify potential environmental concerns that may be associated with its properties may lead to future environmental investigations, which may result in the identification of additional environmental costs and liabilities. The magnitude of such additional liabilities and the costs of complying with environmental laws and containing or remediating contamination cannot be reasonably estimated due to:

(i) the lack of specific technical information available with respect to many sites;

(ii) the absence of any third-party claims with respect to particular sites;

(iii) the potential for new or changed laws and regulations and for development of new remediation technologies and uncertainty regarding the timing of the work with respect to particular sites;

(iv) the ability to recover costs from any third parties with respect to particular sites;

(v) the fact that the environmental responsibility has not been clearly attributed.

There can thus be no assurance that material liabilities or costs related to environmental matters will not be incurred in the future, or will not have a material adverse effect on the Corporation's financial position. Costs related to any future remediation will be accrued in the year in which they become known.

Considering that the costs of corrective action cannot be reasonably estimated no environmental provision has been included in the consolidated financial statements, except for the following:

Accounts payable and accrued liabilities include an environmental liability of $1.5 million that has been established by Keewatin Railway Company for environmental clean-up and decontamination of certain areas of their rail infrastructure.

D | The Corporation is subject to claims and legal proceedings brought against it in the normal course of business. Such matters are subject to many uncertainties. Management believes that adequate provisions have been made in the accounts where required and the ultimate resolution of such contingencies are not expected to have a material adverse effect on the financial position of the Corporation.

19. ASSET RETIREMENT OBLIGATION

The Corporation has certain operating leases where the lessor could request that the land/structures or the other assets be returned in the same condition as they were originally leased or the lessor can retake control of these assets without any compensation for any additions or modifications made to the initial assets. Given the nature of the assets under contract, the fair value of the asset retirement obligation cannot be reasonably estimated. Accordingly, no liability has been recognized in the consolidated financial statements.

20. RECLASSIFICATION

The comparative financial statements have been reclassified from the statements previously presented to conform to the presentation of the 2007 consolidated financial statements.

Corporate Directory

AS AT DECEMBER 31, 2007

BOARD OF DIRECTORS

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Ottawa, Ontario

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President and Chief Executive Officer
Montreal, Quebec

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Montreal, Quebec

Steven Cummings
Montreal, Quebec

Angela Ferrante
Toronto, Ontario

Jean-Louis Hamel
Montreal, Quebec

David Hoff
Vancouver, British Columbia

Leo Housakos
Montreal, Quebec

Wendy A. King
Vancouver, British Columbia

Margaret MacInnis
Halifax, Nova Scotia

Donald Mutch
Toronto, Ontario

Paul G. Smith
Calgary, Alberta

Eric Stefanson
Winnipeg, Manitoba

William M. Wheatley
Regina, Saskatchewan

Donald A. Wright
Chairman of the Board
Toronto, Ontario

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President and Chief Executive Officer

Steve Del Bosco
Chief Customer Officer

Christena Keon Sirsly
Chief Strategy Officer

Carole Mackaay
General Counsel and Secretary

John Marginson
Chief Operating Officer

Denis Pinsonneault
Chief People Officer

Robert St-Jean, CA
Chief Financial and
Administration Officer

Donald A. Wright, Chairman of the Board, *is an ex officio member of each Committee of the Board.*

Paul Côté, President and Chief Executive Officer, *is an ex officio member of each Committee of the Board except for the Audit & Risk Committee.*

The Board wishes to thank the following outgoing members for their important contribution:
Paul Fraser, Wendy Kelly, Lore Mirwaldt, Donald Pettit, Timothy Reid, Charles Ross, Kenneth Savage *and* Louis Tremblay.

COMMITTEES OF THE BOARD

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