2008 ANNUAL REPORT

A MORE HUMAN WAY TO TRAVEL

A GREEN CHOICE

VIA Rail Canada

LETTER TO THE MINISTER OF STATE (TRANSPORT)

The Honourable Rob Merrifield
Minister of State (Transport), Ottawa

Dear Minister:

In accordance with the provisions of the Financial Administration Act, I am pleased to submit VIA Rail Canada Inc.'s Annual Report for the year ending December 31, 2008.

Donald A. Wright
Chairman of the Board

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The Year at a Glance

The following key financial indicators and operating statistics summarize the performance of the Corporation for the year 2008, with comparative data for the years 2004 to 2007. They exclude the financial results of the variable interest entity and all non-funded items.

	2008	2007	2006	2005	2004
KEY FINANCIAL INDICATORS					
(IN MILLIONS OF DOLLARS)					
Total passenger revenue	**282.9**	268.8	266.6	255.6	240.6
Total revenue	**299.2**	285.6	297.1	289.8	258.7
Cash operating expenses (1)	**513.4**	486.2	475.5	465.7	443.8
Cash operating deficit	**214.2**	200.6	178.4	175.9	185.1
Capital expenditures	**42.1**	12.4	14.5	21.2	20.2
Government funding:					
Operating	**214.2**	200.6	169.0	169.0	177.4
Capital	**42.1**	12.4	0.0	0.7	20.2
Total Government funding (2)	**256.3**	213.0	169.0	169.7	197.6
KEY OPERATING STATISTICS (3)					
Revenue/Cash operating expenses ratio (%)	**58.4**	58.9	62.8	62.4	58.8
Total passengers carried (IN THOUSANDS)	**4,605**	4,181	4,091	4,097	3,887
Total passenger-miles (IN MILLIONS)	**951**	874	874	888	851
Government operating funding per passenger-mile (IN CENTS)	**22.5**	23.0	19.3	19.0	20.8
Yield (CENTS PER PASSENGER-MILE)	**29.6**	30.5	30.3	28.6	28.0
Train-miles operated (IN THOUSANDS)	**6,746**	6,658	6,665	6,740	6,771
Car-miles operated (IN THOUSANDS)	**46,961**	46,362	47,625	48,614	48,396
Average passenger load factor (%)	**59**	55	55	55	53
Average number of passenger-miles per train-mile	**141**	131	131	132	126
On-time performance (%)	**75**	77	84	81	70
Number of employees at year-end	**3,109**	3,017	3,003	3,059	3,027

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

Corporate Overview

VIA Rail operates Canada's national passenger rail service on behalf of the Government of Canada. An independent Crown corporation established in 1977, we provide a safe, efficient and environmentally responsible service from coast to coast. We operate up to 503 trains weekly on 12,500 kilometres of track, connecting over 450 Canadian communities. With approximately 3,100 employees, VIA carried more than 4.6 million passengers in 2008.

VISION

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

MISSION

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

CORE BUSINESS STRATEGY

Customer Intimacy

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

VALUES

Customer Focus

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

Respect

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

Passion

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

SERVICES

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

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

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

In rural and remote areas, we operate services designated by the government to meet regional transportation needs, and to provide essential services in some areas of the country.

Left to right:

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

Réjean Rivard
In-charge
(Central Station, Montreal)

Message from the Chairman

VIA Rail performed very well in 2008, continuing a record of improvements that has generated growing interest – and growing confidence – in the future of Canadian passenger rail.

VIA's management strategy continued to focus on immediate challenges: providing consistently excellent customer service, growing market share, and improving day-to-day performance. As a result, VIA achieved growth in both ridership and passenger revenues, while costs were kept under control despite fuel cost increases. VIA completed the year on target for these key performance measures, in line with the Corporation's five-year operating plan.

At the same time, the Corporation moved forward with the five-year, $516 million capital investment program announced by the federal government in the fall of 2007. Good progress has been made on modernizing VIA's locomotives and passenger cars and improving facilities at passenger stations. Negotiations to improve infrastructure are progressing with freight railways, aimed at eliminating traffic bottlenecks on infrastructure shared by both freight and passenger trains.

The investment program as a whole will ensure that VIA's current network and service levels are sustainable and more competitive, while improving the reliability of train service today, and building capacity for faster and more frequent services in the future.

Recognition of VIA's solid performance can be found in the results of the 2008 National Corporate Reputation Study conducted by Leger Marketing. For the second year in a row, VIA's ranking among the top 100 Canadian companies improved. VIA ranked 35, eight positions higher than in 2007.

VIA's Board of Directors continues to place a high priority on implementing principles of good governance, and ensuring that the resources invested in passenger rail are well-managed in order to deliver sustainable value to Canadians in the future. In this regard, the Board welcomes the decision of the governments of Ontario and Quebec and the Government of Canada to update previous studies on high-speed rail.

As the operator of Canada's national passenger rail service, VIA Rail will continue to offer its advice and expertise in evolving new transportation solutions for the country, while ensuring that the services it delivers today return real value to Canadians from coast to coast.

DA Wright

Donald A. Wright
Chairman of the Board

Message from the President

In 2008, once again, the people at VIA Rail pulled together as a team, remained focused on the customer, and delivered exceptional results for passenger rail. Thanks to their dedication, VIA increased passenger revenues for the fifth consecutive year, pushing revenues up more than five per cent over 2007. We set a new record and increased ridership by ten per cent, serving more than 4.6 million customers. We achieved comparable gains in passenger-miles, while increasing load factor to 59%.

These results are significant given the challenges we faced throughout the year. Continuing maintenance problems with aging equipment, along with operating and service disruptions related to the infrastructure caused problems with on-time performance. That directly affected our customers, and their satisfaction with our service.

But the people at VIA kept their eye on the ball, and met each new challenge with extraordinary determination. Their efforts are reflected not only in bottom-line results, but the awards and recognition we received throughout 2008 – including the Agents' Choice award from travel agents, two awards from the Railway Association of Canada, recognition from the International Rail Travelers Association, and awards for innovation in product design and marketing. And we achieved a significant jump in our standing in both national and regional corporate reputation surveys.

We have good reason to be proud of what we have achieved, and to be confident in the future. We made good progress with capital investment projects to resolve longstanding equipment and infrastructure problems. We completed major upgrades to track owned by VIA. Work on modernizing our equipment is on schedule. More comprehensive infrastructure work on CN-owned track is coming.

This work will bring real benefits to travellers over the next few years.

But our immediate challenge remains the same: to stay focused on going the extra mile for our customers and delivering the personal customer service that makes travelling with VIA unique. We are succeeding today because VIA employees take pride in delivering that service every day.

And in 2008 we took steps to reinforce that pride. Building on a company-wide employee engagement survey, we are moving into 2009 with a broad range of new tools, and a renewed commitment to continue evolving as an organization of people proud to serve – and more dedicated than ever to delivering the best possible passenger service for our customers.

Paul Côté

Paul Côté
President and Chief Executive Officer

THE YEAR IN REVIEW

THE YEAR IN REVIEW

THE RIGHT PRODUCT FOR THE MARKETPLACE

VIA Rail entered 2008 with renewed confidence, encouraged by growing interest in the role and potential of passenger rail.

