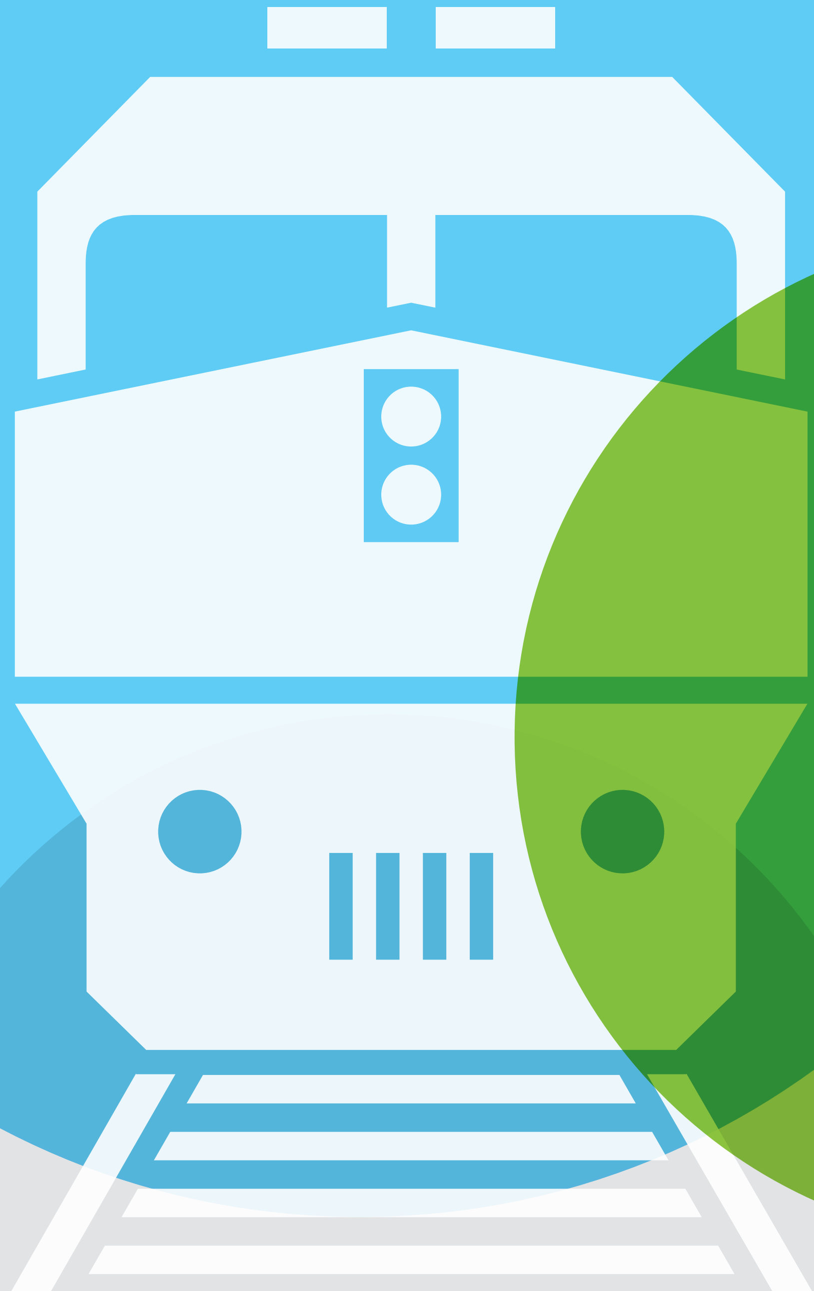


VIA Rail Canada

2012 ANNUAL REPORT

THE HONOURABLE DENIS LEBEL
Minister of Transport, Infrastructure
and Communities, Ottawa

THE HONOURABLE STEVEN FLETCHER
Minister of State (Transport), Ottawa

Dear Ministers,

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, 2012.

Paul G. Smith
Chairman of the Board

viarail.ca

CONTENT

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, VIA Rail provides a safe, efficient and environmentally responsible service from coast to coast in both official languages. The corporation operates almost 500 trains weekly on 12,500 kilometres of track, connecting over 450 Canadian communities. With approximately 2600 active employees, VIA Rail carried 3.9 million passengers in 2012.

VIA RAIL'S SERVICES

Inter-city Travel

In the densely populated Corridor between Ontario and Québec, VIA Rail trains provide fast, convenient, downtown-to-downtown travel between major urban and suburban centres and communities.

Long-distance Travel and Tourism

In Western and Eastern Canada, VIA Rail's trains attract travellers from around the world and support Canada's tourism industry. The *Canadian*, VIA Rail's Western transcontinental train, provides service between Vancouver and Toronto. In Eastern Canada, The *Ocean* runs between Montréal and Halifax.

Mandatory services

VIA Rail provides passenger service in several rural and remote regions of Canada. Mandated by the Government of Canada to meet essential transportation needs, these trains serve many communities where alternative, year-round transportation is limited or unavailable.

DID YOU KNOW

THAT VIA RAIL IS...

A CROWN CORPORATION

Its operations are funded by ticket sales (54%) while the remaining deficit (46%) is subsidized by the Government of Canada*.

*average of yrs 2007-2011

ACROSS CANADA

VIA Rail has up to 497 departures weekly, it connects over 450 Canadian communities and transports approximately 4 million passengers yearly.

FROM SEA TO SEA

VIA Rail serves 3 markets: Remote communities, Long-distances to Vancouver (The Canadian) and Halifax (The Ocean) and the Québec City - Windsor Corridor.

TRANSFORMING ITSELF

Since 2007, the Government of Canada has invested close to $1 Billion in modernizing VIA trains, expanding its tracks, building and renovating its stations and introducing new technology.

PRAISED

VIA Rail is a recognized leader in crossing safety programs (RAC), travel marketing (Baxter Travel Media Agent's Choice Award) and customer loyalty (2009 "Company of the Year" by the Association du marketing relationnel).

2017: A YEAR TO CELEBRATE

In 2017, Canada will celebrate its 150th anniversary while VIA Rail will mark its 40th.

FOR ALL CANADIANS

VIA Rail has invested $12.1M since 2007 into maintaining its leadership in accessible inter-city transportation.

A GREEN CHOICE

One train can replace 10 buses or 180 cars when comparing GHG emissions per capacity, according to Environment Canada.

A 'TREASURED' COMPANY

In 2013, VIA's iconic train, The Canadian, will be featured on Canada's new 10-dollar bill.

CONNECTED

Our trains connect with more than 15 other passenger carriers, including Air Transat, GO Transit and Zipcar, providing Canadians more end-to-end travel options.

THE FASTEST WI-FI ON RAILS

Our world-class mobile Wi-Fi is one of the fastest systems on any passenger service. Over a single weekend, it handled the equivalent of 1 million emails.

A GREEN CHOICE

VIA Rail Canada

MESSAGE FROM THE CHAIRMAN

A Challenging Year

2012 was a challenging year; transitional times are usually both difficult to manage and slow in producing results. However, there are reasons to be optimistic about VIA Rail's future.

Recognizing traffic trends, frequencies were adjusted to meet market demand. Where passenger volumes have been declining for years, the number of trains serving those areas was reduced. On the other hand, where demand has been growing, train frequencies were added. We will continue to monitor demand across the country and, where appropriate, respond to changes in usage patterns.

Of course, such decisions are never easy to make nor are they popular with the people affected. After all, VIA Rail is not an ordinary business. Although it must strive to be commercially viable, it does provide a public service.

The Board of Directors is made up of Canadians from all over our country. Directors are keenly aware of this duality and the challenges posed by the need to be accountable to Canadians and to ensure that taxpayer monies are well-spent.

But in the end, whether it is seen as a commercial pursuit or a public vocation, we believe that getting more people to take the train will benefit Canada's environment, its economic growth and its social progress. This is why, despite a difficult year, we remain optimistic about the future.

On a more personal note, I would like to thank directors who left the Board of Directors in 2012: Ms. France Bilodeau, Ms. Wendy King and Prof. Anthony Perl; and welcome their replacements: Ms. Ramona Materi of Vancouver, Ms. Hind Sergieh of Montreal, Ms. Elizabeth Van den Eynden of Glasgow (NS) and Mr. Steve Mallory of Toronto. We will also fondly remember Mr. Donald Mutch who passed away in 2012. Don made a lasting contribution as Chairman of the Investment Committee.

Paul G. Smith
Chairman of the Board

MESSAGE FROM THE PRESIDENT

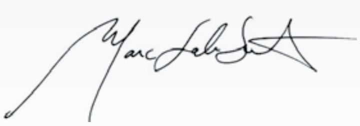
Ready For a Promising Future

In 2012, VIA Rail built the foundation of its future evolution. The frequency adjustments implemented at the end of October, along with our intermodal strategy, have started to deliver promising results. The new frequencies between Ottawa and Toronto, Montréal and Toronto, Montréal and Québec City, and between Québec City and Ottawa, as well as the multiplicity of intermodal connections with our transportation partners are becoming popular with our passengers.

The introduction of electronic ticketing, the new Escape fares, and enhancements to our on-board Wi-Fi system provide our customers with the best in travel technologies. In addition, if we consider our ever-increasing fans and followers on Facebook and Twitter, VIA Rail is definitely succeeding at making itself relevant for the 21st century.

Just as importantly, much progress has been made to our infrastructure, in the spirit of evolution and the protection of our environment. Whether it be the construction or renovation of our stations, or the refurbishment of our locomotives and cars, this work has been done in pursuit of better performance and comfort while making sure to stay true to our environmental goals. Indeed, preserving energy and reducing our environmental footprint are at the core of these activities.

Finally, if 2012 presented many challenges, none were greater or harder on us all then the loss of our three colleagues in the tragic accident of train 92, last February. This tragedy affected all the members of our family. It reminded us of our on-going commitment to safety and security in our operations. It is a promise that each of us makes every day: to each other, to our clients and to the Canadian public, in their memory.



Marc Laliberté
President and Chief Executive Officer

THE YEAR AT A GLANCE

The following key financial indicators and operating statistics summarize the performance of the Corporation for the year 2012, with comparative data for the years 2008 to 2011.

	2012 (1)	2011 (1)	2010 (1)	2009	2008
KEY FINANCIAL INDICATORS (IN MILLIONS OF DOLLARS)					
Total passenger revenues	**257.0**	264.8	257.7	250.5	283.1
Total revenues	**277.6**	282.6	274.7	267.8	299.2
Operating expenses before employee benefits	**562,6**	548,8	545,8	553,1	591,2
Employee benefits	**49,7**	36,9	26,2	(1.1)	(35.1)
Operating expenses	**612.3**	585.7	572.0	552.0	556.1
Operating funding from the Government of Canada (2)	**279.1**	260.9	261.5	226.3	214.2
Amortization of deferred capital funding	**82.0**	46.5	49.0	56.4	50.9
Corporate taxes (recovery)	**(0.0)**	(4.4)	0.1	(4.0)	1.9
Net income for the year	**26.4**	8.7	13.1	2.5	6.3
Actuarial losses on defined benefit plans (3)	**101.2**	288.1	0.0	0.0	0.0
Total comprehensive income (loss) for the year	**(74.8)**	(279.4)	13.1	2.5	6.3
Capital expenditures	**170.3**	237.0	268.6	116.8	42.1
KEY OPERATING STATISTICS (4)					
Total passenger-miles (IN MILLIONS)	**834**	851	846	857	951
Total seat-miles (IN MILLIONS)	**1,541**	1,541	1,495	1,501	1,618
Operating deficit per passenger-mile (IN CENTS) (5)	**33.5**	30.7	30.9	26.4	22.5
Yield (CENTS PER PASSENGER-MILE)	**30.3**	30.8	30.2	29.0	29.6
Train-miles operated (IN THOUSANDS)	**6,441**	6,580	6,668	6,660	6,746
Car-miles operated (IN THOUSANDS)	**44,379**	44,988	43,651	44,525	46,961
Average passenger load factor (%)	**54**	55	57	57	59
Average number of passenger-miles per train mile	**129**	129	127	129	141
On-time performance (%)	**82**	84	82	83	75
Number of active employees at end of period	**2,610**	2,843	2,875	3,053	3,109
*Number of full time equivalent employees during the year**	**2,800**	2,899	2,937	N/A	N/A

* Data available for years 2010 to 2012 only.

(1) Financial results produced according to International Financial Reporting Standards (vs under Canadian Generally Accepted Accounting Principles for the previous years).

(2) Excludes internal funding from the Asset Renewal Fund ($34.9M in 2009).

(3) Reflects a change in accounting standards regarding the reporting of employee benefits which took effect retroactively in 2011 (IAS 19).

(4) Key operating statistics are unaudited.

(5) Operating Government funding received during the year.

KEY OPERATING STATISTICS BY SERVICE GROUP

Passenger Revenues and Ridership (for the years ended December 31)

Service Group	Passenger Revenues* (in thousands)		Passengers (in thousands)		Passenger-Miles (in thousands)		Government Funding (per passenger-mile)	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011
Corridor	**$194,311**	$199,983	**3,588**	3,778	**613,262**	627,465	**$0.24**	$0.21
Longhaul West	**$40,722**	$41,441	**112**	109	**134,485**	129,010	**$0.37**	$0.36
Longhaul East	**$13,349**	$13,983	**131**	134	**59,766**	63,361	**$0.59**	$0.55
Mandatory Services	**$5,940**	$7,296	**92**	109	**26,260**	31,249	**$1.74**	$1.44

* Before off-train and other passenger revenues

MAJOR PROJECTS

In 2012, we completed major projects to modernize and enhance almost all aspects of passenger rail operations. We completed the rebuild of our older locomotives to better-than-new condition, and brought newly refurbished cars into service. We built new track and upgraded our infrastructure, expanding options for providing faster, more frequent service in key markets. We opened new stations, and revitalized old ones. And we introduced new e-commerce and customer service technologies to make travelling with VIA Rail simpler and more convenient than ever before.

LOCOMOTIVES: ONE OF THE MOST RELIABLE, FUEL-EFFICIENT FLEETS IN NORTH AMERICA

In 2012, we completed rebuilding our fleet of 53 F40 locomotives from the ground up – a major undertaking finished ahead of schedule and under budget. We renewed and upgraded engines, mechanics and electrical systems to better-than-new standards, extending the life of the engines by 15 to 20 years.

For VIA Rail, the renewed equipment means lower operating costs. For our customers, it means more reliable service. For the environment, more efficient engines mean lower greenhouse gas emissions and less fuel consumption.

And because the new engines are more powerful, we were able to reduce the number of F40s needed to pull our long-distance train sets. That freed up equipment to operate new train services in the Corridor without buying additional locomotives.

In 2012, we also rebuilt nine of our P42 locomotives, completing the overhaul to the full fleet. And in 2013, we will complete the rebuilds to six of our self-propelled rail-diesel cars (RDC) used for remote passenger services. Taken together, this gives VIA Rail one of the most reliable, most fuel-efficient passenger locomotive fleets in North America.

23.5%

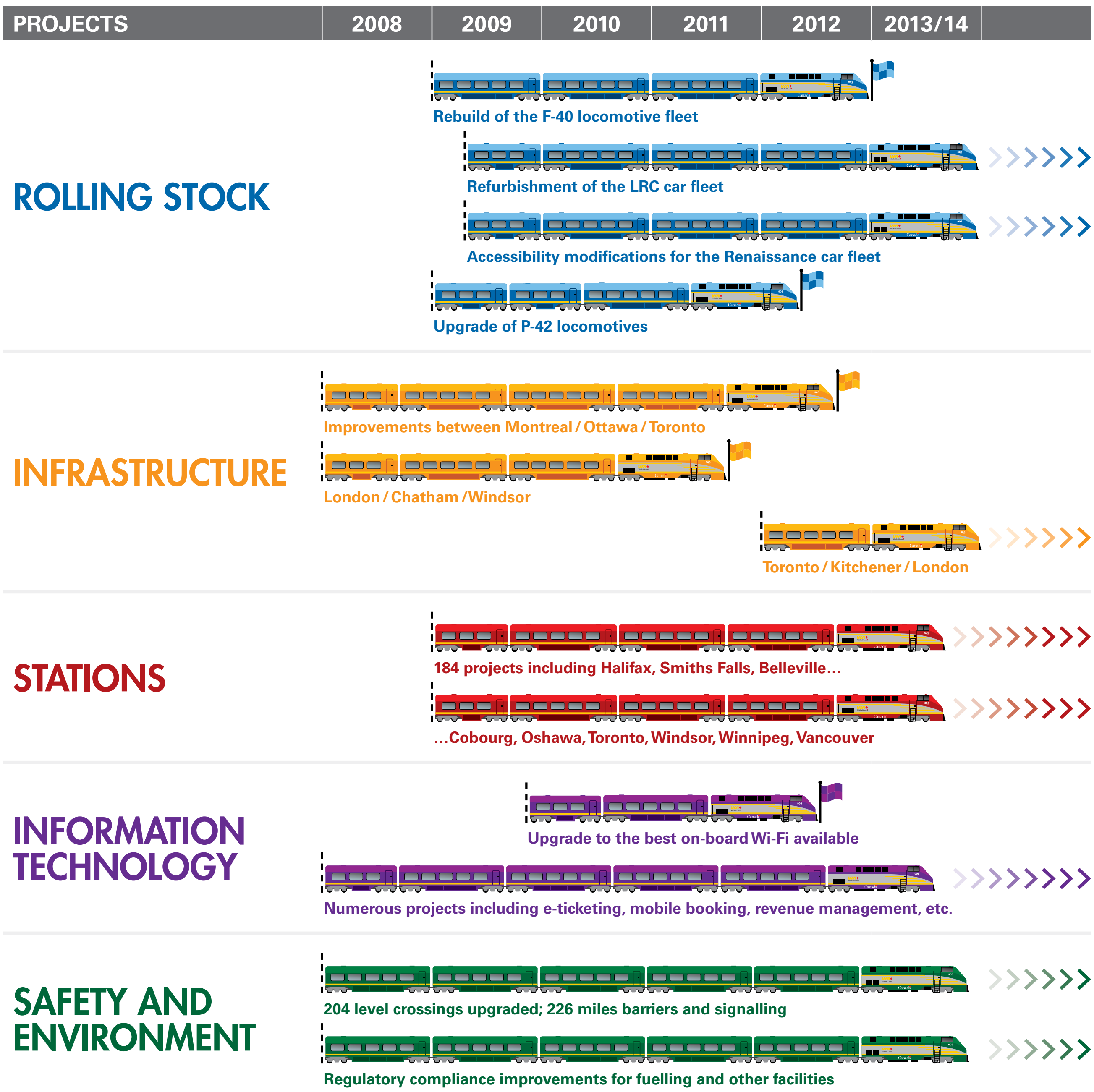
reduction in fuel consumption and a savings of approximately $12.5M a year compared to 2008 costs

$200 M

estimated savings over buying new locomotives

NEARING THE FINISH LINE

Nearly $1 billion in Government capital funding has enabled us to modernize key elements of the passenger rail network. At the end of 2012, the largest capital investment program in VIA's history is 90% complete!



Benefits

Increased track capacity / Improved amenities / Greater passenger comfort / Modernized processes / Improved accessibility / Cost savings / Lower greenhouse gas emissions / A safer operation

START OF PROJECT

PROJECT COMPLETED

ONGOING

PASSENGER CARS: MORE COMFORT, MORE OPTIONS FOR TRAVELLERS

VIA Rail owns several fleets of passenger cars, including 96 LRC (Light, Rapid, Comfortable) cars, 171 HEP-I and 33 HEP-2 (Head End Power) cars and 106 Renaissance cars.

We are modernizing our LRC passenger cars to update mechanical systems and enhance comfort for passengers, with redesigned interiors, better washrooms, and more luggage storage in each car. At the same time, we are building in new options for inter-city travellers such as making single-seat options available in business class cars. Ten economy cars were completed and in service by the end of 2012, with more renewed cars coming in 2013.

In addition, we are modernizing four classic Park Cars and eight Sleeper cars used on VIA Rail's Toronto – Vancouver service. This renewed equipment will start coming into service in 2014.

ACCESSIBILITY: TRAVEL FOR ALL CANADIANS

We are committed to keeping passenger rail the most accessible mode of inter-city transport for Canadians challenged by a physical disability. After consultations with the Canadian Transportation Agency and the Council of Canadians with Disabilities, we made major improvements to our Renaissance fleet in 2012. Nine coach cars – one for each of the six Renaissance Corridor trains and one for each of the three *Ocean* trains – have been reconfigured as accessible coaches. Three sleeping cars have been reconfigured so that each train assigned to the *Ocean* now has an accessible sleeping cabin for travellers with reduced mobility.

In addition, every Renaissance coach car will be modified to provide sufficient space for a passenger who is travelling with a service animal. Also, moveable aisle armrests will be installed on two double-seats and four single seats in all coaches. This work will be completed in 2014.

Work is also underway to make our other passenger equipment more accessible. Four Park Cars used on the *Canadian* will be modified to include a fully accessible deluxe sleeping cabin. Two Rail Diesel Cars used on remote services will be modified to remove accessibility barriers. We have also completed some initial design work to provide an accessible coach on our LRC trains.

70 kms

of new track, along with improved sidings and turnouts, to allow our trains to operate at higher speeds

TRACKS: FASTER, SAFER, MORE FREQUENT SERVICE

We completed major upgrades to tracks in the Montréal-Ottawa-Toronto route in 2012. Most of this track is shared with freight trains. The improvements have reduced conflict between freight and passenger rail operations, allowing our trains to deliver safer, faster service, better on-time reliability, with the capacity to add more frequent services between key destinations.

The work completed in 2012 includes sections of entirely new track on the line between Montréal and Toronto, to reduce delays caused by slower freight trains. New remote controlled signalling systems allow trains to move more quickly and safely between locations and from one track to another. Grade crossings, where roads and tracks meet, have been improved and wherever possible eliminated, to be replaced by safer crossing options. Existing track on VIA Rail-owned subdivisions has been upgraded to support higher speeds and reduce trip times for travellers.

In addition, we began work on tracks owned by Goderich Exeter Railway between Georgetown and London, Ontario. This work includes safety and signalling improvements, and upgrades to more than 70 grade crossings.

50,000

rail ties replaced through ongoing maintenance programs

STATIONS: MODERN AND TRAVELLER-FRIENDLY

Work has either been completed or is underway to improve 24 VIA Rail passenger stations across the country, from Halifax to Vancouver.

In 2012, we opened a new station in Belleville to accommodate more passengers, with two boarding platforms. An accessible overhead walkway allows passengers safe access to trains on the new third line of track. We opened an accessible overhead walkway and new third line of track in Oshawa, and began work at our Heritage designated station in Cobourg (undergoing a restoration in 2013) to accommodate a new platform and walkway. We also opened a new, larger station in Windsor. And in Toronto, where the city of Toronto is doing a comprehensive, multi-year renovation of Union Station, we restored a heritage space within the station for our new Panorama Lounge, that is expected to serve approximately 250,000 Business Class and VIA Préférence customers each year.

TECHNOLOGY: MORE CONNECTED, EFFICIENT SERVICE

We completed a wide range of technology projects in 2012 – both customer focused and "behind the scenes". These give customers fast and convenient access to VIA Rail's services, while greatly improving the efficiency and cost-effectiveness of our operations.

On-board Wi-Fi

Our on-train wireless internet service is recognized around the world as among the fastest Wi-Fi service available to passenger rail travellers. We also completed testing a Wi-Fi based entertainment service that allows customers to watch the latest news, TV shows and documentaries on their laptops and handheld devices, anywhere on-board the train. This service will be launched in 2013.

1 M emails

the amount of data transferred over the service in a single weekend

2 terabytes

of passenger data transferred every week

E-tickets and Mobile Booking

We introduced e-tickets on almost all of our routes in 2012. Passengers can purchase tickets online, and board our trains with either their own ticket print-out or with a barcode displayed on their smartphones. All tickets (electronic and traditional) are now validated by on-board staff using a BlackBerry and scanner.

We also launched our first mobile booking engine, allowing customers to book their tickets and check schedules or train status using any mobile device. We also made it easier to shop for tickets online with a new fare matrix for trips in the Corridor. This new online tool helps customers see all of their options at-a-glance, to help them choose their preferred fare and service. In addition, VIA Préférence members can now use loyalty points online to purchase tickets in the Corridor.

Automated Train Status Information

We launched a new Train Status Information system (TSI+) that provides operational and marketing staff with accurate real-time train statistics, such as location, projected arrival time, speed, and direction. A new feature called Trip Analyzer allows us to identify bottlenecks and improve train performance. We also started using TSI+ in VIA Rail stations to display up-to-the-minute train arrival information on LCD screens for customers, and to broadcast automated gate announcements. We are using these technologies, ticket purchase and printing kiosks, and direct phone lines to customer call centers to enhance self-service options for customers using train stops where staff is not present. Finally, new safety measures including camera monitoring and remote door locking were introduced at select stations.

10/10

the rating given by the majority of customers to our new e-boarding system

SOCIAL MEDIA: CONNECTING WITH CUSTOMERS AND CANADIANS

VIA Rail is a leader in social media, using Twitter to respond quickly to customers' requests and concerns, and Facebook to provide information, hold special contests and promotions, and build our fan base.

We launched our Facebook page in 2011, and had 50,000 fans by the end of the year. We began 2012 with a special promotion to celebrate passing the 50K milestone, and followed up with online contests and promotions throughout the year. By the end of the year we had attracted almost 24,000 new Facebook fans, and increased our followers on Twitter by 71%.

We also connected to customers through a new executive blog (viaevolution.ca), designed to explain our business strategies to Canadians. And in July and August, we invited bloggers to travel with us on our Western and Eastern transcontinental trains, post their impressions along the way on Twitter, and share pictures on the photo sites Instagram and Flicker.

FACEBOOK

47.5%	*increase in Facebook fans*
74,294	*Facebook fans at the end of 2012*

TWITTER

12,824	*Twitter followers at the end of 2012*
696,661	*mentions of #VIAOcean by bloggers on Twitter in August*
122M	*impressions generated by 46,000 mentions of VIA Rail on Twitter throughout the year*

RESPONSIVE SERVICE

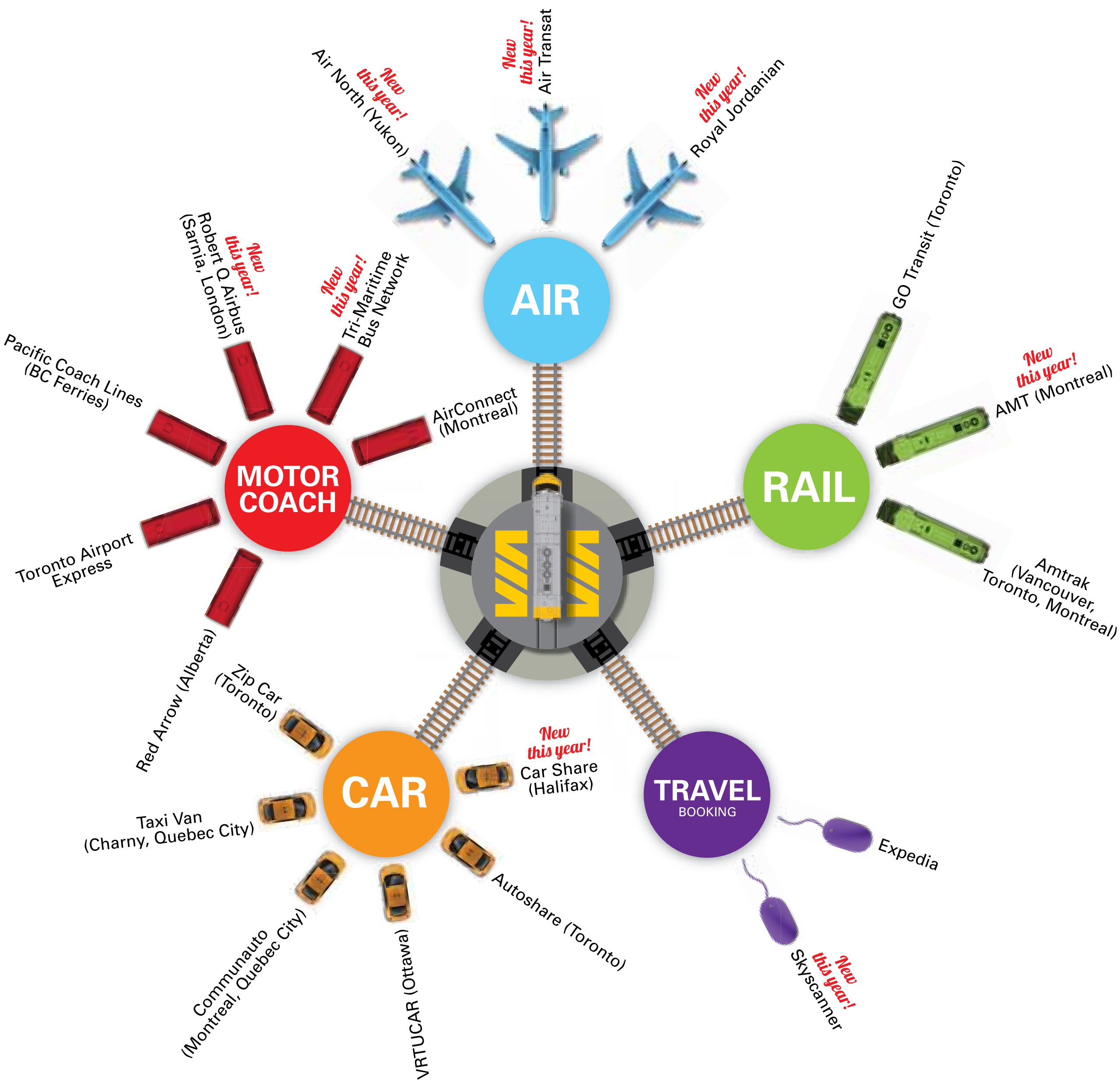
SCHEDULES: IN TUNE WITH MARKETS

In 2012, we took a major step to align our services with market demand. We announced schedule adjustments across our networks that reduced the number of frequencies on some routes while adding frequencies on others. In the Corridor, we reduced frequencies in markets where ridership was too low to justify the existing level of service. This allowed us to reallocate resources to markets where demand is high and growing, while maintaining an adequate level of service on all routes to meet customer needs.

In January, we launched two new services between Ottawa and Toronto, one of which is an express service, arriving under 4 hours. As work to improve track in the Corridor was completed, we added frequencies to optimize the capacity of our trains. By the end of the year, we expanded the number of departure options significantly along the Montréal-Ottawa-Toronto route – our busiest market – while offering faster trip times between destinations. We also added a new direct service between Québec City and Ottawa.

INTER-MODALITY: BUILDING A MORE CONNECTED NETWORK

VIA Rail connected its services with those of eight new intermodal partners in 2012, bringing the total number of partners – motor coach lines, airlines, shuttle and commuter services -- to fifteen across Canada. These partnerships allow us to harmonize our schedules and, in some cases, sell combined tickets in a single transaction. And by offering customers a simple, one-stop solution for door-to-door travel, we have greatly increased their travel options – and made travel on our connected network more attractive.



FARES: MATCHING PRICE, CAPACITY AND CUSTOMER DEMAND

We continued to develop new approaches to marketing, fare discounts and promotions that respond more quickly to shifts in market conditions. Throughout the year, shorter, more frequent seat sales, including 50% fare discounts, proved very effective in attracting new customers and stimulating interest in and repeat usage of rail travel.

In June we implemented a new Revenue Management System that allows us to adjust train capacity and pricing to market demand, and therefore set the best price for a train seat at any given time. This means we can manage fare discounts more effectively to attract more customers and fill empty seats without losing revenues when customer demand is high.

Thanks to this new system, we were able to eliminate the advance purchase requirement for discount fares and launch a new economy Escape Fare in the Corridor designed to attract more customers who may have otherwise travelled by car. As a result, the Revenue Management System helped to increase ridership significantly in the fourth quarter of 2012.

$29

our most competitive Escape Fare, for travel between Montréal and Ottawa

10.4%

ridership gains in the last quarter of 2012 in the Montréal-Ottawa-Toronto triangle compared to the last quarter of 2011

0

the number of days in advance required for purchasing discount tickets

TELEPHONE SALES: BETTER TOOLS, BETTER TRAINING

Our telephone sales offices (TSO) introduced many initiatives to improve efficiency and increase revenues, while sustaining the high customer satisfaction ratings they have received from customers.

For example, a new automated process allows VIA Préférence members to redeem train travel online, so that TSO agents can focus their attention on revenue calls. New web-based computers provide agents with tools to enhance the level of sales and service provided to customers. And a new training program is helping to develop a stronger sales culture, with weekly coaching sessions to support this significant cultural shift.

143

computer terminals replaced and upgraded at our telephone sales offices

SPECIAL TRAINS: CONNECTING THROUGH OUR CUSTOMERS' PASSIONS

We operated two special-event trains in 2012 which gave VIA Rail a high profile among football and music fans.

- In June, VIA Rail worked with Green Coach Productions and CBC Radio 3 to create "Tracks on Tracks" – a train featuring Canadian musicians who performed on-board and at various stations during their trip from Vancouver to Toronto, where they went to perform at the NXNE Festival.
- In the fall, VIA Rail partnered with the Canadian Football League, operating a special train carrying the Grey Cup from Vancouver to Moncton, with stops in 27 cities along the way, to celebrate the trophy's 100th anniversary.

RESPONSIBLE MANAGEMENT

ENVIRONMENT: MAKING VIA RAIL AN EVEN GREENER CHOICE FOR TRAVEL

Passenger rail is widely recognized as the "green choice" for travel, generating far lower greenhouse gas (GHG) emissions than travel by air or private automobile. We are committed to making our trains the most environmentally sustainable option for Canadians.

Every year since 2008, VIA Rail has consistently reduced its diesel fuel consumption and put fewer greenhouse gas emissions into the air, all while ensuring regulatory compliance and managing our waste efficiently. These fuel savings are largely due to the refurbishment of the F40s, more strategic deployment of locomotives, and more efficient equipment cycling.