The Government of Canada's 2007 announcement of new passenger rail funding, including the largest capital investment program in VIA's history, underlined the value of rail service to Canadians, and recognized VIA's consistent record of ridership growth, reduced costs, improved productivity and service performance. Concerns about sustainable development and volatile energy prices brought new recognition of passenger rail as an affordable, environmentally responsible mode of transportation. The decision by the federal, Quebec and Ontario governments to update previous studies on high-speed rail service brought new interest in the potential of this technology to meet future transportation needs.

Louise Saint-Laurent
Station Services Agent
(Central Station, Montreal)

The unique advantages of VIA's service were brought to the forefront at the very beginning of the year. During an unusually long and severe winter season, more people were attracted to the convenience of train travel as a comfortable alternative to driving through ice and snow. Both ridership and revenues began an upward climb that continued into the spring. In the summer, despite a somewhat weaker Canadian tourism market, ridership remained relatively strong, due partly to a keen interest on the part of many travellers to visit Quebec City during its 400th anniversary celebrations. In addition, VIA paid special recognition to members of the Canadian Forces and their families by offering complimentary or discounted travel throughout the month of July – welcoming almost 60,000 additional customers.

Despite growing ridership, VIA faced major operational challenges and intense competition from other transportation services. Problems with aging equipment and infrastructure – which will be resolved in the longer term through capital investment – continued to cause delays. Freight derailments and infrastructure projects disrupted service, with a direct impact on customer satisfaction.

Operating costs, including a $10 million increase in fuel costs when compared to 2007, brought new pressures to increase productivity without jeopardizing service to the customer. Average fares continued to fall across the industry, putting additional pressure on managing seat capacity in order to increase load factors.

VIA responded to each new challenge quickly – developing new operating and scheduling arrangements with the freight railways, adopting new distribution and pricing strategies to capitalize on the popularity and growth in website visits, and a renewed focus on innovation and team building throughout the Corporation. VIA's *Moving Forward* business strategy – which sets out clearly defined business goals built around customer focus – continued to keep efforts on track to position passenger rail for growth.

VIA ended the year with continued confidence in the future – having set a new record for ridership throughout its cross-Canada passenger rail network.

KEEPING PERFORMANCE ON TRACK

VIA's long-term performance trends remained strong in 2008.
Since 1990, VIA has:

- Reduced reliance on government operating funding by 48%
- Increased revenues by 110%
- Increased passengers by 33%
- Increased cost recovery by 100%

Capital Investment Plan

In October 2007, the Government of Canada announced a five-year, $516 million investment to strengthen the national passenger rail service. With a primary focus on renewing equipment and infrastructure, this investment addresses many of the key operational challenges VIA faces today. It will help VIA to maintain and improve the reliability of passenger service across the country, and ensure that the service remains both cost-effective and sustainable in the future.

Immediately after the announcement of the capital program in October, 2007, VIA expanded its project management organization, and enhanced project monitoring and reporting processes for the Board of Directors. At the request of the Board, an internal audit of the Project Management Office was performed in early 2008. The audit results were reviewed and accepted by VIA management in June 2008, and most of the recommendations have been implemented.

By the end of 2008, the Project Management Office was fully staffed to manage the capital program. The Office reports progress on each project on a regular basis to both the Capital Program Steering Committee, comprised of VIA's executive management, and to the Board of Directors.

MODERNIZING LOCOMOTIVES

VIA currently operates 54 General Motors F-40 locomotives – 70 per cent of the total locomotive fleet – which are more than twenty years old. These locomotives are used in all parts of Canada – on VIA's western and eastern transcontinental services, in the Quebec City–Windsor corridor, and for remote services.

As the equipment ages, frequent mechanical problems cause more train delays and higher maintenance costs. In addition, many of the components and systems are now obsolete, making it hard to find spare parts.

In December 2007, VIA began a five-year rebuild of the F-40 fleet. The project, which is now well underway, involves stripping the locomotives down to their shells and rebuilding them from the ground up, incorporating the latest locomotive technologies into the refurbished equipment. This technology will be more reliable, require less power and will weigh less, making the locomotives more fuel efficient. The locomotives will also receive a new paint scheme.

Rebuilding will extend the life of these locomotives by 15 to 20 years, at less than half the cost of buying new ones. At the same time, VIA will ensure that the locomotives meet current environmental and safety standards – reducing their greenhouse gas emissions by up to 12 per cent, and reducing annual maintenance costs by 15 per cent.

The first rebuilt F-40s will be ready in the spring of 2009, and the balance of the fleet will be completed by 2012.

RENEWING THE LRC PASSENGER CARS

In February 2008, VIA issued a request for proposals to upgrade its fleet of 98 LRC (light, rapid, comfortable) passenger cars, which will extend their life by up to 20 years. The cars are used for both first-class and economy service in the Quebec City–Windsor corridor. Although they make up less than a quarter of the entire fleet, the LRC cars generate more than 50 per cent of VIA's total passenger revenues.

The LRC cars have been in service for more than 25 years, and they no longer meet the expectations of travellers in terms of comfort and amenities. Obsolete parts are becoming increasingly expensive to obtain, and reliability is deteriorating.

As part of the LRC upgrade, new electrical and mechanical systems will be installed. Improvements will be made to the lighting as well as the heating and air conditioning systems, reducing energy consumption and costs. VIA will also renovate the interiors of the cars, provide a new look for *VIA 1* and ensure that the equipment meets current standards of safety, comfort and accessibility for passengers with disabilities. The project will be completed over the next four years.

STAINLESS STEEL (HEP I) PARK CAR PROTOTYPE

VIA is preparing for the eventual modernization of its HEP I passenger car fleet used for western transcontinental service with the development of an accessible Park car prototype. The prototype will feature a fully accessible en-suite bedroom, a regular en-suite bedroom, reconfigured Mural and Bullet lounges and a re-finished Dome. Improvements will result in a car that is fully compliant with Canadian Transportation Agency standards regarding accessibility, and with Transportation Safety Board recommendations.

This eventual modernization of the HEP I fleet would update interiors and other features of the cars, providing a more attractive product in line with customer expectations – supporting VIA's goal of increasing ridership and revenues. More ergonomically efficient food preparation areas would lower costs while improving service delivery, staff efficiency and safety. An updated fleet would also reduce costs through greater energy efficiency, and would include features that make the equipment easier to maintain.

INFRASTRUCTURE

Most of the rail infrastructure used by passenger trains is owned by, and shared with, freight railways. In the Quebec City-Windsor corridor, where VIA operates 429 trains per week and serves 90 per cent of its total ridership, increasing freight traffic has resulted in congestion and contributed to frequent delays for passenger trains.

VIA began negotiations with the freight railways in 2008 to upgrade this infrastructure, with major projects on all Corridor routes. This will allow VIA to improve service between all major cities, including Quebec City, Montreal, Ottawa, Toronto, Kitchener, Brantford, London, and Windsor – as well as the many smaller communities in between.

This investment in infrastructure will include:

- Upgraded track, along with new sidings and passing tracks in key locations;
- Rehabilitation of several railway bridges (Alexandria, Chatham and Smiths Falls subdivisions);
- Improved level crossings and crossing protection;
- New pedestrian over- and under-passes;
- Enhanced security;
- Improved signalling, with Centralized Traffic Control (CTC) systems extended to cover all Corridor infrastructure.

Improved infrastructure will enhance safety, while eliminating many delays caused by congestion, and allow passenger trains to operate at higher speeds. As a result, average trip times will be reduced and capacity will increase, allowing VIA to provide faster and more frequent service throughout the Corridor. VIA projects that it will accommodate more than one million additional passengers – an increase in ridership of 32 per cent – when the infrastructure improvements are completed by 2012.

STATIONS: INVESTING IN COMFORT AND SAFETY

As part of the five-year investment plan, VIA is upgrading and modernizing key passenger stations to serve customers more efficiently, and to address operational and safety needs. Major station projects include improved platforms, lounges, lighting and boarding gates, interior and exterior renovations, and in some cases expansion or new facilities. In 2008, projects were approved for 22 stations across the country:

EASTERN CANADA	OTTAWA - QUEBEC CITY	SOUTHWESTERN ONTARIO	WESTERN CANADA
Chambord	Fallowfield	Brantford	Kamloops
Halifax	Montreal	Cobourg	Vancouver
Moncton	Ottawa	Guelph	Winnipeg
New Carlisle	Quebec City	London	
	Ste-Foy	Niagara Falls	
		Oakville	
		Sarnia	
		St. Catharines	
		Toronto	
		Windsor	


BUSINESS
STRATEGY

BUSINESS STRATEGY

FOR MORE THAN 30 YEARS VIA Rail has earned a world-wide reputation among passenger rail operators for providing excellent customer service. Recognizing that this is one of the core competitive strengths of the Corporation – and the core strength that sets passenger rail apart in the marketplace – VIA has built customer service into the core of its business strategy, called *Moving Forward*.

The *Moving Forward* strategy was first developed in 2005; it helped the Corporation to set new records in ridership and revenue growth that year. *Moving Forward* makes customer service the cornerstone of VIA's vision, mission, and values, and defines six key strategic goals for the Corporation. These goals provide a customer-focused framework for managing VIA's people and resources, and adapting to new realities in the marketplace. The goals, and the *Moving Forward* strategy as a whole, are reviewed and updated each year.

Robert Serecki
Service Coordinator on the *Canadian*
(based in Winnipeg)

Ensuring Everyone's Safety and Security

All VIA employees recognize that safety and security are the top priority for our customers, and for our colleagues. The Corporation is widely recognized as a leader in the safe and secure management of its operations, having developed one of the industry's first corporate Safety Management Systems in 2001.

That system – which includes the policies, standards, procedures and responsibilities for safe rail operations – is audited by Transport Canada, and is regularly reviewed and updated by VIA's subject-matter experts.

Safety issues are also monitored by Health and Safety committees at key locations across Canada. These committees inspect local safety conditions and review ongoing performance data to establish specific objectives for improving workplace safety, and to identify issues that require the attention of senior management. Since 2005, safety goals have been integrated into VIA's *Moving Forward* strategy.

Security issues have also become central to the goal of ensuring everyone's safety. VIA works with regulators to ensure that VIA's security standards are compliant with industry partners, and works with law enforcement agencies to maintain open communication channels and to ensure that the best possible facility and operations security controls are maintained.

Every year, employees are required to complete training that familiarizes them with various security related aspects at VIA. This online course helps employees understand their roles and responsibilities with regard to security, recognize risk factors and become more vigilant and attentive to any unusual event in the workplace.

CONSOLIDATING SAFETY, SECURITY AND NON-FINANCIAL RISK MANAGEMENT

With new concerns about the possible spread of contagious diseases through travel or the potential environmental impact of train incidents, the challenge of coordinating and managing all aspects of safety and security risks becomes increasingly complex.

Moving forward

MOVING FORWARD 2008
OUR BUSINESS STRATEGY

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

Our Goals

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

In October 2008, VIA created a coordinating group to ensure that it continues to set the highest possible standards for managing all safety, security, environmental or operational risks.

The Safety, Security and Risk Management team, reporting directly to the President, consolidates all safety, security, environment and non-financial risk management activities under a Senior Director, thus ensuring better coordination among these functions and strengthening overall corporate governance.

EMERGENCY PREPAREDNESS

The Safety, Security and Risk Management group participated in the development of a new, updated Train Emergency Response Plan for employees that was distributed in December 2008. This reference guide summarizes the initial major responsibilities of VIA staff involved in a train emergency, such as a collision, derailment, security incident, or potential health scare.

In addition to employee responsibilities, it includes the chain of command and the steps necessary to ensure good communication and coordination of emergency measures. Since its implementation, employees have received familiarization training in its use and application.

PROTECTING CRITICAL SERVICES

Transportation services are critical not only to the economy of the country, but to the health and safety of individuals and communities. In 2008, VIA completed major steps toward the development and implementation of a corporate Business Continuity Plan to ensure that passenger rail services can continue or resume functioning under a wide range of emergency conditions or circumstances.

SAVING LIVES

In 2008, VIA installed automated external defibrillators – used to revive cardiac arrest victims – on all passenger trains as well as in selected passenger stations and work locations. Some 625 VIA employees across the country were trained in operating these devices.

The program is a first for the passenger rail industry, and earned VIA the 2008 Safety Award from the Railway Association of Canada.

More importantly, the defibrillator program – and alert employees – have already saved a customer's life. Three months after the defibrillators were installed, one was used to revive a cardiac victim on the boarding platform at Toronto's Union Station. First responders said that the swift use of the defibrillator was essential to this person's survival.

Engaging our People

People do their jobs well when they believe that what they do is important, they understand how it contributes to core business goals, and they can make that contribution in an environment that supports and rewards their best efforts. This is especially important in an organization focused on customer service, where business success depends on the personal commitment people bring to the job – a commitment to go the extra mile in meeting customer needs.

With the launch of the *Moving Forward* strategy in 2005, VIA began a consultative process with employees throughout the Corporation to nurture this kind of commitment, and to engage people directly in the values, goals and success of passenger rail. The *Moving Forward* strategy itself is reviewed, updated and communicated to employees regularly through face-to-face meetings with supervisors, and regular progress reports on business performance.

New training initiatives – including a range of online resources and modules – have helped to align personal development tools and career opportunities with the strategic goals of the Corporation.

A new framework for performance reviews, objective-setting, and compensation has helped to make more direct and clear links between individual and team performance, and VIA's success as a business. New programs have helped managers deliver more constructive feedback, and provide more meaningful leadership, coaching and support for employees.

EMPLOYEE ENGAGEMENT SURVEY

In 2008, VIA conducted a corporate-wide employee survey to determine how effective VIA has been at creating an organization where people like to work, feel that the work they do is worthwhile, and feel engaged to contribute to VIA's success. When compared with the views employees expressed in a 2005 employee survey, the results are encouraging, and will help the organization develop new ways to increase employee engagement in the coming years.

Overall, the vast majority of employees said that they are very proud to work for the Corporation, and believe that VIA creates value for the communities served by passenger rail. And the majority – 94 per cent – say that they understand how their jobs link to the customer. That level of understanding, a 20 per cent increase over 2005, provides a solid foundation for VIA's evolution as a customer-focused organization.