In 2011, VIA Rail used 2.2 million fewer litres of fuel compared to 2010, a reduction of 4.2%. And we did even better in 2012: using approximately 4.4 million fewer litres of fuel compared to 2011, a reduction of 8.8% and savings of approximately $4 million. As a result by the end of 2012, we have reduced fuel consumption by 23.5%, and greenhouse gas emissions by 13% per passenger-kilometre, compared to 2008.

$4 M
savings in fuel costs

4.4 M
fewer litres of fuel consumed in 2012

SAFETY: RAISING AWARENESS, REDUCING RISKS

Safety is the number one priority for all VIA Rail employees, and a major focus of our track improvement projects. Work to upgrade track has included replacing railway ties and ballast, adjusting curves to accommodate higher speed trains, new security fencing to prevent trespassing on railway property, bridge and culvert upgrades, improved signaling systems and warning lights at grade crossings.

Grade crossings, where rail lines cross roads, are especially high-risk areas. In conjunction with track upgrades and Transport Canada's crossing closure program, we have actively contacted the owners of private property where such crossings were located, to make arrangements to eliminate these risks wherever possible. In addition, we have invested $40 million to improve lighting and automated warning systems at crossings, on track owned by VIA Rail as well as track owned by freight railways.

In 2012, our regional operating teams conducted comprehensive reviews of high-risk areas in our network, and created plans for further lowering the risk of trespassing or crossing incidents. In response to a significant number of accidents and near-misses in the Belleville area, we organized an event during Rail Safety Week to raise awareness and promote prevention.

64
crossings eliminated in 2011

$40 M
invested to improve safety at crossings

NEW BAGGAGE POLICY

Handling overweight baggage has been an unfortunate cause of injuries for both customers and employees. In order to address this, in October VIA Rail began phasing in a new carry-on baggage policy. Developed in consultation with VIA Rail's Health and Safety Committees and frontline employees, the policy sets clear baggage size and weight guidelines. In addition to reducing the risk of injury, the policy reduces baggage-related delays at our stations.

WORKPLACE INJURY IMPROVEMENTS

In 2012, the number of workplace injuries was reduced by 16% compared to 2011, and the time lost due to injuries was reduced by 43% compared to 2011. These great results can be attributed to the implementation of new corporate programs (such as the Critical Incident Program, the Return to work Process and the New Baggage Policy) and to the involvement and engagement of the employees.

It is a confirmation of the benefits of cooperation and dialogue, as well as the will to change behaviour and attitudes.

380
more trains leaving on time

36 minutes
maintenance saved per train at the TMC

$90,000
saved by reconfiguring trains

LEAN CONTINUOUS IMPROVEMENT: EFFICIENCY AND PRODUCTIVITY

Lean Management represents a proven approach to improve operational efficiency, increase productivity, and deliver more value to customers. 2012 was the second full year of VIA Rail's LEAN Continuous Improvement Program, and more than 40 Lean projects were underway during the year.

By 2012, we were already benefitting from this approach:

- Our T-30 project reduced delays in train departures by focusing on the 30 minutes before a scheduled departure time. As a result, 94.1% of our trains left on time in 2012, compared to 90.8% in the previous year.
- At our Toronto Maintenance Centre (TMC), one of the locations where we maintain our equipment, a more organized work environment and restructured procedures eliminated most of these delays.
- A project team examined the Montréal to Gaspé and Halifax trains, that run together up to Matapédia, Québec, where they are separated. A new train configuration and separation process reduced fuel consumption and provided a more comfortable experience for customers.

EMPLOYEE ENGAGEMENT: CREATING A BETTER WORKPLACE

In response to the Employee Engagement survey we conducted in 2011, VIA Rail launched a number of initiatives in 2012 to create a better work environment for employees and increase their engagement towards VIA Rail's business objectives.

- We implemented a new regional-based organizational structure which brought senior leadership closer to day-to-day operations.
  We developed a new talent and succession development framework which will allow us to identify talent at all levels of the organization and accelerate the development of potential successors.
- We piloted a new training program for front-line leaders designed to improve their overall management skills and developed a new recognition program to be launched in 2013.
- We conducted workshops where employees identified local issues and solutions that could make a difference in our operations.

We plan to measure the impact of these initiatives by conducting another employee engagement survey in 2014.

AWARDS

HONORARY AWARD FROM HERITAGE BC

We received an honorary award from Heritage BC recognizing high standards of quality and our commitment to preserving heritage, demonstrated by our renovations of Pacific Central Station in Vancouver. The renovations were completed in December 2011.

GLOBAL CORPORATE CHALLENGE AWARD

The Global Corporate Challenge (GCC) is an international organization promoting fitness in the workplace. In 2012, GCC named VIA Rail the 2nd most active team in Canada among those who participated in the challenge.

AGENT'S CHOICE AWARD

Reliable service and on-board Wi-Fi access helped VIA Rail win the 2012 Baxter Travel Media's Agent's Choice Award for the 6th year in a row. In choosing VIA Rail, travel agents also praised VIA Rail for developing a new online training course for travel agents, and for continuously improving passenger services. We have won this award 11 times in the last 12 years.

THOMAS AWARD OF EXCELLENCE

In December, VIA Rail received the first Thomas International Award of Excellence for the caliber of its selection process for the locomotive engineer training program.

SAFETY AWARD, RAILWAY ASSOCIATION OF CANADA

The Railway Association of Canada awarded VIA Rail recognition for the public safety conference - attended by police forces, Transport Canada, Coroners and the Chief Coroner of Québec, Operation Lifesaver and the Teamsters Canada Rail Conference - we coordinated in Kingston, Ontario, to raise awareness about safety on railway infrastructure.

GOVERNANCE AND ACCOUNTABILITY

THE BOARD OF DIRECTORS

The Board of Directors consists of the Chairperson, the President and Chief Executive Officer and other directors appointed by the Government of Canada. The Board is responsible for overseeing the strategic direction and management of the Corporation, and reports on VIA Rail's operations to the Minister of Transportation, the Honourable Denis Lebel, and the Minister of State (Transport), the Honourable Steven Fletcher.

With the appointment of four new members in 2012, the Board of Directors is now composed of 13 directors. During 2012, there were four Board meetings and 25 Board Committee meetings. The average attendance rate of directors at all of these meetings was 96 percent. Cumulative fees for Board members during this time period totaled $179,946.

PUBLIC MEETINGS AND REPORTS

VIA Rail held its second Annual Public Meeting on May 29 in Winnipeg Station. Simultaneously broadcast over the Internet, the meeting allowed the public to learn more about business, financial performance and improvement projects at VIA Rail. This meeting gave the public the opportunity to speak directly to the Chairman of the Board, the President and CEO and senior management of VIA Rail. Executives also responded to questions emailed by people who could not attend the meeting in person.

VIA Rail also publishes quarterly reports on its web site, detailing financial performance and operations.

In conjunction with Board meetings, which take place in communities across Canada, VIA Rail organized a number of meetings with local stakeholders, business partners and elected officials interested in the economic benefits of VIA Rail operations in Halifax, Ottawa, Toronto and Winnipeg.

THE INSTITUTE FOR CANADIAN CITIZENSHIP

On July 1st VIA Rail announced a new partnership with the Institute for Canadian Citizenship (ICC) which allows new Canadian citizens to discover their adopted country by train. VIA Rail offers all new citizens, through the ICC's Cultural Access Pass program, a 50% discount on the lowest available fare on any VIA Rail train. The offer is valid for one trip, by a new citizen and up to four of their children under the age of 18, in the first year of their citizenship.

THE CANADIAN MILITARY

VIA Rail continues to support the Canadian military and their families through its participation in several non-profit events. In addition, VIA Rail offers unlimited travel, year round, at discounted fares for military members and their families as well as veterans, allowing them to travel across the country at very attractive rates.

NATIONAL CHARITABLE CAMPAIGN

VIA Rail employees, retirees and board members participated in our fall National Charitable Campaign across the country. Under the theme "Drive VIA Rail's Generosity Train!" the campaign raised more than $239,000 in donations for United Way (Centraide) and Healthpartners. The money will be used to help people in need and support research against disease.

OFFICIAL LANGUAGES

VIA Rail is committed to the principles of the Official Languages Act. VIA Rail employees actively demonstrate a willingness to provide service in either English or French. Our Official Languages policies apply to all communications, whether on the telephone, in a station, or on-board our trains. We maintain a work environment where employees can speak the language of their choice, in regions designated bilingual. All internal and external communications are written in French and in English, and VIA Rail uses both languages in its business practices.

The number of complaints VIA Rail receives under the Act has declined steadily since 2007. In 2012, VIA Rail received seven such complaints.

VIA Rail recognizes that it can play a valuable role in promoting linguistic duality in Canada. The 2011 Annual Report of the Commissioner of Official Languages noted VIA Rail's positive contribution in this regard through participation in the Summer Work Student Exchange YMCA (Youth), an initiative of Heritage Canada and VIA Rail.

VIA Rail supported the National Acadian Day by communicating its commitment to linguistic duality through corporate messages and social media. In addition, the corporation supported Linguistic Duality Day for the third consecutive year through its communications activities.

ACCESS TO INFORMATION AND PRIVACY

VIA Rail believes that openness and transparency are the starting point in building a trusted relationship with customers, and with the public in general. VIA Rail became subject to both the Access to Information Act and the Privacy Act in 2007.

As of January 2013, and since April 2012, VIA has received 31 new requests and 3 new complaints to date under the *Access to Information Act* and the *Privacy Act* in comparison to a total of 28 requests and 8 complaints during the same period from April 2011 – January 2012.

In June of 2012, VIA Rail began posting a brief summary of all completed requests that were answered by VIA Rail under the Access to Information Act on its website at viarail.ca.

TRAVEL, HOSPITALITY AND CONFERENCE EXPENSES

The following travel, hospitality and conference expenses were submitted during 2012:

Paul G. Smith, Chairman of the Board – $7,983

Marc Laliberté, President and CEO – $36,430

Executive management committee members – $151,050

Board of Directors members – $60,978

MANAGEMENT DISCUSSION AND ANALYSIS

This is a review of VIA Rail Canada's operations, performance and financial position for the quarter and year December 31, 2012, compared with the quarter and year ended December 31, 2011. It should be read in conjunction with the consolidated financial statements and notes.

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

The Corporation decided on an early adoption of the accounting standard IAS 19 – *Employee Benefits (2011)* with a date of initial application of January 1, 2012 (this standard would have been effective January 1, 2013 if the Corporation had not decided on an early adoption). As a result of this change, the Corporation recognized the actuarial gains and losses immediately in other comprehensive income and applied this change retroactive to January 2011.

According to the IAS 19 – *Employee Benefits (2011)* standard, actuarial gains or losses on defined benefit plans are recognized in the year they occur, and no longer amortized over many years.

1. FINANCIAL HIGHLIGHTS

	Quarters ended December 31				Years ended December 31			
IN MILLION OF CANADIAN DOLLARS	2012	2011	Var $	Var %	2012	2011	Var $	Var %
Passenger Revenues	**60.8**	63.6	(2.8)	(4.4%)	**257.0**	264.8	(7.8)	(2.9%)
Total Revenues	**66.5**	68.1	(1.6)	(2.3%)	**277.6**	282.6	(5.0)	(1.8%)
Operating expenses	**163.9**	144.4	19.5	13.5%	**612.3**	585.7	26.6	4.5%
Operating loss before funding from Government of Canada and corporate taxes	**(97.4)**	(76.3)	21.1	27.7%	**(334.7)**	(303.1)	31.6	10.4%
Operating funding from Government of Canada	**62.4**	61.7	0.7	1.1%	**279.1**	260.9	18.2	7.0%
Amortization of deferred capital funding	**38.4**	13.4	25.0	n/a	**82.0**	46.5	35.5	76.3%
Corporate taxes (recovery)	**(4.8)**	(1.4)	(3.4)	n/a	**(0.0)**	(4.4)	(4.4)	(100.0%)
Net income (loss)	**8.2**	0.2	8.0	n/a	**26.4**	8.7	17.7	n/a
Actuarial losses on defined benefit plans	**113.9**	297.2	(183.3)	(61.7%)	**101.2**	288.1	(186.9)	(64.9%)
Total Comprehensive income (loss)	**(105.7)**	(297.0)	(191.3)	(64.4%)	**(74.8)**	(279.4)	(204.6)	(73.2%)

Revenues have decreased by 1.8 percent compared to last year; passenger-miles have decreased by 2.0 percent and yields have decreased by 0.9 percent.

Operating expenses rose by $26.6M, the increase mainly due to higher amortization and losses on write-down of property, plant and equipment and intangible assets.

As a result, the Operating deficit before funding from the Government of Canada, amortization of deferred capital funding and corporate taxes has increased by $31.6M (10.4 percent).

Highlights of the quarter

Compared with the quarter ended December 31, 2011:

/ Revenues have decreased by 2.3 percent and total $66.5M for the quarter;

/ Operating expenses before corporate taxes and amortization of deferred capital funding have increased by 13.5 percent and amount to $163.9M for the quarter;

/ Operating funding from Government of Canada increased by 1.1 percent to $62.4M for the quarter;

/ There is a net income of $8.2M for the quarter, compared to a net income of $0.2M for the same quarter of 2011;

/ There were actuarial losses on defined benefit plans of $113.9M for the quarter compared to $297.2M for the corresponding quarter last year;

/ There is a total comprehensive loss of $105.7M for the quarter, compared to a loss of $297.0M for the last quarter of 2011.

Highlights of the year ended December 31, 2012

Compared with the results of the year ended December 31, 2011:

/ Revenues have decreased by 1.8 percent and total $277.6M for the period;

/ Operating expenses before corporate taxes and amortization of deferred capital funding have increased by 4.5 percent and amount to $612.3M for the period;

/ Operating funding from Government of Canada increased by 7.0 percent to $279.1M for the period;

/ There is a net income of $26.4M for the period compared to $8.7M in 2011;

/ There were actuarial losses on defined benefit plans of $101.2M for the period, compared to $288.1M for the year 2011;

/ There is a total comprehensive loss of $74.8M in 2012, compared to a loss of $279.4M in 2011.

2. HIGHLIGHTS OF OPERATING RESULTS

a) Passenger Revenues

	REVENUES (IN '000 000$)							
	Quarters ended December 31				Years ended December 31			
	2012	2011	Var $	Var %	2012	2011	Var $	Var %
Corridor East	**40.8**	39.7	1.1	2.8%	**153.5**	155.1	(1.6)	(1.0%)
Southwestern Ontario (SWO)	**9.8**	11.6	(1.8)	(15.5%)	**40.8**	44.9	(4.1)	(9.1%)
Ocean	**2.3**	3.2	(0.9)	(28.1%)	**13.3**	14.0	(0.7)	(5.0%)
Canadian	**6.3**	6.9	(0.6)	(8.7%)	**40.7**	41.4	(0.7)	(1.7%)
Mandatory Services	**1.5**	1.6	(0.1)	(6.3%)	**5.9**	7.3	(1.4)	(19.2%)
Other	**0.1**	0.6	(0.5)	(83.3%)	**2.8**	2.1	0.7	33.3%
TOTAL	**60.8**	63.6	(2.8)	(4.4%)	**257.0**	264.8	(7.8)	(2.9%)

	PASSENGER MILES (IN '000 000)							
	Quarters ended December 31				Years ended December 31			
	2012	2011	Var #	Var %	2012	2011	Var #	Var %
Corridor East	**143.1**	125.3	17.8	14.2%	**498.1**	500.4	(2.3)	(0.5%)
Southwestern Ontario (SWO)	**29.4**	32.6	(3.2)	(9.8%)	**115.2**	127.1	(11.9)	(9.4%)
Ocean	**10.4**	13.9	(3.5)	(25.2%)	**59.8**	63.4	(3.6)	(5.7%)
Canadian	**23.3**	25.0	(1.7)	(6.8%)	**134.5**	129.0	5.5	4.3%
Mandatory Services	**6.5**	6.7	(0.2)	(3.0%)	**26.3**	31.2	(4.9)	(15.7%)
Other	**-**	-	-	-	**-**	-	-	-
TOTAL	**212.7**	203.5	9.2	4.5%	**833.9**	851.1	(17.2)	(2.0%)

Passenger revenues total $60.8M for the quarter, a decrease of 4.4 percent compared to the corresponding quarter last year. The decrease stems mostly from the impact of the frequency adjustments in Southwestern Ontario, as well as on the *Ocean* and the *Canadian*; revenues decreased but the frequency adjustments generated greater savings in operating expenses as these services were not profitable. The frequency adjustments, announced earlier this year, took effect at the end of October for the *Ocean* and the *Canadian*. In Southwestern Ontario, some frequencies were reduced in July, others at the end of October also.

On an annual basis, passenger revenues totaled $257.0M and have decreased by 2.9 percent compared to the previous year. The decrease is attributable to lower ridership in all major train services, combined with slightly lower yields.