In addition, more employees say they feel encouraged to take action to improve the customer's experience. Employees indicated that VIA's leadership is now providing clearer direction for the future of the company. More people indicated that they have good relationships with their managers, and that managers are providing more consistent feedback on how they perform their jobs.

At the same time, the survey identified areas where VIA can improve employee engagement. For example, while employees felt that the Corporation now has a clearer direction for the future, leaders were not doing enough to make employees feel excited about that direction. Only 54 per cent said that they have the tools and resources they need to be as productive as possible on the job. Employees would also like to see further improvements in the areas of managing performance, recognition and development opportunities.

Following analysis of the survey results, senior leaders are working on a corporate action plan, while team leaders are working with staff to conduct feedback sessions, and to develop more local action plans where necessary. These will provide the basis for strengthening VIA in 2009 and beyond, as an organization where people like the work they do, and can contribute to VIA's success.

COMMUNITY INVOLVEMENT

An important element of employee engagement is recognition – and support – for employee involvement with the communities they care about. In 2008, VIA continued to support employee involvement with worthwhile organizations, events and important causes, and strengthened partnerships with community organizations.

- In January 2008, VIA partnered with the Kid's Help Phone organization to support that organization's 24-hour toll-free phone and online counselling and referral service for young people. During a VIA Day at the Montreal Maintenance Centre – which turned out to be the largest employee-oriented event in VIA's history – some 1,500 employees raised funds for the service. Smaller groups of employees from Vancouver to Halifax also participated in Kid's Help Phone fundraising events.

- The Green Team at the Montreal Maintenance Centre, involved in environmental projects, has partnered with a nearby primary school and is sharing revenues raised from recycling metals and aluminium cans with the school. The funds are used for projects such as facilities for disabled children, and improving the school library.

- In the fall of 2008, VIA held its annual National Charitable Campaign, raising funds for United Way Canada and HealthPartners. Under the slogan "Be a Part of Change", employees raised more than $257,000 for these organizations.

- Employees volunteered to help coordinate the second year of EnviroExpo, a nation wide program that encourages students to develop science projects focused on solutions to environmental problems. VIA established EnviroExpo in 2007, in partnership with the Youth Science Foundation.

- For a number of years, employees have played an active role in organizing Santa Trains in western Canada. These have grown so popular over the years that they now sell out in only a few days, or in some cases, in just a few hours. In 2008, over $7,400 were collected thanks to the Santa Trains, with all profits going to children's hospitals in Jasper, Prince George and Prince Rupert.

- In October, some 600 passengers travelled from Vancouver to Mission, BC and back on the Railroader Express, a special train composed of a vintage steam locomotive and thirteen loaned VIA coaches. This initiative, organized by a group of Vancouver-area employees, with the cooperation of Canadian National, Canadian Pacific and Burlington Northern Railway, raised over $17,000 for the BC Lions Society's Easter Seals Camps campaign. VIA employees have been active participants in the annual Easter Seals 24-Hour Relays in cities across Canada for more than 20 years.

Delivering our Customer Promise

"Delivering the customer promise" at VIA means ensuring that customers' expectations for service match what they actually experience on the train. Throughout 2008, VIA continued to refine and improve its understanding of customer expectations, and to find better ways to meet those expectations. For example, VIA continued a comprehensive review, launched in 2007, of its Corridor products and services. The objective of the review is to determine how well the customer experience matches the promise made to customers through VIA's advertising, promotions and other channels, and to design services that will better meet changing expectations in the future.

VIA also developed a new training program for front-line employees, called *Creating Stellar Customer Relations*. The program updates an earlier training course on customer service, combining both e-Learning and classroom modules that give employees new tools and techniques for creating consistent, positive experiences for their customers.

THE ON-TIME PERFORMANCE CHALLENGE

One of the top priorities for customers on all VIA trains is reliable, on-time service, with trains arriving and departing on schedule. This has become a significant challenge in recent years, and became a major issue for VIA – and for customers – in 2008. Severe winter conditions contributed to an increase in train delays during the first part of the year. And VIA's aging equipment is increasingly subject to breakdowns and maintenance problems – an issue that will not be fully resolved until locomotives and passenger cars are rebuilt under the capital investment plan.

In addition, increased ridership in the Corridor contributed to delays, as more time was needed for passengers boarding and leaving trains. VIA performed a full review of Corridor station dwell times, and identified where time should be added to schedules in order to accommodate increasing numbers of passengers at these locations. A new schedule for Corridor trains was launched in June, with revised arrival and departure times that are more reliable.

VIA also developed a new and productive relationship with Canadian National, which owns much of the infrastructure used by its trains. As a result, CN is now working more closely with VIA to create a better shared understanding of its operating requirements, and to find ways to manage the infrastructure that address those requirements more efficiently. This renewed partnership helped to improve on-time performance during the second half of the year, and will lead to further improvements in 2009.

TRAIN SERVICES AGREEMENTS

A new train services agreement was negotiated with CN in 2008 that will provide a better operating framework to improve on-time performance. VIA operates its trains over the infrastructure of freight railways under terms and conditions of an agreement first signed with CN in 1989, which was to expire on December 31, 1998. In 1995, prior to CN becoming a publicly-traded company, the contract was extended for an additional 10 years – until December 31, 2008.

The new agreement with CN, covering the period from January 1, 2009 to December 31, 2018, provides a simplified approach for access fees for Corridor and non-Corridor services. It also provides a simpler way to measure on-time performance and responsibility for delays, an on-time performance target to be met by CN, and a bonus/penalty scheme to reflect actual performance versus the target. Other clauses of the agreement have been modernized or eliminated to reflect changes in VIA's operations over the years.

At the end of 2008, VIA was also renegotiating agreements with two shortline railways – the Hudson Bay Railway (The Pas to Churchill) and the Goderich-Exeter Railway (Guelph, Kitchener and Stratford). In the interim, the CN train services agreement, which had been transferred to these shortline railways, remains in effect until new agreements are reached.

A NEW SCHEDULE FOR THE *CANADIAN*

After consultation with customers, communities and CN concerning operating delays affecting VIA's western services, VIA introduced a new, redesigned schedule for the *Canadian* in December 2008. One night was added to the schedule in each direction, and CN is co-operating to ensure that trains will be able to depart and arrive on time.

The departure times from both Vancouver and Toronto are now in the evening, allowing VIA to offer a coast-to-coast connection for passengers travelling between eastern Canada and the west, in both directions, without an overnight stay in Toronto. The schedule also includes time in Winnipeg to allow customers to tour the city. The new schedule is also more convenient for passengers travelling between Saskatoon and Winnipeg.

MORE OPTIONS FOR OTTAWA-MONTREAL TRAVELLERS

In January 2008, VIA added a new mid-day service between Montreal and Ottawa in both directions. Customers can now choose from six daily departure times for weekday travel. The new departures also provide more convenient connections for customers travelling to and from Quebec City. So far, ridership on this new departure has exceeded expectations.

RECOGNITION AND AWARDS

For the second year in a row, VIA won first place for passenger rail services in the annual Agents' Choice Awards – once again coming out ahead of operators such as Rocky Mountaineer, Orient Express, Amtrak, Japan Rail, and the Trans-Siberian Railway. Travel agents cited VIA's knowledgeable staff and good service in awarding the distinction to VIA Rail.

Also in 2008, the *Canadian* was recognized by the Society of International Railway Travelers as one of the world's top 25 train journeys. The *Canadian* was the only regularly-scheduled service in North America to be included on the list.

IMPROVING ACCESSIBILITY

VIA continued to work with the Canadian Transportation Agency, the Council of Canadians with Disabilities, and experts in accessible design to provide a more accessible travel experience for passengers with special needs. Following preliminary design approval, VIA is reconfiguring certain of its Renaissance sleeper and coach cars to increase space in wheelchair tie-down areas and washrooms, provide additional space for service animals, and combine two existing sleeper spaces into a single enlarged, accessible bedroom with ensuite washroom.

With the help of the Canadian Institute for the Blind, VIA is developing more visible and standardized signage, tactile and Braille signage, and reconfigured seating areas in stations, all to meet the needs of visually-impaired travellers. A 2008 pilot of the new signage and seating was launched in Cobourg, Ontario, to be followed by modifications in the London, Kingston and Ottawa stations.

OFFICIAL LANGUAGES

VIA demonstrates its commitment daily to providing its customers with quality service in the official language of their choice. In 2008, 98 per cent of passengers who responded to a customer satisfaction survey confirmed that they were served by VIA in the language of their choice, whether it was on the telephone, in a station, or on board our trains. The Office of the Commissioner of Official Languages received only one complaint regarding VIA in 2008, compared to 26 the previous year. VIA also offers a work environment where employees can speak the language of their choice in regions that are designated as bilingual. All official communications are written in French and English, and VIA uses both languages in its business practices.

Growing our Business

VIA is well positioned to respond to market demand and to grow both ridership and revenues in the future. As refurbished equipment and infrastructure improvements are completed under the five-year capital investment plan, VIA expects to develop the capacity to serve up to a million more passengers by 2012.

In 2008, VIA's priority was to grow its position in the marketplace through aggressive marketing and pricing. Following significant demand in the first part of the year, VIA developed a new discount fare strategy to increase ridership throughout the summer and early fall, including initial tests of a discount e-pass to encourage customers to travel more frequently by train. Partnerships with tour operators focused on regaining and growing tourism business, in response to the rising value of the Canadian dollar. New ways to manage and deploy equipment were tested to prepare for continued growth in the Corridor.

DISCOUNT FARES FOR THE CANADIAN FORCES

As a way of saying thank you for their service, VIA offered current and retired Canadian Forces members and National Defence employees unlimited travel in *Comfort* class free of charge for the month of July. This special offer applied anywhere within the VIA network, and included a 50 per cent discount for family members. Military members and their families took almost 60,000 trips during the month, logging some 20 million passenger-miles from coast to coast.

GROWING THROUGH PARTNERSHIPS

VIA continued to work with agents, tour operators and agencies to promote rail leisure travel and tourism, and to build partnerships for future growth. For example, VIA has a well-established presence in Asian markets, having opened an overseas marketing office in Japan in 1995. That office has helped to make VIA one of the most recognized overseas travel brands in the region, and VIA is working to extend this presence to China, one of the largest emerging markets for travel in Canada.

In addition, VIA continues to work with the Canadian Tourism Commission, regional and local tourism associations, as well as local chambers of commerce and boards of trade. These partnerships allow VIA to share the expertise and resources required to reach and develop new markets, while helping to support the Canadian tourism industry as a whole.

VIA also works with industry partners to develop new products and services. As a result of a new 2008 partnership with Jonview Canada, one of the largest inbound tourism packagers in the country, customers can now book complete vacation packages – including rail travel, hotel and sightseeing options – directly through VIA's web site. Confirmations are issued online and no documents need to be mailed. Hotel and sightseeing vouchers are printed by the consumer, and rail tickets can be picked up at VIA's self-service kiosks.

RENEWING THE VIA PRÉFÉRENCE PROGRAM

The VIA Préférence program, which encourages customer loyalty and more frequent travel, rewards VIA customers with travel points that can be redeemed for free rail travel. With its simple accumulation scheme (1 point per 1 dollar spent) and relatively small numbers of points needed for redemption, VIA Préférence is one of the most generous programs of its kind in Canada, and has earned a growing membership over the past decade with over 365,000 members.

In 2008, VIA completely re-engineered the program. VIA Préférence is now a second-generation program that includes e-mail, direct marketing and frontline support. It features a dynamic communications program, personalized for each member, and aims to support all major aspects of the customer experience, including direct communications, the on-train experience, purchases, and customer service. Program changes reflect the latest industry trends, moving beyond a traditional loyalty and points program to provide more comprehensive benefits and enhanced service for program members.

In addition, VIA Préférence launched its own e-Boutique in December, where members can accumulate points on purchases made at over 75 online retailers, including the Apple Store, Canadian Tire, Reitmans, and Sears.

TESTING RENAISSANCE EQUIPMENT IN THE CORRIDOR

In 2008, VIA introduced its new Renaissance passenger cars on a trial basis for express service between Montreal and Toronto. This move is partly a response to intense competition on the route, especially for *VIA 1* customers, and is part of a comprehensive strategy to rebuild ridership and revenues for this service.

The tests helped VIA to identify areas that need improvement in the equipment, while confirming that customers will respond well to the Renaissance option. In surveys conducted on the test runs, passengers consistently rated their experience as 8 or 9 out of 10 – higher than the typical scores for other equipment.

VIA PRÉFÉRENCE

HIGH PRAISE FOR VIA'S INNOVATIVE MARKETING

The revamped VIA Préférence program has attracted the attention of the Relationship Marketing Association of Quebec, which awarded VIA the Board of Directors Prize – the most prestigious prize it bestows upon any organization – in October.

The Association praised VIA for developing VIA Préférence as an innovative, bold approach to relationship marketing.

Enhancing our Entrepreneurial Attitude

VIA nurtures an entrepreneurial attitude throughout the Corporation, focused on controlling costs, increasing productivity, and exploring new business opportunities. This attitude has helped to transform VIA Rail as a business, and remained a priority in 2008. Cost-control initiatives at all levels helped to keep operating expenses under control and cost recovery on track, despite the rising price of fuel. New partnerships helped to open up untapped niche markets and revenues. Innovative technologies continued to focus on reducing costs and increasing efficiency while enhancing interactions with all customers.

COMMERCIALIZING VIA'S EXPERTISE

In July, VIA signed a cooperation agreement with SNCF International, an independent subsidiary of the French railway Société Nationale des Chemins de Fer Français. Under this agreement, the two railways will work together to promote their know-how in operating and managing existing passenger train services both in North America and elsewhere in the world. VIA Rail and SNCF International will share their knowledge and experience in order to commercialize their expertise, professional standing and technical resources around the world. Collaboration between the two companies will range from joint participation in requests for proposals to technical or operational support in the development of projects, especially in the fields of customer service, operations, maintenance of rolling stock, training, management and information exchange.