For the quarter:

- Corridor East revenues are 2.8 percent above last year, and result mainly from higher ridership (14.2 percent more passenger miles), partly offset by lower yields (decrease of 10.0 percent). The increase in passenger-miles during the quarter was more significant than the increase in passengers, reflecting the fact that the growth in ridership on end to end markets;
- Revenues in SWO have decreased by 15.5 percent as a result of lower ridership (9.8 percent less passenger-miles), due mainly to the impact of the frequency adjustments, combined with lower yields (-6.3 percent);
- Revenues on the *Ocean* have decreased by 28.1 percent, due to lower ridership (25.2 percent less passenger-miles) resulting directly from the frequency adjustments (from 6 to 3 frequencies per week), combined with lower yields (-3.9 percent):
- Revenues on the *Canadian* have decreased by 8.7 percent over the previous year. The performance stems from lower volumes (6.8 percent less passenger-miles) attributable to the frequency adjustments (from 3 to 2 frequencies per week), combined with slightly lower yields (-2.0 percent);
- Mandatory services have generated lower revenues (-6.3 percent), a situation which results from the situation affecting the Montreal-Gaspe service. The train service cannot be provided all the way to Gaspe because of poor track conditions, the train therefore stops at New Carlisle where passengers are transferred on a bus and taken to Gaspe. This situation has had a negative impact on ridership.

For the year ended December 31:

- Corridor East revenues have decreased by 1.0 percent, as a result of lower ridership (-0.5 percent) combined with lower yields (-0.6 percent);
- Revenues in SWO have decreased by 9.1 percent and also result from lower ridership (-9.4 percent) attributable in part to the frequency adjustments, partly offset by slightly higher yields (+0.3 percent);
- Revenues on the *Ocean* have decreased by 5.0 percent due to lower ridership (5.7 percent less passenger-miles) resulting from the impact of the frequency adjustments, partly offset by slightly higher yields (+0.7 percent);
- Revenues on the *Canadian* are 1.7% below last year's levels, the decrease mainly due to lower yields (-5.7 percent), partly offset by a higher ridership during the first three quarters of the year (4.3 percent additional passenger-miles);
- Mandatory services have generated lower revenues (-19.2 percent), the decrease directly attributable to the situation affecting the Montreal-Gaspe service. The train service cannot be provided all the way to Gaspe due to poor track conditions, the train therefore now stops at New Carlisle where passengers are transferred on a bus and taken to Gaspe. This situation has negatively impacted the service.

b) Operating Expenses

IN MILLIONS OF CANADIAN DOLLARS	Quarters ended December 31				Years ended December 31			
	2012	2011	Var $	Var %	**2012**	2011	Var $	Var %
Compensation & Benefits	**50.9**	54.9	(4.0)	(7.3%)	**217.2**	226.8	(9.6)	(4.2%)
Employee Benefits	**11.3**	10.2	1.1	10.8%	**49.7**	36.9	12.8	34.7%
Train Operations & Fuel	**29.9**	33.4	(3.5)	(10.5%)	**123.9**	126.5	(2.6)	(2.1%)
Other operating expenses	**71.6**	47.8	23.8	49.8%	**221.7**	199.4	22.3	11.2%
Unrealized loss (gain) on derivative financial instruments	**0.6**	0.0	0.6	n/a	**1.4**	2.4	(1.0)	(41.7%)
Realized loss (gain) on derivative financial instruments	**(0.4)**	(1.9)	1.5	78.9%	**(1.6)**	(6.3)	4.7	74.6%
Total Operating expenses before Amortization of deferred capital funding & Corporate Tax expense	**163.9**	144.4	19.5	13.5%	**612.3**	585.7	26.6	4.5%
Corporate Taxes (recovery)	**(4.8)**	(1.4)	(3.4)	n/a	**(0.0)**	(4.4)	4.4	100.0%
TOTAL OPERATING EXPENSES BEFORE AMORTIZATION OF DEFERRED CAPITAL FUNDING	**159.1**	143.0	16.1	11.3%	**612.3**	581.3	31.0	5.3%

For the quarter:

/ Operating expenses before amortization of deferred capital funding & corporate tax have increased by 19.5 million and total 163.9 million for the quarter, mainly due to higher amortization and losses on write-down and disposal of property, plant and equipment and intangible assets (included in other operating expenses), partly offset by lower compensation and benefit costs.

/ Compensation & benefits costs and Train operations and fuel expenses have decreased and a portion of the cost reductions results from the frequency adjustments made during the quarter.

For the year completed December 31:

/ Operating expenses before amortization of deferred capital funding & corporate tax rose by $26.6M and amount to $612.3M. The increase results primarily from higher amortization and losses on write-down and disposal of property, plant and equipment and intangible assets (included in other operating expenses), as well as higher employee benefit costs and lower gains on derivative financial instruments.

c) Operating Deficit and government funding

/ VIA has been consistently improving its financial situation, both commercially and operationally. In fact, over the four years, VIA has required $38.6 million less government funding for operations (before contributions to pension plans).

IN MILLIONS OF CANADIAN DOLLARS	2012	2011	2010	2009
Government Operating Funding and Asset Renewal Fund before pension plans	**208.9**	216.8	237.6	247.5
Employer Contributions to Pension Plans	**70.2**	44.1	23.9	13.8
TOTAL GOVERNMENT OPERATING FUNDING	**279.1**	260.9	261.5	261.3

3. CAPITAL INVESTMENTS

Fixed assets (net of accumulated depreciation) amount to $1,238.6M, up $86.5M compared to the balance as at December 31, 2011. Capital investments for the quarter totaled $54.3M, and $170.3M for the year.

/ Investments of $19.6M were made in major infrastructure projects. The majority of investments were made in the Kingston Subdivision where work is done to add sections of a third track between Montreal and Toronto to minimize congestion. The total investment made in major infrastructure projects was $69.9M for the year.

/ A total of $10.6M was invested in major equipment projects, including $7.8M for the LRC fleet rebuild project, and $1.5M for the F40 locomotive fleet rebuild project. For the year, a total of $49.1M has been invested in major equipment projects.

/ An amount of $8.8M was invested in Information Technology projects (including the Mainframe migration, Disaster recovery plan and Oracle system upgrade projects). Investments in Information Technology projects totaled $20.8M for the year.

/ Investments of $8.5M were also made in Other Infrastructure projects during the quarter, bringing the annual investments to $18.0M for the year ended December 31.

4. CASH FLOW AND FINANCIAL POSITION

The Corporation's cash balance is $15.9M as at December 31, 2012, up $2.6M compared to December 31, 2011.

5. RISK ANALYSIS

RISK	TREND	CURRENT SITUATION
PENSION COSTS		
Pension costs could increase significantly given current and projected discount rates as well as demographics.	→	The situation has worsened due to declining interest rates. Management has adopted changes to the Pension plan programs to minimize cost increases and ensure costs are contained as much as possible. Some of these changes are being implemented in 2012 and 2013.
CAPITAL INVESTMENT PROJECTS		
Major delays in infrastructure or equipment projects, or an increase in project costs would adversely affect VIA's financial performance.	→	Issues concerning the production timelines of specific equipment projects have materialized. Since the beginning of the year, VIA terminated the remainder of the Renaissance and LRC contracts as a result of the supplier's failure to meet the delivery schedule. VIA has since developed a new schedule for the completion of the projects and some of the work has already started.
PASSENGER REVENUES		
Passenger Revenues have been declining since the fourth quarter of 2011.	→	VIA has implemented initiatives to mitigate the impact of declining passenger revenues. These include optimizing train services between Montreal, Ottawa and Toronto in growing markets, the introduction of a new low fare product and through information technology improvements that support revenue generation initiatives. These initiatives have generated positive results as ridership has improved, during the fourth quarter of 2012, in Corridor routes not impacted by frequency adjustments.

↑ INCREASING	→ STABLE	↓ DECREASING

RISK	TREND	CURRENT SITUATION
OPERATING FUNDING		
VIA continues to face operational funding challenges.	→	The Corporation is pursuing the development and the implementation of a range of initiatives to reduce its deficit by reducing costs and increasing revenues. VIA has made frequency adjustments on the *Ocean*, the *Canadian*, and on certain trains in South Western Ontario to better align with demand, improve its financial performance and reduce its funding requirements. Furthermore, VIA continues to work with Transport Canada to address the challenge of operating loss and develop sustainable funding solutions.
CAPITAL FUNDING		
VIA will need to continue investing in equipment, stations, maintenance systems, facilities and information technology after 2012, when the current investment program is completed.	→	The Corporation is working with Transport Canada to address ongoing capital funding requirements, and to ensure that VIA has the capital funding it requires to deliver on its mandate. VIA received an additional $60M envelope for the 2012-2013 government fiscal year.
FUEL COST FLUCTUATIONS		
Fuel is a major cost for passenger rail operations, and fuel costs could vary significantly from VIA's estimates due to the uncertainty and volatility of fuel prices.	↓	Fuel consumption has decreased compared to previous years as a result of the introduction of the refurbished locomotives as well as other initiatives to reduce fuel consumption. VIA's proven hedging strategy adds certainty to future fuel costs and can delay the impact of fuel price fluctuations. Given that contracts used to hedge fuel prices are denominated in U.S. dollars, VIA also hedges against foreign exchange risks.
CROSSING INCIDENTS		
VIA's train operate through many protected and unprotected level road crossings where vehicles can cross and where incidents/accidents could occur.	→	VIA has developed a crossing improvement (protection, fences) and closure program. They work actively with communities and owners of the land where there are crossings. The objectives of the program are to close crossings where possible and to increase public awareness about the potential dangers they represent.

↑ INCREASING → STABLE ↓ DECREASING

6. OUTLOOK

The performance of revenues was below expectations during the year, however ridership increased in the fourth quarter in most services not affected by frequency adjustments, reflecting the impact of the initiatives launched by the Corporation to stimulate revenues and increase ridership.

Measures to contain costs and minimize the adverse impact of sustained competition from bus companies and airlines were maintained throughout the year, and the Corporation was able to meet its financial objectives for 2012 with the exclusion of the recent pension cost increases.

Frequency adjustments were also made during the year to better align service with demand as well as to improve the Corporation's financial performance.

Furthermore, in December 2012, new frequencies were announced in the Corridor, giving passengers more travel options and a new Quebec-Ottawa service was also introduced. These additional frequencies, combined with the revenue initiatives, should allow the Corporation to return to growth in 2013. Cost control measures will also be maintained to ensure expenses are kept to minimum levels without compromising customer service.

At the same time, VIA is focusing on completing its capital investment projects, and will ensure that passenger rail delivers better value to more Canadian travelers.

FINANCIAL STATEMENTS

MANAGEMENT'S RESPONSIBILITY STATEMENT

YEAR ENDED DECEMBER 31, 2012

Management of the Corporation is responsible for the preparation and fair presentation of the financial statements contained in the Annual Report. These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) 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 financial statements. Management considers that the financial statements present fairly the financial position of the Corporation and its financial performance 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 PricewaterhouseCoopers, LLP, as internal auditors. The external auditor, the Auditor General of Canada, has audited the Corporation's financial statements for the year ended December 31, 2012 and his report indicates the scope of his audit and his opinion on the financial statements.

The Audit, Risk and Finance Committee of the Board of Directors, consisting 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 financial statements have been reviewed and approved by the Board of Directors on the recommendation of the Audit, Risk and Finance Committee.

Marc Laliberté
President and
Chief Executive Officer

Robert St-Jean, CPA, CA
Chief Financial
and Administration Officer

Montréal, Canada
March 12, 2013

Auditor General of Canada
Vérificateur général du Canada

INDEPENDENT AUDITOR'S REPORT

To the Minister of Transport, Infrastructure and Communities

Report on the Financial Statements

I have audited the accompanying financial statements of VIA Rail Canada Inc., which comprise the statement of financial position as at 31 December 2012, and the statement of operations and comprehensive income, statement of changes in shareholder's equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

.../2

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of VIA Rail Canada Inc. as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

As required by the *Financial Administration Act*, I report that, in my opinion, the accounting principles in International Financial Reporting Standards have been applied, after giving retrospective effect to the change in the method of accounting for employee benefits as explained in Note 3 to the financial statements, on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of VIA Rail Canada Inc. 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 regulations and the articles and by-laws of VIA Rail Canada Inc.

Maurice Laplante, CPA auditor, CA
Assistant Auditor General
for the Auditor General of Canada

12 March 2013
Montréal, Canada

FINANCIAL STATEMENTS

STATEMENT OF FINANCIAL POSITION

As at (IN THOUSANDS OF CANADIAN DOLLARS)	December 31, 2012	December 31, 2011	January 1, 2011
CURRENT ASSETS		Restated	Restated
Cash and cash equivalents	**$ 15,857**	$ 13,253	$ 76,829
Accounts receivable, trade	**6,823**	10,707	7,988
Prepaids, advances on contracts and other receivables	**5,951**	11,147	14,414
Receivable from the Government of Canada	**10,408**	-	15,702
Derivative financial instruments (NOTE 21)	**771**	2,225	4,649
Materials (NOTE 8)	**22,646**	21,287	21,302
Asset Renewal Fund (NOTE 11)	**13,248**	24,022	15,295
	75,704	82,641	156,179
NON-CURRENT ASSETS			
Property, plant and equipment (NOTE 9)	**840,287**	814,876	729,932
Intangible assets (NOTE 10)	**398,338**	337,182	235,371
Asset Renewal Fund (NOTE 11)	**2,485**	9,881	25,645
	1,241,110	1,161,939	990,948
Total assets	**$ 1,316,814**	$ 1,244,580	$ 1,147,127
CURRENT LIABILITIES			
Trade and other payables (NOTE 12)	**$ 102,983**	$ 103,841	$ 135,952
Provisions (NOTE 13)	**12,551**	18,050	16,342
Deferred government funding	**-**	6,148	51,000
Derivative financial instruments (NOTE 21)	**1,157**	1,173	1,201
Deferred revenues (NOTE 17)	**27,361**	26,734	25,546
	144,052	155,946	230,041
NON-CURRENT LIABILITIES			
Employee benefit liability (NOTE 14)	**388,345**	314,352	40,682
Deferred investment tax credits	**281**	566	909
Other non-current liabilities	**-**	-	623
	388,626	314,918	42,214
DEFERRED CAPITAL FUNDING (NOTE 16)	**1,229,001**	1,143,800	965,546
SHAREHOLDER'S EQUITY			
Share capital (NOTE 18)	**9,300**	9,300	9,300
Retained earnings	**(454,165)**	(379,384)	(99,974)
	(444,865)	(370,084)	(90,674)
Total liabilities and shareholder's equity	**$ 1,316,814**	$ 1,244,580	$ 1,147,127

Commitments and Contingencies (Notes 19 and 24, respectively)

The notes are an integral part of the financial statements.

Approved on behalf of the Board,

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

Paul G. Smith
Director and Chairman of the Board

FINANCIAL STATEMENTS

STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

Year ended December 31 (IN THOUSANDS OF CANADIAN DOLLARS)	2012	2011
REVENUES		**Restated**
Passenger	**$ 257,027**	$ 264,767
Other	**20,564**	17,797
	277,591	282,564
EXPENSES		
Compensation and benefits	**266,946**	263,693
Train operations and fuel	**123,850**	126,465
Stations and property	**33,990**	33,286
Marketing and sales	**29,154**	29,615
Maintenance material	**29,320**	32,513
On-train product costs	**15,455**	15,085
Operating taxes	**9,628**	6,865
Professional services	**9,641**	7,786
Amortization and losses on write-down and disposal of property, plant and equipment and intangible assets (NOTES 9 AND 10)	**71,924**	49,662
Unrealized net loss on derivative financial instruments	**1,438**	2,396
Realized gain on derivative financial instruments	**(1,562)**	(6,270)
Other	**22,561**	24,639
	612,345	585,735
OPERATING LOSS BEFORE FUNDING FROM THE GOVERNMENT OF CANADA AND CORPORATE TAXES	**334,754**	303,171
Operating funding from the Government of Canada	**279,133**	260,865
Amortization of deferred capital funding (NOTE 16)	**82,017**	46,530
Income before corporate taxes	**26,396**	4,224
Corporate tax recovery (NOTE 15)	**46**	4,445
NET INCOME FOR THE YEAR	**26,442**	8,669
Other comprehensive income (loss)		
Amounts not to be reclassified subsequently to net income:		
Actuarial losses on defined benefit plans	**(101,223)**	(288,079)
OTHER COMPREHENSIVE INCOME (LOSS) FOR THE YEAR	**(101,223)**	(288,079)
TOTAL COMPREHENSIVE INCOME (LOSS) FOR THE YEAR	**$ (74,781)**	$ (279,410)

The notes are an integral part of the financial statements.

STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY

Year ended December 31 (IN THOUSANDS OF CANADIAN DOLLARS)	2012	2011
		Restated
SHARE CAPITAL	**$ 9,300**	$ 9,300
Retained Earnings		
Balance, beginning of year	**(379,384)**	66,330
Impact of adoption of revised accounting standards	**-**	(166,304)
RESTATED BALANCE BEGINNING OF YEAR	**(379,384)**	(99,974)
Net income for the year	**26,442**	8,669
Other comprehensive income (loss) for the year	**(101,223)**	(288,079)
Balance, end of year	**(454,165)**	(379,384)
Total Shareholder's equity	**$ (444,865)**	$ (370,084)

The notes are an integral part of the financial statements.