EXPLORING NEW NICHE MARKETS

VIA operated the innovative Bike Train service once again between Toronto and Niagara Falls. Piloted in 2007 in partnership with the Niagara-on-the-Lake Chamber of Commerce, the City of Toronto, and the Ontario government, this service encourages cyclists to bring their bicycles when visiting the region. Since its launch, the concept of promoting local and regional tourism through special train services has attracted widespread attention, with other communities expressing interest in extending the service.

In western Canada, VIA works with a wide range of resorts, hotels and tourism organizations to develop new travel opportunities, such as the Snow Train between Edmonton and Jasper. In British Columbia, VIA has developed a partnership with Sun Peaks Resort near Kamloops to encourage more rail travel by skiers and snowboard enthusiasts. Schedule changes on the *Canadian* now allow passengers travelling to and from Vancouver or Jasper to arrive in Kamloops in the late evening or early morning, and then catch a shuttle to the resort.

LOWERING DISTRIBUTION COSTS AND INCREASING SALES THROUGH TECHNOLOGY SOLUTIONS

VIA has been effectively using online ticketing and reservation systems as a means to reduce distribution costs, create new revenue opportunities, and provide more convenient ways for customers to access rail services. VIA continued to explore and expand the innovative use of web-based technologies in 2008.

After migrating North American travel agencies to the ReserVIA web portal, VIA turned to its offshore (Europe and Australia/New Zealand) general sales agents in 2008, and began a similar process to expand and diversify their online sales. In the process, VIA, in partnership with BMO Financial, developed a new payment and settlement process using private-label virtual credit cards, which are recognized as a major innovation throughout the travel industry.

As a result, web-based sales continued to generate a growing portion of total revenues. When web-based sales were first introduced in 1997, VIA achieved $1 million in annual sales online. By 2008, web-based sales had climbed to $128 million, representing 45 per cent of VIA's total passenger revenue. Increased web sales and other technology enhancements have resulted in operating savings of approximately $1.6 million per year.

A STRATEGIC PLAN FOR INFORMATION TECHNOLOGY

Information technologies provide valuable tools to reduce costs and increase productivity in all aspects of VIA's operations. In 2008, VIA developed a comprehensive IT strategic plan to identify and coordinate those information technology projects that most effectively support the business goals of the Corporation, and help VIA to become a more competitive and customer-focused passenger service.

A priority under the plan is a new corporate intranet, developed in 2008 for launch in early 2009, which will give employees a single web-based point of entry to access all VIA information and services. Other key projects under development include a review of VIA's public web site, a project to provide up-to-the-minute train status information for customers, improvements to the VIAnet reservation system to help telephone sales agents provide faster, more efficient service to customers, and the implementation of technologies that will improve maintenance productivity.

The development and implementation of the strategic plan is managed by an IT Steering Committee, which ensures that all projects are aligned with VIA's business strategy, and adhere to effective IT governance processes.

Didier Luchmun
Counter Sales Agent
(Oshawa Station)

Enhancing our Environmental Sustainability

VIA's employees take great pride in providing leadership with respect to environmentally sustainable transportation and business practices. Environmental reporting is an integral part of the Corporation's planning and accountability framework under the *Moving Forward* strategy. Specific, measurable targets for improving environmental performance are established each year. A corporate-wide policy encourages sustainable practices in all aspects of the Corporation's business – in train maintenance centres, in offices and stations, as well as in the operation of passenger trains.

Rebuilding VIA's older locomotives and passenger cars under the capital investment plan will reduce fleet emissions further. New technologies included in rebuilding the F-40 locomotives will ensure that they meet current environmental standards for locomotive emissions. The rebuilt LRC cars will also incorporate environmental enhancements, including new, more efficient heating, cooling, ventilation, lighting and lay-over systems. Together, these modifications will result in an additional nine per cent reduction in fuel consumption and GHG emissions.

REDUCING EMISSIONS

Passenger rail is widely recognized as an environmentally responsible mode of transportation, and VIA works to continually improve the performance of its trains. Since 1990, VIA has cut fuel consumption by 30 per cent per passenger-kilometre, and greenhouse gas (GHG) emissions by 15,5 per cent. VIA has been able to achieve this result while operating more trains and carrying more passengers than in any year since 1990.

REDUCE, RE-USE, RECYCLE

Everyone at VIA is encouraged to develop "reduce, re-use, recycle" strategies in the workplace and on board. A Green Procurement guide emphasizes the use of environmentally responsible products in all business activities. For example, recycled paper is used for onboard products such as napkins and toilet paper, and for printed materials such as train schedules. Coffee served on trains is 100 per cent fair trade coffee,

ENVIROEXPO | VIA Rail Canada

A 2008 Canada Day celebration in Ottawa showcased the winners of the first EnviroExpo, a national contest that combines art and science in the quest for environmental solutions. Launched by VIA in 2007 in partnership with the Youth Science Foundation, EnviroExpo is a new environmental innovation category of the Canada-Wide Science Fairs. Some 30,000 schools and 20,000 teens participated in the project, with three winners receiving post-secondary scholarships from VIA valued at $10,000. More than 100 VIA employees volunteered to help organize and coordinate contest events at science fairs across the country, helping to make EnviroExpo the largest division at the national science fair in 2008.

The second year of EnviroExpo was launched in November 2008.

which supports environmentally sustainable agriculture while improving living conditions in developing countries. Wherever possible, the Corporation recycles materials – from batteries to paper to discarded computer parts. And in recent years, maintenance teams have reduced the use of chemicals for processes such as water treatment and train cleaning by almost 50 per cent.

In 2008, VIA continued to reduce the environmental impact of on board service. For example, more products, such as coffee cups, are made from recycled materials, and fair trade teas are now available. And like many responsible hotels, VIA now offers customers on the four-night journey between Toronto and Vancouver the option of receiving freshly laundered linens on request, rather than every day.

VOLUNTEER GREEN TEAMS

Throughout the Corporation, volunteer Green Teams encourage all employees to identify ways to improve VIA's environmental performance. In 2008, VIA won the Environmental Award from the Railway Association of Canada for developing Green Teams as a management approach. In 2007, visiting delegates from Canadian Business for Social Responsibility commented that "VIA Green Teams are a unique approach allowing employees to create positive changes within their environments, from a bottom-up/democratic point of view." The Green Team structure encourages employees at all levels to work together to provide environmentally friendly travel experiences to our customers and to continually improve VIA's environmental performance. Our 11 Green Teams, which are spread across our network, are made up of volunteer employees who carry our passion for the environment to every corner of our organization.

Corporate Governance

VIA's Board of Directors is responsible for overseeing the strategic direction and management of the Corporation, and reports on VIA's operations to Parliament.

The Corporation and its Board of Directors are committed to implementing principles and best practices of good governance, and an independent review in 2008 gave the Board a positive evaluation in this regard. In addition, the Auditor General's Special Examination of VIA Rail, conducted every five years, included a positive assessment of the Board's governance practices.

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

BOARD COMMITTEES

Audit and Risk Committee

Provides oversight and monitoring of the Corporation's standards of integrity and behaviour; its financial information reporting, disclosure, and annual report; its internal control practices; and its risk management policies and procedures.