FINANCIAL STATEMENTS

STATEMENT OF CASH FLOWS

Year ended December 31 (IN THOUSANDS OF CANADIAN DOLLARS)	2012	2011
OPERATING ACTIVITIES		Restated
Net income for the year	$ 26,442	$ 8,669
Adjustments to determine net cash (used in) from operating activities:		
Amortization of property, plant and equipment and intangible assets	58,929	48,333
Losses on write-down and disposal of property, plant and equipment and intangible assets	13,280	1,672
Receipt of letters of credit	10,500	-
Amortization of deferred investment tax credits	(285)	(343)
Amortization of deferred capital funding	(82,017)	(46,530)
Interest income	(725)	(883)
Change in fair value of financial instruments (Asset Renewal Fund)	(1,052)	(364)
Unrealized net loss (gain) on derivative financial instruments	1,438	2,396
Post-employment benefits funding in excess of amount expensed	(101,223)	(288,079)
Net change in non-cash working capital items	(25,829)	(44,597)
Change in defined benefit liability	73,993	273,670
Change in other non-current liabilities	-	(623)
Net cash (used in) provided by operating activities	(26,549)	(46,679)
INVESTING ACTIVITIES		
Capital funding	167,218	224,784
Change in capital funding receivable from the Government of Canada	4,577	13,716
Acquisition of investments in the Asset Renewal Fund	(79,156)	(270,959)
Proceeds from sale and maturity of investments in the Asset Renewal Fund	98,378	278,360
Change in capital accounts payable and accrued liabilities	6,687	(26,921)
Acquisition of property, plant and equipment and intangible assets	(170,312)	(237,042)
Interest received	725	883
Proceeds from disposal of property, plant and equipment and intangible assets	1,036	282
Net cash (used in) provided by investing activities	29,153	(16,897)
CASH AND CASH EQUIVALENTS		
Increase (Decrease) during the year	2,604	(63,576)
Balance, beginning of year	13,253	76,829
Balance, end of year	$ 15,857	$ 13,253
REPRESENTED BY:		
Cash	$ 10,236	$ 4,376
Short-term investments	5,621	8,877
	$ 15,857	$ 13,253

The notes are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

AS AT DECEMEBER 31

1. AUTHORITY AND OBJECTIVES

VIA Rail Canada Inc. is a Crown corporation named in Part I of Schedule III to the *Financial Administration Act*. The corporation was incorporated in 1977 in Canada, under the *Canada Business Corporations Act*. The corporate headquarters is located at 3 Place Ville-Marie, Montreal (Quebec). The Corporation's vision is to make passenger rail the preferred way to move and connect people in Canada with a mission to offer a safe, attractive and stress-free travel experience, while consistently providing the best value for money. 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 in Canada. The corporation's activities are considered seasonal since passenger traffic increases significantly during the summer and holiday periods resulting in an increase in revenue for these same periods.

These financial statements were approved and authorized for issue by the Board of Directors on March 12, 2013.

2. BASIS OF PREPARATION

A) STATEMENT OF COMPLIANCE

The Corporation's financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

B) FUNCTIONAL AND PRESENTATION CURRENCY

These financial statements are presented in Canadian dollars, which is the Corporation's functional currency. All financial information presented in Canadian dollars has been rounded to the nearest thousand in the corporate financial statements and rounded to the nearest million in the Notes to the financial statements.

3. CHANGES IN ACCOUNTING POLICIES

The Corporation decided on an early adoption of the accounting standard IAS 1 – *Presentation of financial statements* with a date of initial application of January 1, 2012. The IAS 1 – *Presentation of financial statements* would have been effective January 1, 2013 if the Corporation had not decided on an early adoption. The revised standard will have an impact on the presentation of the Financial Statements as well as the note disclosure.

The Corporation decided on an early adoption of the accounting standard – IAS19 – *Employee Benefits (2011)* with a date of initial application of January 1, 2012. The IAS19 – *Employee Benefits (2011)* would have been effective January 1, 2013 if the Corporation had not decided on a early adoption.

As a result of this change, the Corporation recognized the actuarial gains and losses immediately in other comprehensive income.

Also, the Corporation now determines the net interest expense on the net defined benefit liability for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the year to the net defined benefit liability at the beginning of the year. The net interest expense includes changes in the net defined liability during the year as a result of contributions and benefit paid during the year. The net interest on the net defined benefit liability is comprised of the interest cost on the defined benefit obligation and the interest income on plan assets. Previously, the Corporation determined interest income on plan assets based on their long-term rate of expected return.

The amended standard also improves the disclosure on the risk arising from defined benefit plans.

This standard was applied retrospectively and changes are included in note 14.

3. CHANGES IN ACCOUNTING POLICIES (CONT'D)

Reconciliation of the opening Statement of Financial Position as at January 1, 2011 and December 31, 2011:

(IN MILLIONS OF DOLLARS)	Dec. 31, 2010 IAS19	Adjustment	Jan. 1, 2011 IAS19R	Dec. 31, 2011 IAS19	Adjustment	Dec. 31, 2011 IAS19R	Notes
Current assets	**156.2**	**-**	**156.2**	82.6	-	82.6	
Defined benefit asset	**159.1**	**(159.1)**	**-**	186.9	(186.9)	-	a
Other non-current assets	**990.9**	**-**	**990.9**	1,162.0	-	1,162.0	
Non-current assets	**1,150.0**	**(159.1)**	**990.9**	1,348.9	(186.9)	1,162.0	
Total Assets	**1,306.2**	**(159.1)**	**1,147.1**	1,431.5	(186.9)	1,244.6	
Current liabilities	**230.0**	**-**	**230.0**	156.0	-	156.0	
Defined benefit liability	**33.1**	**7.6**	**40.7**	35.3	279.0	314.3	b
Deferred corporate tax liabilities	**0.4**	**(0.4)**	**-**	-	-	-	c
Other non-current liabilities	**1.5**	**-**	**1.5**	0.6	-	0.6	
Non-current liabilities	**35.0**	**7.2**	**42.2**	35.9	279.0	314.9	
Deferred capital funding	**965.6**	**-**	**965.6**	1,143.8	-	1,143.8	
Share capital	**9.3**	**-**	**9.3**	9.3	-	9.3	
Retained earning	**66.3**	**(166.3)**	**(100.0)**	86.5	(465.9)	(379.4)	
Shareholder's equity	**75.6**	**(166.3)**	**(90.7)**	95.8	(465.9)	(370.1)	
Total liabilities and shareholder's equity	**1,306.2**	**(159.1)**	**1,147.1**	1,431.5	(186.9)	1,244.6	

Reconciliation of the Statement of Operations and Comprehensive income for the year ended December 31, 2011:

(IN MILLIONS OF DOLLARS)	Dec. 31, 2011 IAS19	Adjustment	Dec. 31, 2011 IAS19R	Notes
Revenues	**282.6**	-	282.6	
Compensation and benefits	**252.6**	11.1	263.7	d
Other expenses	**322.1**	-	322.1	
Expenses	**574.7**	11.1	585.8	
Operating loss before funding from the Government of Canada and corporate taxes	**292.1**	11.1	303.2	
Operating funding from the Government of Canada	**260.9**	-	260.9	
Amortization of deferred capital funding	**46.5**	-	46.5	
Income before corporate taxes	**15.3**	(11.1)	4.2	
Corporate tax recovery	**4.9**	(0.4)	4.5	c
Net Income for the year	**20.2**	(11.5)	8.7	
Other comprehensive income (loss) net of tax effect				
Actuarial losses on defined benefit plans	**-**	(288.1)	(288.1)	
Total comprehensive income (loss) for the year	**20.2**	(299.6)	(279.4)	

The financial effects of applying the amended accounting standard IAS19 – *Employee Benefits (2011)* is summarized below:

a) The Defined benefit asset was reversed since the amended standard does not allow the corridor method for the amortization of actuarial gains or loss.

b) The Defined benefit liability was adjusted to reflect the actual plan deficits for employee benefit plans.

c) The impact on the deferred corporate tax liabilities results from the recognition in the OCI of the unamortized actuarial losses. Since there is no more Defined benefit asset, the deferred tax liabilities was reduced to nil.

d) Net impact of determining interest income by applying the discount rate used to measure the defined benefit obligation at the beginning of the year to the net defined benefit liability instead of determining interest income based on plan assets long-term rate of expected return.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by the Corporation are summarized as follows:

A) 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 (See Note 7 for reconciliation). The funding is determined on the basis of operating expenses less commercial revenues excluding unrealized gains and losses on financial instruments, employee benefits, non-cash transactions relating to property, plant and equipment, intangible assets and deferred corporate taxes, and is based on the operating budget approved by the Government of Canada for each year.

Funding for depreciable property, plant and equipment and intangible assets is recorded as deferred capital funding on the statement of financial position and is amortized from the acquisition date on the same basis and over the same periods as the related property, plant and equipment and intangible assets. Upon disposal of the funded depreciable property, plant and equipment and intangible assets, the Corporation recognizes into net income all remaining deferred capital funding related to the relevant assets.

Funding for non-depreciable property, plant and equipment is recorded as deferred capital funding on the statement of financial position and is amortized from the acquisition date on the same basis and over the same periods as the related property, plant and equipment.

B) CASH EQUIVALENTS

Cash equivalents investments include bankers' discount notes and bankers' acceptances which may be liquidated promptly and have short-term maturities.

C) ASSET RENEWAL FUND

Asset Renewal Fund investments include Provincial treasury bills and/or promissory notes and bankers' acceptances which may be liquidated promptly and have original maturities of three months or less. It also includes Master Asset Vehicle (MAV) notes which may not be liquidated in the near future and have legal maturities from 2013 to 2056. Changes in fair value are recorded in other revenues.

D) REVENUE RECOGNITION

The consideration received from the sale of tickets is allocated between the points attributed under the loyalty program (VIA Préférence) and the passenger transportation service based on their relative fair values. The deferred revenue related to the loyalty program points are recorded as revenue based on the number of points that have been redeemed in exchange for train tickets, relative to the total number of points that are expected to be redeemed in exchange for train tickets. The revenue is recorded as deferred revenue until the transportation has been provided or in the case of the points when these are redeemed for train tickets. Deferred revenue is also recorded as revenue when it is no longer considered probable that the related loyalty program points will be redeemed. Other revenues that include revenues from third parties and investment income are recorded as they are earned. The change in fair value of the financial instruments held for trading other than a derivative financial instrument is recorded in other revenues.

E) FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect at the end of the reporting period. Gains and losses resulting from the changes in exchange rates are reflected in the Statement of Operations and Comprehensive Income.

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

F) MATERIALS

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

G) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at the acquisition or manufacturing cost, less accumulated amortization and any accumulated impairment losses. When major components of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment and are amortized over their respective useful lives.

Maintenance and repair costs are recognized as follows:

i) Rolling stock:

Maintenance expenses incurred during the useful life of equipment (regular maintenance activities to maintain the asset in a good condition) are recorded as operating expenses.

The cost of periodic major overhaul programs are capitalized as a separate component and amortized over their useful lives.

ii) Fixed installations:

Maintenance and repair expenses (technical inspections, maintenance contracts, etc.) are recorded as operating expenses.

The costs of periodic major building repair programs are capitalised as a separate component and amortized over its expected useful life.

Retired property, plant and equipment are written down to their estimated recoverable amount.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT`D)

Amortization of property, plant and equipment is calculated on a straight-line basis, from the date they are available for use, at rates sufficient to amortize the cost of property, plant and equipment, less their residual value, over their estimated useful lives except for leasehold improvements related to the lease of buildings and stations where the amortization period is the shorter of the lease term or its estimated useful life. The estimated useful lives are as follows:

	Years
Rolling stock	**10 to 50**
Maintenance buildings	**15 to 50**
Stations and facilities	**10 to 50**
Owned infrastructure	**10 to 50**
Leasehold improvements	**10 to 40**
Machinery and equipment	**5 to 15**
Computer hardware	**3**
Other property, plant and equipment	**15**

The estimated useful life, amortization method and residual value are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. No amortization is provided for projects in progress and retired property, plant and equipment.

H) INTANGIBLE ASSETS

Intangible assets acquired separately are reported at cost less accumulated amortization and accumulated impairment losses. Amortization is charged on a straight-line basis over their estimated useful lives. The estimated useful life and amortization method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

For internally-generated intangible assets, the expenditure on research activities is recognized as an expense in the year in which it is incurred and the development expense from the development phase of an internal project is recognized if, and only if, all of the following have been demonstrated:

/ the technical feasibility of completing the intangible asset so that it will be available for use or sale;

/ the intention to complete the intangible asset and use or sell it;

/ the ability to use or sell the intangible asset;

/ how the intangible asset will generate probable future economic benefits;

/ the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

/ the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognized for internally-generated intangible assets is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria listed above. Where no internally-generated intangible asset can be recognized, development expenditure is charged to net income in the year in which it is incurred.

The Corporation's intangible assets have a finite useful life and are amortized over their useful life according to the straight-line method over the following years:

	Years
Internally generated software	**3**
Rights of access to rail infrastructure	**38**
Other Intangible assets	**20 to 25**

I) IMPAIRMENT

The Corporation reviews at each statement of financial position date whether there is any indication (obsolescence, physical deterioration, significant changes in the method of utilisation, performances falling short of forecasts, decline in revenues, other external indicators) of impairment of tangible and intangible assets. If such an indication exists, the asset value is adjusted accordingly.

J) PROVISIONS

Provisions including provisions for environmental issues, legal litigation, travel credit, ticket refunds and restructuring are recognized when the Corporation has a present obligation (legal or constructive) as a result of a past event, it is probable that the Corporation will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the statement of financial position date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

A restructuring provision is recognized when the Corporation has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures, mainly severance costs, arising from the restructuring, which are those amounts that are both necessarily entailed by the restructuring and not associated with the ongoing activities of the entity. Restructuring costs presented in the Statement of Operations and Comprehensive Income primarily consist of employee departure costs.

The environmental provision includes estimated costs to meet Government standards and regulations when such costs can be reasonably estimated. Estimates of the anticipated future costs for remediation work are based on the Corporation's prior experience.

K) CORPORATE TAXES

The Corporation utilizes the asset and liability method of accounting for corporate taxes under which deferred 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. Deferred corporate tax assets and liabilities are measured using enacted or substantively enacted tax rates that are expected to apply for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred corporate tax assets and liabilities of a change in tax rates is recognized in earnings in the year that includes the enactment date. Deferred corporate tax assets are recognized to the extent that realization is considered probable.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

L) 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.

M) EMPLOYEE BENEFITS

i) Post-employment benefits

The Corporation accrues obligations under its post-employment benefit plans.

Post-employment benefits include post-retirement medical, dental and life insurance benefits as well as defined benefit pension plans.

The Corporation's obligations for the defined benefit pension plans is actuarially determined using the projected unit credit method and management's best estimate of the amount of future benefits earned in return for their service in the current and prior years. The present value of the defined benefit obligations are calculated using discount rates determined by reference to market yields at the end of the reporting period on high quality Canadian corporate bonds that have terms to maturity approximating the terms of the related defined benefit obligation.

The Corporation determines the net interest expense on the net defined benefit liability for the year by applying the discount rate used to measure the defined obligation at the beginning of the year to the net defined benefit liability.

The current service costs, the net interest cost on the net defined benefit liability, the gains and losses on curtailment or settlement and plan amendments are recognized in net results in the year they are incurred.

Remeasurement arising from defined benefit plans comprised of changes in demographic assumptions, changes in financial assumptions, the return on plan assets excluding amounts included in net interest on the net defined benefit liability are recognized in other comprehensive income in the year they are incurred.

The Corporation's obligations for the post-employment benefit plans, other than pension plans, are calculated using the projected unit credit method. This method incorporates management's best estimate of cost escalation as well as demographic and other financial assumptions.

ii) Employment benefits other than post-employment benefits

The Corporation provides employment benefits other than post-employment benefits as follows:

- Compensation and short-term employee benefits include the annual salary, performance bonuses, paid vacations not included in the annual salary, short-term sick leave, health, dental and life insurance benefits. These benefits are measured on an undiscounted basis and are expensed as the related service is provided.

/ Long-term employee benefits include workers' compensation benefits as well as long-term disability benefits and continuation of benefit coverage for employees on long-term disability. The actuarial obligation for workers' compensation benefits is calculated on an event driven basis. The method involves dividing the obligation into two distinct components: awarded pensions and future awards. The actuarial obligation for awarded pensions is the actuarial present value of all future projected payments for the award determined as at the valuation date. The actuarial obligation for future awards is the discounted value of expected cash flow for awards yet to be made. The Corporation is self-insured for its workers' compensation benefits. The actuarial obligation for other long-term disability benefits and continuation of benefit coverage for employees on long-term disability is determined using the projected unit credit method. This method incorporates management's best estimate of cost escalation as well as demographic and other financial assumptions. Any actuarial gains and losses and other changes in the Corporation's obligations are recognized in net income in the year in which they arise.

/ Termination benefits include benefits that are payable when an employment contract is terminated before the normal retirement date. They are recognized as a liability and expense for termination benefits at the earlier of the following dates:

a) when the entity can no longer withdraw the offer of those benefits; and

b) when the entity recognizes costs for a restructuring (provision) and involves the payment of termination benefits.

/ Network restructuring obligations include job security benefits administered by various union agreements. These benefits are calculated on an event driven basis and represents managements best estimates of the present value of all future projected payments to unionized employees.

N) FINANCIAL INSTRUMENTS

Financial assets and financial liabilities, including derivative financial instruments, are initially measured at fair value at the date they are originated. Subsequent to initial recognition, financial assets and financial liabilities are measured based on their classification: fair value through profit and loss, loans and receivables, available for sale or other financial liabilities. The Corporation derecognized a financial asset or liability when the contractual rights or obligation to the cash flows from the asset or liability expires.

i) Financial assets and liabilities at fair value through profit and loss (FVTPL)

Financial instruments are classified as FVTPL when they are principally acquired or incurred for the purpose of selling and repurchasing in the short-term, part of a portfolio of identified financial instruments that are managed together and for which there is evidence of short-term profit taking or derivatives not designated for hedge accounting. A financial instrument is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition.

The Corporation has classified cash and derivative financial instruments as FVTPL. Instruments in MAV notes that include embedded derivatives have been designated as FVTPL.

Financial assets and financial liabilities recorded at FVTPL are measured at fair value with changes in those fair values recognized in net income. Transaction costs are expensed as incurred. Regular-way purchases or sales of financial assets are accounted for at settlement-date.

ii) Loans and receivables (L&R)

The L&R classification includes trade receivables and other receivables that have fixed or determinable payments that are not quoted in an active market. Assets are measured initially at fair value and then at amortized cost, using the effective interest rate method, less any impairment. The fair values of loans and receivables are estimated on the basis of the present value of the expected cash flows. 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.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

iii) Available-for-sale (AFS)

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the statement of financial position date. Short term investments and investments in the Asset Renewal Fund not designated as FVTPL have been classified as available for sale. AFS financial assets are recognized at fair value in subsequent years. Fluctuations in fair value between statement of financial position dates are recognized in other comprehensive income.

iv) Other financial liabilities

Other financial liabilities represent liabilities that are not classified as FVTPL. They are initially measured at fair value, net of transaction costs and subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis. Where the time value of money is not material due to their short-term nature, they are carried at the original invoice amount.

v) Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the assets have been affected.

An impairment loss is recognized in net income and calculated as the difference between its carrying amount and the present value of the estimated future cash flows.

When a subsequent event such as a change in the estimates used to determine the recoverable amount, causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through net income.

However, any subsequent recovery in the fair value of an impaired available-for-sale investment is recognized in other comprehensive income.

O) 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 U.S. dollar of at least 50 per cent and up to 80 per cent of its consumption of fuel. 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 U.S dollar related to the purchase of materials from the U.S. as part of a major capital project to refurbish some of its locomotive fleet.

The Corporation's derivative financial instruments are classified as FVTPL. Changes in the fair value of derivative financial instruments are recorded in unrealized loss (gain) on derivative financial instruments.

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 derivative financial instruments liabilities.

P) NON-MONETARY TRANSACTIONS

Non-monetary transactions are recorded at the estimated fair value of the goods or services received. When the fair value of the goods and services received cannot be measured reliably, the transactions are recorded at the estimated fair value of the goods or services given. Revenues from non-monetary transactions are recognized when the related services are rendered. Expenses resulting from non-monetary transactions are recognized during the year when goods or services are provided by third parties.

5. SIGNIFICANT ACCOUNTING ESTIMATES AND ASSUMPTIONS

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future years. These estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

A) USEFUL LIVES OF DEPRECIABLE ASSETS

Management reviews the useful lives of depreciable assets annually. As at December 31, 2012 management assesses that the useful lives represent the expected utility of the assets to the Corporation.

B) *VIA PRÉFÉRENCE* PROGRAM

The *"Via Préférence"* program allows members to acquire "award points" as they travel on the train. These award points entitle members to free travel on our trains. In determining the fair value of the award points, the Corporation takes into consideration the probability of the awards being converted into tickets. The estimated probabilities are based on historical information on point redemption and may not reflect the actual redemption rate in the future. As such, the amount allocated between the transportation service and the award points may have been significantly different if different probability estimates had been used.

C) DEFINED BENEFIT LIABILITY

Measurement of pension obligation is based on the projected unit credit method prescribed by IAS 19R for defined benefit pension plans. The measurement of pension provisions within the statement of financial position is based on a number of assumptions.

They include, in particular, assumptions about long-term salary and average life expectancy. The assumptions on salary reflect expected long-term growth in earnings whereas assumptions on average life expectancy are based on recognized mortality tables.

The interest rate used for discounting future payment obligations is the market rate for high quality corporate bonds with a comparable time to maturity.

D) CORPORATE TAXES

Management uses judgment and estimates in determining the appropriate rates and amounts in recording deferred income taxes, giving consideration to timing and probability of realization. Actual taxes could significantly vary from these estimates as a result of a variety of factors including future events, changes in income tax law or the outcome of reviews by tax authorities and related appeals. The resolution of these uncertainties and the associated final taxes may result in adjustments to the Corporation's deferred and current tax assets and liabilities.

6. FUTURE ACCOUNTING CHANGES

IFRS 9 - *Financial Instruments* - deals with classification and measurement standards for financial assets and liabilities. This standard is applicable for annual periods beginning on or after January 1, 2015.

IFRS 13 - *Fair Value Measurement* - defines fair value, sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies to IFRS that require or permit fair value measurements or disclosures about fair value measurement. This standard will become effective for annual periods beginning on or after January 1, 2013.

The Corporation is in the process of evaluating the impact of each of these new or modified standards.

7. RECONCILIATION OF NET INCOME AND COMPREHENSIVE INCOME TO GOVERNMENT FUNDING BASIS

The Corporation receives its funding from the Government of Canada based primarily on cash flow requirements. Items recognized in the Statement of Operations and Comprehensive Income in one year may be funded by the Government of Canada in different years. Accordingly, the Corporation has different net results of operations for the year on a government funding basis than on a IFRS basis. These differences are outlined below:

(IN MILLIONS OF DOLLARS)	2012	2011
		Restated
Total comprehensive income (loss) for the year	**(74.8)**	(279.4)
Items not requiring (not providing) operating funds:		
Amortization of property, plant and equipment and intangible assets	**58.9**	48.3
Losses on write-down and disposal of property, plant and equipment and intangible assets	**23.8**	1.7
Amortization of deferred capital funding	**(82.0)**	(46.5)
Employee benefits to be funded in subsequent years	**74.0**	273.7
Adjustment of prior year tax provision	**-**	(1.4)
Unrealized net loss (gain) on derivative financial instruments	**1.4**	2.4
Adjustment for accrued compensation	**(0.7)**	1.6
Increase in investment's fair value	**(1.1)**	(0.4)
Other	**0.5**	-
Operating funding surplus (deficit) for the year	**-**	-

8. MATERIALS

The cost of its materials recorded as an expense during the year amounted to $25.8 million (December 2011: $29.0 million). The Corporation has no significant expense related to write-down of the value of its materials for 2012 and 2011.

9. PROPERTY, PLANT AND EQUIPMENT

(IN MILLIONS OF DOLLARS)	January 1, 2012	Additions	Retirement and Disposals	December 31, 2012
Cost:				
Land	**9.6**	2.7	-	**12.3**
Rolling stock	**823.4**	67.5	(41.8)	**849.1**
Maintenance buildings	**138.4**	(0.2)	(0.4)	**137.8**
Stations and facilities	**64.2**	40.4	(1.8)	**102.8**
Owned infrastructures	**164.6**	14.3	(2.1)	**176.8**
Leasehold improvements	**73.6**	8.0	(4.3)	**77.3**
Machinery and equipment	**36.2**	0.8	(3.1)	**33.9**
Computer hardware	**12.7**	6.6	(0.2)	**19.1**
Other property, plant and equipment	**22.5**	(0.3)	(1.3)	**20.9**
Total cost	**1,345.2**	139.8	(55.0)	**1,430.0**
Accumulated amortization and impairments:				
Rolling stock	**386.5**	28.3	(20.2)	**394.6**
Maintenance buildings	**83.6**	3.6	(0.3)	**86.9**
Stations and facilities	**29.5**	3.1	(1.7)	**30.9**
Owned infrastructures	**51.4**	4.9	(2.1)	**54.2**
Leasehold improvements	**49.2**	2.6	(4.1)	**47.7**
Machinery and equipment	**27.1**	1.3	(3.0)	**25.4**
Computer hardware	**9.8**	2.5	-	**12.3**
Other property, plant and equipment	**19.6**	0.3	(1.4)	**18.5**
Total accumulated amortization and impairments	**656.7**	46.6	(32.8)	**670.5**
Project in progress	**126.3**	(45.5)	-	**80.8**
Retired assets	**0.1**	-	(0.1)	**-**
Total net carrying amount	**814.9**	47.7	(22.3)	**840.3**

9. PROPERTY, PLANT AND EQUIPMENT (CONT'D)

(IN MILLIONS OF DOLLARS)	January 1, 2011	Additions	Retirement and Disposals	December 31, 2011
Cost:				
Land	**8.5**	1.2	(0.1)	**9.6**
Rolling stock	**803.6**	43.3	(23.5)	**823.4**
Maintenance buildings	**134.4**	4.0	-	**138.4**
Stations and facilities	**55.9**	8.3	-	**64.2**
Owned infrastructures	**133.2**	31.4	-	**164.6**
Leasehold improvements	**71.5**	2.1	-	**73.6**
Machinery and equipment	**35.9**	0.3	-	**36.2**
Computer hardware	**11.1**	1.6	-	**12.7**
Other property, plant and equipment	**22.2**	0.3	-	**22.5**
Total cost	**1,276.3**	92.5	(23.6)	**1,345.2**
Accumulated amortization and impairments:				
Rolling stock	**382.9**	26.1	(22.5)	**386.5**
Maintenance buildings	**79.7**	3.9	-	**83.6**
Stations and facilities	**27.3**	2.2	-	**29.5**
Owned Infrastructures	**47.6**	3.8	-	**51.4**
Leasehold improvements	**46.5**	2.7	-	**49.2**
Machinery and equipment	**25.8**	1.3	-	**27.1**
Computer hardware	**8.5**	1.3	-	**9.8**
Other property, plant and equipment	**19.2**	0.4	-	**19.6**
Total accumulated amortization and impairments	**637.5**	41.7	(22.5)	**656.7**
Projects in progress	**91.0**	35.3	-	**126.3**
Retired asset	**0.1**	-	-	**0.1**
Total net carrying amount	**729.9**	86.1	(1.1)	**814.9**

Projects in progress primarily consist of rolling stock, improvements to infrastructure and stations. The projects in progress amount includes $19.3 million (December 31, 2011: $21.1 million) of materials used in the refurbishing of rail cars.

The amortization expense of property, plant and equipment was $46.6 million for the year (December 31, 2011: $41.7 million).

In April 2012, one of the Corporation's suppliers was placed in receivership by the Province of New-Brunswick. On October 1, 2012 the Court of Queen's Bench of New Brunswick issued an order that was favorable to the Corporation and settles all outstanding matters with respect to the completion of the remaining railcars in Moncton, New Brunswick as well as all on-going litigations related to the railcar refurbishment contracts. The Corporation has negotiated a Management Agreement with the Receiver appointed by the Court as well as a third party to oversee the completion of these railcars. The Corporation has recorded an asset depreciation of $18.3 million in the Statement of Operation and Comprehensive income in the Amortization and losses on write-down and disposal of property, plant and equipment and intangible assets line item. This amount consisted of capital expenditures incurred that have no future benefits for the Corporation.

The Corporation has also drawn the letters of credit that were taken in relation to these contracts and has recognized a credit of $10.5 million in the Amortization and losses on write-down and disposal of property, plant and equipment and intangible assets in the Statement of Operation and Comprehensive income. The net financial impact of this event is an expense of $7.8 million for the year 2012.

The Losses on write down of property, plant and equipment and intangible assets of $23.8 million in 2012 (December 31, 2011: $1.7 million) is primarily composed of the above $18.3 million.

10. INTANGIBLE ASSETS

(IN MILLIONS OF DOLLARS)	January 1, 2012	Additions	Retirement and Disposals	December 31, 2012
Cost:				
Internally generated software	**54.3**	14.3	(1.8)	**66.8**
Right of access to rail infrastructure	**173.4**	238.3	(2.3)	**409.4**
Other intangible	**3.5**	0.3	-	**3.8**
Total cost	**231.2**	252.9	(4.1)	**480.0**
Accumulated amortization and impairments:				
Internally generated software	**46.9**	6.4	(1.1)	**52.2**
Right of access to rail infrastructure	**43.9**	5.7	(0.3)	**49.3**
Other intangible	**1.5**	0.1	-	**1.6**
Total accumulated amortization and impairments	**92.3**	12.2	(1.4)	**103.1**
Project in progress	**198.3**	(176.8)	-	**21.5**
Total net carrying amount	**337.2**	63.9	(2.7)	**398.4**

(IN MILLIONS OF DOLLARS)	January 1, 2011	Additions	Retirement and Disposals	December 31, 2011
Cost:				
Internally generated software	**51.2**	3.9	(0.8)	**54.3**
Right of access to rail infrastructure	**75.5**	97.9	-	**173.4**
Other intangible	**3.5**	-	-	**3.5**
Total cost	**130.2**	101.8	(0.8)	**231.2**
Accumulated amortization and impairments:				
Internally generated software	**43.3**	3.6	-	**46.9**
Right of access to rail infrastructure	**41.7**	2.2	-	**43.9**
Other intangible	**0.7**	0.8	-	**1.5**
Total accumulated amortization and impairments	**85.7**	6.6	-	**92.3**
Project in progress	**190.8**	7.5	-	**198.3**
Total net carrying amount	**235.3**	102.7	(0.8)	**337.2**

The amortization expense of intangible assets for the year was $12.2 million (December 31, 2011: $6.6 million).

11. ASSET RENEWAL FUND

A) ASSET RENEWAL FUND

The Corporation has been authorized by the Treasury Board of Canada Secretariat to set aside funds 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 investments in the Asset Renewal Fund include the following:

(IN MILLIONS OF DOLLARS)	2012 Carrying Value and Fair Value	2011 Carrying Value and Fair Value
Bankers' acceptances	**7.8**	21.9
Provincial Treasury bills and /or promissory notes	**2.2**	7.0
Master Asset Vehicle (MAV) notes	**5.7**	5.0
Balance at end of year	**15.7**	33.9
Less: Current portion	**13.2**	24.0
Non-current portion	**2.5**	9.9

The Treasury Board of Canada Secretariat has authorized the Corporation to use up to $13.2 million (December 31, 2011: $24.0 million) of the Asset Renewal Fund to meet future working capital requirements. This amount is presented in the current portion of the Asset Renewal Fund.

The weighted average effective rate of return on short-term investments excluding MAV notes as at December 31, 2012 was 1.13 per cent (December 31, 2011: 1.11 per cent). The weighted average term to maturity excluding MAV notes as at December 31, 2012 is three months (December 31, 2011: three months).

The fair value of short-term investments is based on the current bid price at the statement of financial position date, except for the MAV notes as described in Note 11 c).

Apart from the MAV notes, the Asset Renewal Fund is invested in 13 short-term instruments (December 31, 2011: 26) that have a rating of "R-1 low" or higher. Diversification in the short-term instruments is achieved by limiting to 10 per cent or less the percentage of the market value of the Asset Renewal Fund assets invested in instruments of a single issuer.

The Corporation is subject to credit risk from its holdings in the Asset Renewal Fund. The Corporation minimizes its credit risk by adhering to the *Minister of Finance of Canada Financial Risk Management Guidelines for Crown Corporations* and to the Corporation's Asset Renewal Fund Investment Policy, which requires that funds be invested in high quality financial instruments.

B) CHANGES IN THE ASSET RENEWAL FUND

The changes in the closing balance of the Asset Renewal Fund resulted from the following movements during the year:

(IN MILLIONS OF DOLLARS)	2012	2011
Balance at beginning of the year	**33.9**	40.9
Proceeds from sale or lease of surplus assets	**1.2**	0.5
Investment Income	**0.4**	0.4
Change in fair value	**1.0**	0.4
Less: Cash drawdown during the year (NOTE 1)	**(20.8)**	(8.3)
Balance at end of the year	**15.7**	33.9

Note 1 – Authorized cash drawdowns were used to fund capital projects and previous years operating deficits.

C) MASTER ASSET VEHICLE (MAV) NOTES

On January 12, 2009, the Ontario Superior Court issued the final implementation order in the Asset Backed Commercial Paper (ABCP) restructuring process. The restructuring closed on January 21, 2009. On this date, the Corporation received $8.6 million in face value of restructured long-term amortizing floating rate notes in exchange for $8.7 million face value of original ABCP held previously that had been illiquid since the market disruptions of August 2007.

The new notes, now referred to as Master Asset Vehicle (MAV) notes, have legal maturities ranging from 2013 to 2056 and have remained somewhat illiquid since issued. In the absence of a truly liquid secondary market, management has developed a discounted cash flow valuation model to estimate the fair value of the MAV notes. The valuation model incorporates assumptions for interest rates, required market yields and effective maturities, some of which are derived from observable market indicators. In 2012, $0.4 million of capital was received ($1.5 million since the restructuring) and, since restructuring, a $0.3 million notional loss was recognized, leaving an outstanding face value as at December 31, 2012 of $6.8 million (December 31, 2011: $7.2 million). The estimated fair value of the outstanding notes is $5.7 million as at December 31, 2012 (December 31, 2011: $5.1 million) representing 84 per cent of their face value.