Corporate Governance Committee

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

Human Resources Committee

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

Investment Committee

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

Nominating Committee

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

Planning and Finance Committee

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

Real Estate and Environment Committee

Makes recommendations to the Board of Directors on strategic direction for the Corporation's real estate assets, and receives reports on the status of environmental matters within the Corporation.

ACCESS TO INFORMATION

VIA Rail believes that openness and transparency are the starting point in building a trusted relationship with customers, and with the public in general.

In September 2007, legislation came into effect which made VIA subject to the Access to Information Act and the Privacy Act. These acts govern the legal and enforceable right of public access to records that are under the control of the federal government and its institutions. VIA has developed a process for receiving and responding to information requests, and in 2008, the federal Commissioner of Information asked to use VIA's Access to Information and Privacy web site as a model for other Crown corporations.

In 2008, VIA Rail received 74 requests under the Access to Information Act. Two requests were carried over into 2009. During 2008, the Canadian Newspaper Association's annual audit of how access to information laws are being administrated gave VIA top marks for transparency among federal agencies.

EXCEEDING EXPECTATIONS

CUSTOMER FOCUS

ENGAGING OUR PEOPLE

SAFETY AND SECURITY

G OUR BUSINESS GROWING OUR BUSINESS GROWING OUR

ENTREPRENEURSHIP

ENVIRONMENTAL SUSTAINABILITY

VICE EXCELLENCE SERVICE EXCELLEN

BEST TOTAL TRAVEL EXPERIENCE

RESPECT PASSION

MOVING FORWARD

Management Discussion and Analysis

This discussion and analysis presents data and comments on the Corporation's financial position and results of operations for the year 2008, excluding the financial results of VIA's variable interest entity (included in the Consolidated Financial Statements) and all non-funded items. It should be read in conjunction with the Consolidated Financial Statements that follow, and the Year at a Glance on page 1.

OVERVIEW OF FINANCIAL RESULTS

( ) = UNFAVOURABLE

	2008	vs Budget		vs 2007	
(IN MILLIONS OF DOLLARS)	$	$	%	$	%
PASSENGER REVENUES	**282.9**	11.3	4.2	14.1	5.2
TOTAL REVENUES	**299.2**	11.4	4.0	13.6	4.7
CASH OPERATING EXPENSES	**513.4**	(4.8)	(0.9)	(27.2)	(5.6)
CASH OPERATING DEFICIT	**214.2**	6.6	3.0	(13.6)	(6.8)
RIDERSHIP (THOUSANDS OF PASSENGERS)	**4,605**	355	8.4	423	10.1

VIA achieved strong financial results in 2008, matching or exceeding most targets set out in the corporate plan. The year began with significant growth in ridership and revenues during the winter holiday season, and results remained strong throughout the year until October, when all travel markets were affected by a drop in consumer confidence following the global financial crisis. However, growth returned in December, and VIA ended the year with a new record in ridership, having carried more than 4.6 million passengers, and an increase in total revenues of more than $13 million.

Revenue growth partially offset increased operating expenses. Higher passenger volumes, soaring fuel prices, disruptions in service caused by train derailments, and a significant decline in on-time performance contributed to rising expenses over 2007. Total operating costs rose by $27.2 million. As a result, the ratio of revenues to operating expenses declined slightly (down half of a percentage point), but government operating funding per passenger-mile decreased by 0.5 cents.

PASSENGER REVENUE AND RIDERSHIP

Overall, total revenues increased $13.6 million over 2007, a 4.7 per cent increase that surpassed annual budget targets by 4.0 per cent. The gains in ridership were impressive across all routes, increasing 10.1 per cent to 4.6 million trips, while passenger-miles, at 951 million, increased 8.7 per cent. Revenue per passenger-mile declined to 29.6 cents, or 3.0 per cent lower than 2007, as a result of growth-oriented revenue management.

Early in 2008, an unusually severe winter season, along with sustained increases in gasoline prices, underscored VIA's competitive advantage as a safe and reliable carrier, providing good value for money. With more people choosing not to travel by automobile, and both air and bus services imposing fuel surcharges on tickets, customer surveys reported that travellers shifted from those modes to the train.

In early spring, VIA adopted an aggressive revenue management strategy – making more discount fares available – to maintain ridership growth during the summer. In July, a special appreciation program offered unlimited free *Comfort* class travel to Canadian Armed Forces personnel. The response to the offer was overwhelming: close to 60,000 trips were made, totalling more than 20 million passenger-miles, with close to half of these on eastern and western long-distance trains.

New train schedules in the Quebec City-Windsor corridor improved reliability of service, and VIA strengthened its customer loyalty program with the relaunch of the VIA Préférence program. To expand leisure travel in this market, VIA concluded an agreement to share inventory with Jonview Holidays, a large Canadian tour operator that features Corridor rail tour packages. These initiatives supported continued ridership growth through the summer and early fall. However, *VIA1* ridership and fares declined in the second half of the year, as VIA faced stiff airline competition for the Montreal-Ottawa-Toronto business markets.

The high value of the Canadian dollar encouraged more vacationers to travel in the U.S. and overseas. As a result of reliability problems – particularly on long-haul routes, where tourism dominates – a number of major tour operators cancelled their rail-tour packages, leaving unsold space.

By early October, the global financial crisis began to erode business and consumer confidence, and discretionary travel contracted for all markets. Ridership flattened, and revenue growth turned negative toward the end of the year, until winter conditions once again brought a shift in demand towards the train.

OPERATING COSTS

Operating costs rose by $27.2 million or 5.6 per cent over 2007. One-third of this increase ($10.3 million) is strictly due to soaring fuel prices. The effect of fuel prices would have been twice as large without VIA's hedging policy, which has protected VIA against the full impact of rising fuel prices.

Other sources of cost increases include inflationary pressures on train operations, equipment repair and overhaul costs, compensation, and higher marketing and sales costs for promotional campaigns focused on maintaining and increasing revenues and ridership. In addition, VIA faced increased costs due to several train incidents, including two during the summer, resulting in additional equipment repair and legal expenses.

The Corporation holds $8.7 million (face value) in Non-Bank Asset Backed Commercial Paper (ABCP) in the Asset Renewal Fund which became completely illiquid in August 2007. The Corporation recorded in 2008 an additional provision for loss based on an estimated change in fair value of 30 per cent following a charge of 15 per cent recorded in 2007, for a cumulative provision of 45 per cent. In January 2009, the Superior Court of Ontario granted an implementation order to a restructuring plan which is expected to improve recoverable values on the ABCP notes if held to maturity. This provision is a non-funded item.

CAPITAL EXPENDITURES

2008 marks the first full year of the five-year, $516 - million capital investment program announced by the government in October of 2007. Most of this money is dedicated to equipment projects, and to improving Corridor rail infrastructure to increase capacity and improve reliability.

Total capital spending for the year was $42.1 million, as compared to $12.4 million in 2007. Slightly more than half of 2008 expenditures related to major equipment and infrastructure projects. This includes the F-40 rebuild program as well as infrastructure upgrades on the Smiths Falls, Brockville, Chatham, and Alexandria subdivisions. The remainder of the expenditures were for station and information technology projects, and smaller equipment and infrastructure projects.