12. TRADE AND OTHER PAYABLES

The Accounts payable and accrued liabilities balance includes the following:

(IN MILLIONS OF DOLLARS)	2012	2011
Wages payable and accrued	**34.6**	39.6
Capital Payables	**33.2**	26.6
Trade payables	**27.1**	29.5
Capital tax, income tax and other taxes payable	**7.4**	7.0
Other	**0.7**	1.1
	103.0	103.8

13. PROVISIONS

The provision balance includes:

(IN MILLIONS OF DOLLARS)	January 1, 2012	Charge (used)	Reversal (used)	Reversal (not used)	Other movements	December 31, 2012
Environmental costs (NOTE A)	**0.2**	1.1	-	(0.2)	-	**1.1**
Litigation and contractual disputes (NOTE B)	**14.5**	5.6	(5.3)	(5.3)	-	**9.5**
Restructuring costs (NOTE C)	**3.0**	-	(1.2)	(0.7)	-	**1.1**
Other	**0.4**	0.4	-	-	-	**0.8**
Total provisions	**18.1**	7.1	(6.5)	(6.2)	-	**12.5**

(IN MILLIONS OF DOLLARS)	January 1, 2011	Charge (used)	Reversal (used)	Reversal (not used)	Other movements	December 31, 2011
Environmental costs (NOTE A)	**0.8**	-	(0.6)	-	-	**0.2**
Litigation and contractual disputes (NOTE B)	**15.2**	-	(0.7)	-	-	**14.5**
Restructuring costs (NOTE C)	**-**	3.0	-	-	-	**3.0**
Other	**0.3**	0.1	-	-	-	**0.4**
Total provisions	**16.3**	3.1	(1.3)	-	-	**18.1**

A) ENVIRONMENTAL COSTS

The Corporation has made a provision of $1.1 million for environmental costs related to fuel spills that occurred during the year (December 31, 2011: $0.2 million), which is recorded in Provisions.

B) LITIGATION AND CONTRACTUAL DISPUTES

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 is not expected to have a material adverse effect on the financial position of the Corporation.

C) RESTRUCTURING COSTS

The Corporation has announced some cost saving measures by implementing a new regionally-based organizational structure. These changes were announced in December 2011 and will be completed in 2013.

14. EMPLOYEE BENEFITS

The Corporation provides a number of funded defined benefit pension plans as well as unfunded other post-employment benefits including post-retirement medical, dental and life insurance benefits. The Corporation also provides long-term employee benefits such as an unfunded self-insured workers' compensation benefits, long-term employee disability benefits and continuation of benefit coverage for employees on long-term disability. The actuarial valuations for employee benefits are carried out by external actuaries who are members of the Canadian Institute of Actuaries.

Defined Benefit Pension Plans

The Corporation Pension Plans are governed according to applicable federal legislation such as the *Pension Benefits Standards Act* and the *Income Tax Act*. The Pension Plans are under the jurisdiction of the Office of the Superintendent of Financial Institutions Canada. Participants contribute a fixed percentage of their earnings to the Pension Plan while the sponsor contributes the amount needed to maintain adequate funding as dictated by the prevailing regulation. The Pension Plans may be required to take measures to offset any funding and solvency deficit by changing the Corporation's and participants' contribution rate. Moreover, additional contributions by the Corporation may be required if these rules are not complied with.

The defined benefit pension plans are based on years of service and final average salary of the employee's best five consecutive calendar years up to retirement.

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 actuarial valuations of the various employee benefit plans are as follows:

	Actuarial Valuation	
EMPLOYEE BENEFIT PLANS	Latest valuation	Next valuation
Pension Plans	December 31, 2011	**December 31, 2012**
Supplemental Executive Retirement Plan	December 31, 2012	**December 31, 2013**
Supplemental Retirement Plan for management employees (SRP), with respect to active members	December 31, 2011	**December 31, 2012**
Supplemental Retirement Plan for management employees (SRP), with respect to retired members	December 31, 2012	**December 31, 2013**
Post-employment unfunded plan	May 1, 2010	**May 1, 2013**
Self-insured Workers' Compensation	December 31, 2009	**December 31, 2012**
Other long-term employee benefits	December 31, 2012	**December 31, 2013**

14. EMPLOYEE BENEFITS (CONT'D)

A) PENSION PLANS AND POST-EMPLOYMENT BENEFITS PLANS

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 2012	Pension Plans 2011	Post-employment Benefit Plans 2012	Post-employment Benefit Plans 2011
DEFINED BENEFIT OBLIGATION:				
Balance at beginning of the year	**1,860.6**	1,593.5	**16.9**	13.6
Service cost	**23.4**	24.7	**0.4**	0.4
Interest expense	**84.1**	87.2	**0.8**	0.8
Plan amendment	**-**	-	**-**	0.7
Employee contributions	**10.1**	10.1	**-**	-
Benefits paid	**(97.0)**	(92.8)	**(0.5)**	(0.6)
Effect of change in demographic assumptions	**-**	21.5	**-**	(0.1)
Effect of change in financial assumptions	**170.4**	209.0	**1.6**	2.3
Effect of employee transfers	**26.4**	-	**-**	-
Effect of experience adjustments	**-**	7.4	**(0.1)**	(0.2)
Balance at end of the year	**2,078.0**	1,860.6	**19.1**	16.9
FAIR VALUE OF PLAN ASSETS:				
Balance at beginning of the year	**1,586.1**	1,588.2	**-**	-
Interest Income	**70.6**	86.3	**-**	-
Return on plan assets (excluding interest income)	**70.7**	(48.2)	**-**	-
Employer contributions	**70.2**	44.1	**0.5**	0.6
Employee contributions	**10.1**	10.1	**-**	-
Benefits paid	**(97.0)**	(92.8)	**(0.5)**	(0.6)
Effect of employee transfers	**26.4**	-	**-**	-
Administration expenses	**(2.1)**	(1.6)	**-**	-
Balance at end of the year	**1,735.0**	1,586.1	**-**	-
Net Defined benefit liability	**(343.0)**	(274.5)	**(19.1)**	(16.9)

The percentages of the fair value of the total pension plan assets by major category are as follows:

ASSET CATEGORIES	2012 Active Market	2012 Non Active Market	2011 Active Market	2011 Non Active Market
Cash and short-term notes	**2.2%**	-	**1.8%**	-
Equity securities (public market)	**51.3%**	-	**48.8%**	-
Fixed income securities (public market)	**40.0%**	-	**42.8%**	-
Derivative financial instruments	**-**	6.5%	**0.3%**	6.3%
	93.5%	6.5%	**93.7%**	6.3%

Expected employer contribution for the next year:

(IN MILLIONS OF DOLLARS)	Pension Plans 2013	Post-employment Benefit Plans 2013
Expected employer contribution for the next year:	**67.0**	**0.6**

	Pension Plans		Post-employment Benefit Plans	
	2012	2011	2012	2011
WEIGHTED-AVERAGE OF SIGNIFICANT FINANCIAL ASSUMPTIONS:				
Defined benefit obligation:				
Discount rate	**3.90%**	4.50%	**4.00%**	4.50%
Rate of salary increase	**3.00% - 3.25%**	3.00% - 3.25%	**3.25%**	3.25%
Initial weighted average health care trend rate	**-**	-	**7.01%**	7.31%
Ultimate weighted average health care trend rate	**-**	-	**4.32%**	4.33%
Year ultimate rate reached	**-**	-	**2025**	2025
Rate of price inflation	**2.25%**	2.25%	**-**	-
Rate of pension increase	**1.13%**	1.13%	**-**	-
Defined benefit cost:				
Discount rate	**4.50%**	5.50%	**4.50%**	5.50%
Rate of price inflation	**2.25%**	2.50%	**-**	-
Rate of salary increase	**3.00% - 3.25%**	3.00%	**3.25%***	3.00%*
Rate of pension increase	**1.13%**	1.13%	**-**	-
Initial weighted average health care trend rate	**-**	-	**7.31%**	7.47%
Ultimate weighted average health care trend rate	**-**	-	**4.33%**	4.50%
Year ultimate rate reached	**-**	-	**2025**	2025
SIGNIFICANT DEMOGRAPHIC ASSUMPTIONS:				
Defined benefit cost:				
Post retirement mortality tables	**UP94 generational scale AA**	UP94 generational scale AA	**UP94 generational**	UP94 generational

*Applicable to executive employees only.

Sensitivity analysis

Future pension funding requirements and fluctuation from current levels are subject to significant risks. Regulatory amendments, discount rates levels, registered or anticipated investment returns and changing plan demographics are all factors that could individually or collectively influence materially funding requirements. Past service cost is the main component of funding requirement particularly subject to large variances, while current service is less material and typically less volatile from one year to the next.

The Corporation has reviewed the assumptions used in the actuarial calculations and has identified the following assumptions as those that could result in a significant impact on the defined benefit obligation:

Assumed inflation rates have a significant effect on the amounts reported for the pension plans. A change of 25 basis points in assumed inflation rates would have an impact of $38.5 million on the Defined benefit obligation at year end.

14. EMPLOYEE BENEFITS (CONT'D)

Assumed discount rates have a significant effect on the amounts reported for the pension plans. A change in assumed discount rates of 25 basis points would have an impact of $74.3 million on the Defined benefit obligation at year end.

Assumed discount rates have a significant effect on the amounts reported for the Post-employment benefit plans. A change in assumed discount rates of 25 basis points would have an impact of $0.7 million on the Post-employment benefit plan obligations at year end.

Assumed salary increase rates have a significant effect on the amounts reported for the pension plans. A change of 25 basis points in assumed salary increase rates would have an impact of $9.0 million on the Defined benefit obligation at year end.

Assumed mortality tables have a significant effect on the amounts reported for the pension plans. If each plan members was one year younger it would have an impact of $57.3 million on the Defined benefit obligation at year end.

B) LONG-TERM EMPLOYEE BENEFIT PLANS

Based on these actuarial valuations and projections to December 31, the summary of the principal valuation results for the self-insured workers' compensation benefits and other long-term employee benefits is as follows:

(IN MILLIONS OF DOLLARS)	2012	2011
DEFINED BENEFIT OBLIGATION:		
Balance at beginning of the year	**22.2**	20.9
Service cost	**5.3**	5.0
Interest expense	**0.9**	1.0
Plan amendment	**-**	-
Employee contributions	**-**	-
Benefits paid	**(6.2)**	(6.6)
Effect of change in demographic assumptions	**(0.6)**	-
Effect of change in financial assumptions	**0.4**	1.3
Effect of experience adjustments	**-**	0.6
Balance at end of the year	**22.0**	22.2
FAIR VALUE OF PLAN ASSETS:		
Balance at beginning of the year	**-**	-
Interest Income	**-**	-
Return on plan assets	**-**	-
Employer contributions	**6.2**	6.6
Employee contributions	**-**	-
Benefits paid	**(6.2)**	(6.6)
Administration expenses	**-**	-
Balance at end of the year	**-**	-
Net Defined benefit liability	**(22.0)**	(22.2)

Expected employer contribution for the next year:

(IN MILLIONS OF DOLLARS)	2013
Expected employer contribution for the next year	**6.2**

Weighted-average of significant assumptions:

(IN MILLIONS OF DOLLARS)	2012	2011
DEFINED BENEFIT OBLIGATION:		
Discount rate	**3.20%**	3.75%
Rate of salary increase	**3.00% - 3.25%**	3.00% - 3.25%
Initial weighted average health care trend rate	**5.85%**	5.95%
Ultimate weighted average health care trend rate	**3.93%**	3.93%
Rate of price inflation	**2.25%**	2.25%
DEFINED BENEFIT COST:		
Discount rate	**3.75%**	4.75%
Rate of salary increase	**3.00% - 3.25%**	3.00%
Initial weighted average health care trend rate	**5.95%**	6.04%
Ultimate weighted average health care trend rate	**3.93%**	3.93%
Rate of price inflation	**2.25%**	2.50%
Post-retirement mortality tables	**WC 1996-2000 mortality table projected to 2009 for workers' compensation and 2009 CIA study for Other employment benefits**	WC 1996-2000 mortality table projected to 2009 for workers' compensation and 2009 CIA study for Other employment benefits

Sensitivity analysis

The Corporation has reviewed the assumptions used in the actuarial calculations and has identified the following assumptions as those that could result in a significant impact on the defined benefit obligation:

Assumed discount rate have a significant effect on the amounts reported for long term employee benefit plans. A change of 25 basis points in assumed discount rate would have an impact on the long term employee benefits obligagtion of $0.3 million at year end.

C) OTHER LONG-TERM BENEFIT PLANS

Other long-term employee benefit obligation for the maintenance of earnings is as follows:

(IN MILLIONS OF DOLLARS)	2012	2011
Network restructuring obligation	**(4.2)**	(0.7)

14. EMPLOYEE BENEFITS (CONT'D)

D) SUMMARY OF PENSIONS PLANS, POST-EMPLOYMENT BENEFIT PLANS AND LONG-TERM EMPLOYEE BENEFIT PLANS RECOGNIZED IN THE FINANCIAL STATEMENTS

Total amounts recognized in the Statement of financial position:

(IN MILLIONS OF DOLLARS)	2012	2011
Liabilities:		
Pension Plans	**(343.0)**	(274.5)
Post-employment benefit plans	**(19.1)**	(16.9)
Long-term employee benefit plans	**(22.0)**	(22.2)
Network Restructuring obligation	**(4.2)**	(0.7)
Total	**(388.3)**	(314.3)

Total amounts recognized in the Statement of Operations and Comprehensive income:

(IN MILLIONS OF DOLLARS)	2012	2011
Operating expense:		
Pension Plans	**39.0**	27.2
Post-employment benefit plans	**1.2**	1.9
Long-term employee benefit plans	**6.0**	7.9
Network Restructuring obligation	**3.5**	(0.1)
Total	**49.7**	36.9

These operating expenses are included in the Compensation and benefits line item of the Statement of Operations and Comprehensive income.

(IN MILLIONS OF DOLLARS)	2012	2011
Other comprehensive income (loss):		
Pension Plans	**(99.7)**	(286.1)
Post-employment benefit plans	**(1.5)**	(2.0)
Total	**(101.2)**	(288.1)

15. CORPORATE TAXES

The corporate tax (recovery) expense of the Corporation consists of the following:

(IN MILLIONS OF DOLLARS)	2012	2011
Current corporate tax (recovery) expense	**-**	(4.4)
Deferred corporate tax (recovery) expense	**-**	-
Current corporate tax recovery	**-**	(4.4)

The overall corporate tax recovery for the year differs from the amount that would be computed by applying the combined Federal and provincial statutory income tax rates of 24.37% (December 2011: 26.19%) to income before corporate taxes. The reasons for the differences are as follows;

(IN MILLIONS OF DOLLARS)	2012	2011
Income before corporate taxes	**26.4**	4.2
Computed corporate tax recovery - statutory rates	**6.4**	1.1
Large corporation tax and corporate minimum tax	**-**	(4.4)
Non-taxable portion of capital and accounting gains and other	**(0.4)**	0.5
Effect on reversal of unused tax credits	**-**	1.8
Effect of (decrease)/increase in unrecognized tax attributes	**(2.8)**	(3.6)
Effect of tax rate changes on deferred corporate taxes	**(3.2)**	0.2
Corporate tax recovery	**-**	(4.4)

The combined applicable statutory rate has decreased by approximately 1.8% resulting mainly from the reduction in the federal statutory rate.

Deferred corporate tax reflects 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 deferred corporate tax assets and (liabilities) of the Corporation are as follows:

DEFERRED TAX BALANCES – DECEMBER 31, 2012

(IN MILLIONS OF DOLLARS)	Opening Balance	Recognized in net income	Closing Balance
Deferred corporate tax assets (liabilities):			
Unrealized loss on derivative financial instruments	**(0.3)**	0.3	**-**
Loss carry-forward	**0.3**	(0.3)	**-**
Deferred corporate tax assets (liabilities)	**-**	-	**-**

15. CORPORATE TAXES (CONT'D)

DEFERRED TAX BALANCES – DECEMBER 31, 2011

(IN MILLIONS OF DOLLARS)	Opening Balance	Recognized in net income	Closing Balance
Deferred corporate tax assets (liabilities):			
Unrealized loss on derivative financial instruments	**(0.9)**	0.6	**(0.3)**
Loss carry-forward	**0.9**	(0.6)	**0.3**
Deferred corporate tax assets (liabilities)	**-**	-	**-**

The Corporation has $55.9 million (December 31, 2011: $50.3 million) of unused Quebec and $53.5 million (December 31, 2011: $48.2 million) of unused Federal non-capital tax losses carried forward and expiring between 2029 and 2032.

Unrecognized deductible temporary differences and unused tax losses for which no deferred tax assets have been recognized are attributed to the following:

(IN MILLIONS OF DOLLARS)	2012	2011
Federal:		
Government assistance	**-**	7.0
Property, plant and equipment	**81.4**	80.5
Contingencies, other liabilities and net amounts	**21.0**	19.8
Defined benefit liability	**384.2**	313.7
Unused losses carry forward	**53.5**	46.7
	540.1	467.7
Quebec:		
Government assistance	**-**	7.0
Property, plant and equipment	**463.0**	462.1
Contingencies, other liabilities and net amounts	**21.0**	19.8
Defined benefit liability	**384.2**	313.7
Unused losses carry forward	**55.9**	49.2
	924.1	851.8

16. DEFERRED CAPITAL FUNDING

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

(IN MILLIONS OF DOLLARS)	2012	2011
Balance, beginning of the year	**1,143.8**	965.6
Government funding for property, plant and equipment and intangible assets (including the cost of land)	**167.2**	224.7
Amortization of deferred capital funding	**(82.0)**	(46.5)
Balance, end of the year	**1,229.0**	1,143.8

17. DEFERRED REVENUE

Deferred revenue is comprised of the following:

(IN MILLIONS OF DOLLARS)	2012	2011
Advanced ticket sales	**9.4**	9.3
Gift cards	**2.5**	2.4
Non-monetary transactions	**1.6**	1.7
VIA Préférence	**13.6**	13.2
Other	**0.3**	0.1
Total deferred revenue	**27.4**	26.7

18. CAPITAL

The authorized share capital of the Corporation is comprised of an unlimited number of common shares with no par value. For all years presented, 93,000 shares at $100 per share are issued and fully paid.

The Corporation defines its capital as share capital and retained earnings and is regulated by the *Financial Administration Act*. The Corporation is not allowed to modify its capital structure without Government approval. The Corporation must obtain Government approval to issue debt instruments. Accordingly, the Corporation does not have access to external financing and does not have a flexible capital structure.

The Corporation manages its equity by prudently managing revenues, expenses, assets, liabilities, investments and general financial dealings to ensure that the Corporation effectively achieves its objectives and purpose while remaining a going concern. The Corporation did not change the way it manages its equity compared to last year.

19. COMMITMENTS

a) The Corporation has operating leases in place mainly for facilities, maintenance of way and computer equipment. The most important leases are for the Montreal and Toronto stations with respective terms of 10 and 49 years without renewal option as well as the lease for the Corporate headquarters in Montreal for a term of 12 years with a renewal option. The lease payments are increased to reflect normal inflation.

In 2012, an amount of $13.6 million (December 31, 2011: $12.5 million) was recognized as an expense related to facilities operating leases. All operating leases have a cancellation option.

b) As at December 31, 2012, the Corporation has outstanding major contract commitments amounting to $45.5 million (December 31, 2011: $182.8 million) consisting mainly for the completion of rolling stock refurbishment and infrastructure improvement projects.

c) As mentioned in note 1, the Corporation has entered into train service agreements for the use of tracks and the control of train operations that expire on December 31, 2018.

d) The Corporation has provided letters of credit from a banking institution totalling approximately $28.4 million (December 31, 2011: $29.3 million) to various provincial government workers' compensation boards as security for future payment streams.

20. FINANCIAL INSTRUMENTS

A) CLASSIFICATION OF FINANCIAL INSTRUMENTS

The financial instruments held by the Corporation are classified as follows:

(IN MILLIONS OF DOLLARS)	2012 Carrying Value			2011 Carrying Value		
	FVTPL	AFS	L&R	FVTPL	AFS	L&R
Financial Assets:						
Cash and cash equivalents	**10.3**	**5.6(3)**	**-**	4.4	8.9(3)	-
Accounts receivables and other receivables	**-**	**-**	**6.4(1)**	-	-	10.3(1)
Derivative financial instruments	**0.8(2)**	**-**	**-**	2.2(2)	-	-
Asset Renewal Fund – MAV notes	**5.7**	**-**	**-**	5.0	-	-
Asset Renewal Fund – Other investments	**-**	**10.0(3)**	**-**	-	28.9(3)	-
		FVTPL	Other liability		FVTPL	Other liability
Financial Liabilities:						
Trade and other payables		**-**	**94.3(4)**		-	95.1(4)
Derivative financial instruments		**1.2(2)**	**-**		1.2(2)	-

FVTPL – Fair Value through profit and losses
AFS – Available for sale
L&R – Loans and receivables
(1) Comprised of trade receivables.
(2) Comprised of derivative financial instruments not designated in a hedge relationship.
(3) Comprised of short-term investments.
(4) Comprised of trade accounts payable, accrued liabilities and accrued wages.

B) FAIR VALUE

The estimated fair value of the recognized financial instruments other than financial instruments measured at FVTPL approximates their carrying value due to their short-term nature. FVTPL financial instruments and derivatives are carried at fair value.

The Corporation estimates the fair value of its MAV notes by discounting expected future cash flows. The valuation model incorporates assumptions for interest rates, required market yields and effective maturities, some of which are derived from observable market indicators. There is a significant amount of uncertainty in estimating the amount and timing of cash flows associated with the MAV notes.

The assumptions used in the valuation model include:

Criteria	Assumptions 2012	Assumptions 2011
Expected term to maturity	**3.8 years**	4.6 years
Discount Rates	**4.6% to 17.9%**	7.1% to 67.0%
Coupon rates	**CDOR swap - 50bps to CDOR swap + 30bps**	CDOR swap - 50bps to CDOR swap + 30bps

If these assumptions were to change, the fair value of the MAV notes could change significantly. A 1.0% increase (decrease) in the discount rate would decrease (increase) the fair value of the MAV notes by approximately $0.2 million (December 31, 2011: $0.2 million).

All financial instruments measured at fair value are classified in fair value hierarchy levels, which are as follows:

Level 1 – Financial instruments are considered Level 1 when valuation can be based on quoted prices in active markets for identical assets or liabilities.

Level 2 – Level 2 financial instruments are valued using quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or models using inputs that are observable.

Level 3 – Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable.

The following table summarizes the fair value hierarchy applicable to the fair value measurement of financial assets and financial liabilities held by the Corporation (Note 1):

(IN MILLIONS OF DOLLARS)	2012	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	**15.9**	15.9	-	-
Asset Renewal Fund – MAV notes	**5.7**	-	-	5.7
Asset Renewal Fund – Other investments	**10.0**	10.0	-	-
Derivative financial instruments	**0.8**	-	0.8	-
Liabilities:				
Derivative financial instruments	**1.2**	-	1.2	-

Note 1 – There have been no significant transfers between Level 1 and Level 2 during the year.

(IN MILLIONS OF DOLLARS)	2011	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	**13.3**	13.3	-	-
Asset Renewal Fund – MAV notes	**5.0**	-	-	5.0
Asset Renewal Fund – Other investments	**28.9**	28.9	-	-
Derivative financial instruments	**2.2**	-	2.2	-
Liabilities:				
Derivative financial instruments	**1.2**	-	1.2	-

Note 1 – There have been no significant transfers between Level 1 and Level 2 during the year.

20. FINANCIAL INSTRUMENTS (CONT'D)

The table below presents a reconciliation of all financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

(IN MILLIONS OF DOLLARS)	2012	2011
Asset Renewal Fund – MAV notes:		
Opening balance	**5.0**	4.9
Total gains in net income	**1.1**	0.4
Sales	**(0.4)**	(0.3)
Closing balance	**5.7**	5.0

C) RISK MANAGEMENT

As part of its operations, the Corporation enters into transactions with financial risks exposure such as credit, liquidity and market risks. Exposure to such risks is significantly reduced through close monitoring and strategies that include the use of derivative financial instruments.

D) FOREIGN EXCHANGE RISK

The Corporation is exposed to foreign exchange risks on the following balances that are denominated in U.S. dollars (USD):

(IN MILLIONS OF DOLLARS)	2012	2011
Assets:		
Derivative financial instruments	**0.8**	2.2
Liabilities:		
Trade and other payables	**0.8**	0.8
Derivative financial instruments	**1.2**	1.2

The Corporation's risk management objective is to reduce cash flow risk related to foreign denominated cash flows. To help manage this risk, the Corporation has entered into foreign exchange forward contracts related to fuel swaps and the purchase of materials from the U.S. to refurbish some of its locomotives fleet.

A variance of 5% in the exchange rate of USD would not have a significant impact on the Corporation's net income.

E) CREDIT RISK

Credit risk is the risk that one party to a financial instrument might not meet its obligations under the terms and conditions of the agreement. The carrying amount of financial assets is $38.8 million (December 31, 2011: $59.7 million) and represents the Corporation's maximum exposure to credit risk. The Corporation does not use credit derivatives or similar instruments to mitigate this risk and, as such, the maximum exposure is the full carrying value or face value of its financial assets. The Corporation minimizes credit risk on cash and cash equivalents, investments, Asset Renewal Fund and derivative financial instruments by dealing only with reputable and high quality financial institutions. The Corporation's exposure to credit risks on trade accounts receivable is reduced by applying a credit policy that establishes limits on the concentration of risk, requires assessing and monitoring of counterparty credit risk and sets credit limits. Only Canadian Government departments and agencies, Crown corporations issuing government travel warrants and travel agents who are members of the International Air Transport Association (Billing and Settlement Plan /Airline Reporting Corporation) are exempt from the Corporation's credit approval process.

As at December 31, 2012, approximately 18.7% (December 31, 2011: 31.5%) of trade accounts receivable were over 90 days past due, while approximately 70.3% (December 31, 2011: 57.2%) of trade accounts receivable were current (under 30 days).

As at December 31, 2012, the allowance for bad debt was $2.0 million (December 31, 2011: $1.3 million). The allowance for bad debt is based on an account by account analysis that considers the aging of the account and the current credit-worthiness of the customer.

F) FUEL PRICE RISK

In order to manage its exposure to changes in fuel prices and minimize volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries based on the price of a commodity (i.e. heating oil) or a market index. A fluctuation of 10% in the USD price of heating oil or fuel would not have a significant impact on the financial statements.

G) LIQUIDITY RISK

The Corporation manages its liquidity risk by preparing and monitoring detailed forecasts of cash flows from operations and anticipated investing and funding activities. The liquidity risk is low since the Corporation does not have debt instruments to service and receives regular funding from the Government of Canada.

The reported financial liabilities in item a) above totaling $95.5 million (December 31, 2011: $96.3 million) represent the maximum liquidity risk exposure for the Corporation.

The following table summarizes the contractual maturities for the derivative and non-derivative financial liabilities as at December 31, 2012:

(IN MILLIONS OF DOLLARS)	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 2 years	Over 2 years	Total
Trade and other payables	92.3	2.0	-	-	-	**94.3**
Derivative financial liabilities	0.2	0.2	0.5	0.2	0.1	**1.2**

The following table summarizes the contractual maturities for the derivative and non-derivative financial liabilities as at December 31, 2011:

(IN MILLIONS OF DOLLARS)	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 2 years	Over 2 years	Total
Trade and other payables	90.2	-	-	2.5	2.4	**95.1**
Derivative financial liabilities	0.2	0.3	0.6	0.1	-	**1.2**

H) INTEREST RATE RISK

Interest rate risk is defined as the Corporation's exposure to a loss of earnings or a loss in the value of its financial instruments as a result of fluctuations in interest rates. The Corporation is exposed to interest rate risk associated with cash and cash equivalents and the Asset Renewal Fund for a total of $31.6 million (December 2011: $47.2 million). A variation of 100bps in the interest rates would affect the investment income but would not have a significant impact on the financial statements.

21. DERIVATIVE FINANCIAL INSTRUMENTS

The Corporation uses commodity price swaps where it exchanges cash payments based on changes in the price of a commodity (i.e. heating oil) compared to the agreed benchmark. The Corporation also enters into foreign exchange forward contracts to either buy or sell USD at a specified price and date in the future. These contracts are related to fuel swaps.

At the end of the year, the Corporation had the following derivative financial instruments:

CRUDE SWAP	2012		2011	
	Notional Quantity (000's of U.S. Gallons)	Fair Value CAD (000's)	Notional Quantity (000's of U.S. Gallons)	Fair Value CAD (000's)
Assets	**5,796**	495	**4,032**	1,509
Liabilities	**6,048**	563	**9,324**	1,173

As at December 31, 2012, the fuel swaps have a fixed price per U.S. gallon in USD between 2.309 and 3.124 (December 31, 2011: between 1.957 and 3.071) and the maturity dates are 2013 to 2014 (December 31, 2011: 2012 to 2013). These financial instruments have a monthly settlement schedule.

FOREIGN EXCHANGE CONTRACTS	2012		2011	
	Notional Amount (USD) (000's)	Fair Value CAD (000's)	Notional Amount (USD) (000's)	Fair Value CAD (000's)
Assets	**11,132**	276	**37,697**	716
Liabilities	**16,081**	594	**-**	-

As at December 31, 2012, the forward contracts rates are between 0.980 and 1.041 (December 31, 2011: between 0.954 and 1.036) in US dollars and the maturity dates are 2013 to 2014 (December 31, 2011: 2012 to 2013). These financial instruments have a monthly settlement schedule.

	2012	2011
	Fair Value CAD (000's)	Fair Value CAD (000's)
Total assets	**771**	2,225
Total liabilities	**1,157**	1,173

The fair values of the derivative financial instruments are estimated as the discounted unrealized gain or loss calculated based on the market price at the end of the year, which generally reflects the estimated amount that the Corporation would receive or pay to terminate the contracts at the statement of financial position date. The fair values of the derivative financial instruments are provided to the Corporation by the chartered banks that are the counterparties to the transactions. The credit risk related to these banks is considered very low since the Corporation deals only with reputable and high quality financial institutions.

The fair values are determined using well-established proprietary valuation models, such as the modified Black-Scholes model, and incorporate prevailing market rates and prices on the underlying instruments. The Corporation has performed additional review procedures on the fair value amounts to satisfy itself that they are reasonable.

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 appropriate discount factors.

22. RELATED PARTY TRANSACTIONS

The Corporation is related in terms of common ownership to all Government of Canada created departments, agencies and Crown corporations. The Corporation enters into transactions with these entities in the normal course of business on trade terms similar to those applied to other individuals and enterprises and these transactions are recorded at fair value. Other than disclosed elsewhere in these Financial Statements, related party transactions are not significant.

The remuneration of key executives is determined by the Human Resources Committee having regard to the performance of individuals and market trends. The Human Resources Committee recommendation is then presented and approved by the Board of Directors.

The Corporation's key executives have been defined as the executive staff members that are members of the Corporate Management Committee.

The compensation of the key executives of the Corporation is as follows:

(In millions of dollars)	2012	2011
Compensation and short-term employee benefits	**2.4**	2.5
Post-employment benefits	**0.9**	0.6

23. NON-MONETARY TRANSACTIONS

The Corporation recorded revenue from non-monetary transactions of approximately $1.5 million for the year ended December 31, 2012 (December 31, 2011: $1.3 million) under "Passenger revenue" in the Statement of Operations and Comprehensive Income. The Corporation also recorded expenses from non-monetary transactions of approximately $1.4 million (December 31, 2011: $1.5 million) mainly under "Marketing and sales" and "Other expenses" in the Statement of Operations and Comprehensive Income. The nature of non-monetary transactions is mainly related to advertising activities.

24. CONTINGENCIES

A) ENVIRONMENT

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 mitigate 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 properties likely to be contaminated or the activities or property, plant and equipment likely 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.

When remediation costs can be reasonably estimated, a provision is recorded based on the anticipated future costs.

However, 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 uncertainty regarding the ability to recover costs from any third parties with respect to particular sites;

(iv) 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.

B) ASSET RETIREMENT

The Corporation has entered into certain operating leases where the lessor has the option of requesting that the land/structures or the other assets be returned in the same condition as they were originally leased, or of retaking control of these assets without any compensation to the Corporation for any additions or modifications made to the initial assets. Given the nature of the assets under contract and the options available to the lessor, the asset retirement obligation cannot be reasonably estimated. No liability has been recognized in the financial statements.

25. RECLASSIFICATION

The Corporation has reclassified the "Employee benefits" expense item presented separately at December 31, 2011 to the Compensation and benefits line item in the Statement of Operations and Comprehensive Income in order to present all employee benefit related expenses on the same line item.

CORPORATE DIRECTORY

BOARD OF DIRECTORS

Paul G. Smith,
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France Bilodeau
Quebec City, Quebec
(until December 13. 2012)

Jeffrey R. Clarke
Ottawa, Ontario

Denis Durand
Montréal, Quebec

Angela Ferrante
Toronto, Ontario

David Hoff
Vancouver,
British Columbia

Wendy A. King
Vancouver,
British Columbia
(until October 4, 2012)

Marc Laliberté,
President and Chief
Executive Officer
Montréal, Quebec

Stephen Mallory
Toronto, Ontario
(from December 13, 2012)

Jean-Martin Masse
Montréal, Quebec

Ramona Materi
Vancouver,
British Columbia
(from October 4, 2012)

Donald Mutch
Toronto, Ontario
(until July 5, 2012)

Anthony Perl
Vancouver, British
Columbia
(until October 4, 2012)

Hind Sergieh
Montreal, Québec
(from December 13, 2012)

Eric Stefanson
Winnipeg, Manitoba

Elizabeth Van den Eynden
Glasgow, Nova-Scotia
(from October 4, 2012)

William M. Wheatley
Regina, Saskatchewan

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Yves Desjardins-Siciliano
Chief Legal and
Corporate Affairs Officer,
Corporate Secretary

Denis Pinsonneault
Chief Customer
Experience and
Operating Officer

Robert St-Jean
Chief Financial and
Administration Officer

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