ON-TIME PERFORMANCE

On-time performance continued to be a major challenge for VIA throughout 2008. At 75 per cent, overall on-time performance dropped two percentage points versus 2007.

Much of this decline is directly attributable to problems with aging equipment and infrastructure problems, which are being addressed through the five-year capital investment program. For example, in the Quebec City-Windsor corridor, equipment maintenance delays have increased by 28 per cent, with aging equipment making an important contribution. Long-term infrastructure work programs by the freight railways, which were extended over the summer period, also contributed to delays. In addition, VIA's own infrastructure work programs and an increase in passenger volumes have increased train delays in the Corridor.

In western Canada on-time performance was 22 per cent, a one per cent drop versus 2007. In eastern Canada, performance dropped by 23 percentage points, with a significant increase in the length of train delays due to slow orders because of the condition of track between Charny, QC, and Moncton, NB.

While on-time performance for the year as a whole declined, performance began to improve during the second half of the year. VIA worked very closely with the host railways and regional management to reduce the length of delays, and extensive discussions with the host railways resulted in an overhaul of schedules in the Corridor and western Canada. In the Corridor, VIA and CN worked together to develop a new schedule, with more realistic arrival and departure times, so that customers now have more reliable service. In western Canada, the addition of one night to the schedule for the *Canadian* will ensure more reliable, on-time service, with new touring options for travellers at stops en route.

OUTLOOK FOR 2009

In 2009, the situation relative to fuel prices and their variations will have an impact on ridership and passenger revenues. Lower prices may weaken the perception that the train is an economical means of transportation and a good substitute for the car, especially in medium-haul markets where the Corporation achieved its highest growth in ridership in 2008.

In the immediate future, travel and tourism markets will continue to reflect the uncertainty in the Canadian, U.S. and world economies. Unpredictable fluctuations in the value of the Canadian dollar will impact the decisions of Canadians choosing to vacation within the country, the U.S. or overseas, as well as the level of inbound tourism. Industry forecasts predict that domestic travel will remain stagnant, and competition for customers among transportation services will likely intensify.

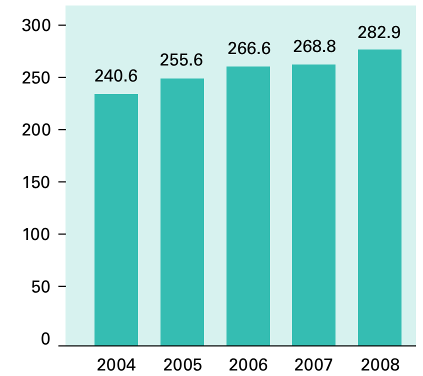
VIA is, however, well positioned to deliver a competitive, attractive service to customers in these markets, with advantages that cannot be replicated by other modes. Train travel remains the most dependable, all-weather mode of transportation, offering stress-free transportation with a high level of comfort, and it responds to growing concerns about the environmental impact of transportation. Above all, VIA excels in delivering excellent customer service, one of the key differentiators in travel markets today. VIA's marketing and promotion strategies will highlight these strengths, while innovative pricing strategies will continue to attract new customers to the train.

Customer service will continue to be the core of VIA's business strategy, focused on retaining existing customers, building customer loyalty, and increasing ridership. Enhanced products and services, along with continual improvements in service delivery, will allow VIA to meet and exceed customer expectations more consistently. And customers will see significant improvements in reliability and on-time performance, as a result of new and constructive relationships with the freight railways.

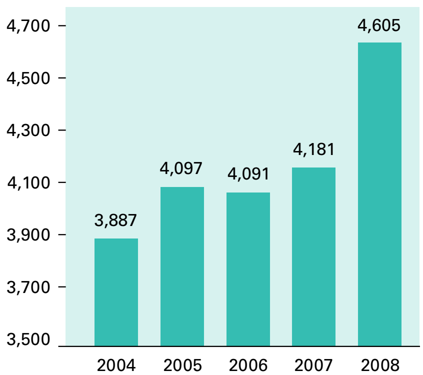
At the same time, VIA will continue to position passenger rail for long-term, sustainable growth. Planned infrastructure and equipment projects for 2009 will move forward quickly, ensuring that the Government of Canada's capital investment in the future of passenger rail delivers the results Canadians expect – a national passenger service that is reliable, efficient, safe and financially sustainable.

In February 2008, the Canadian Accounting Standards Board confirmed January 1, 2011 as the changeover date for Canadian publicly accountable enterprises to start using International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures. The Corporation is currently evaluating the impact of the adoption of IFRS on its future consolidated financial statements.

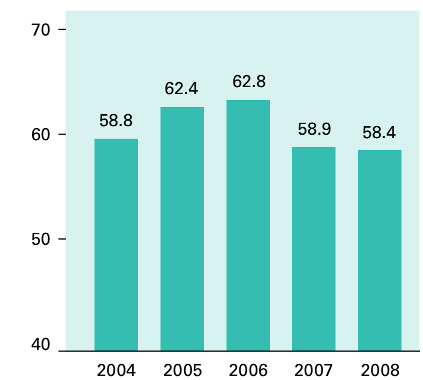
PASSENGER REVENUES
(in thousands of dollars)



RIDERSHIP
(in thousands)



REVENUE/EXPENSES RATIO
(in percentage)



CONSOLIDATED FINANCIAL STATEMENTS

Management's Responsibility Statement

Year ended December 31, 2008

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

To fulfill its responsibility, the Corporation maintains systems of internal controls, policies and procedures to ensure the reliability of financial information and the safeguarding of assets. The internal control systems are subject to periodic reviews by Samson Bélair/Deloitte & Touche, LLP, as internal auditors. The external auditor, the Auditor General of Canada, has audited the Corporation's consolidated financial statements for the year ended December 31, 2008, and her report indicates the scope of her audit and her opinion on the consolidated financial statements.

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

Paul Côté
President and Chief Executive Officer

Robert St-Jean, CA
Chief Financial and Administration Officer

Montreal, Canada
February 13, 2009

Auditor's Report

TO THE MINISTER OF TRANSPORT, INFRASTRUCTURE AND COMMUNITIES

I have audited the consolidated balance sheet of VIA Rail Canada Inc. as at December 31, 2008 and the consolidated statement of operations, comprehensive income and retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

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

In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act*, I report that, in my opinion, these principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of the Corporation that have come to my notice during my audit of the consolidated 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 the articles and by-laws of the Corporation.

Sheila Fraser

Sheila Fraser, FCA auditor
Auditor General of Canada

Montreal, Canada
February 13, 2009

CONSOLIDATED BALANCE SHEET

AS AT DECEMBER 31
(IN THOUSANDS)

	2008	2007
CURRENT ASSETS		
Cash and cash equivalents	**$ 9,205**	$ 5,147
Accounts receivable, trade	**6,701**	7,445
Accounts receivable, prepaid and other	**2,899**	4,575
Receivable from the Government of Canada	**-**	303
Derivative financial instruments **(Note 16)**	**5,067**	6,262
Materials **(Note 5)**	**22,548**	20,629
Asset renewal fund **(Note 7)**	**17,900**	17,700
Future corporate taxes **(Note 10)**	**6,187**	-
	70,507	62,061
LONG-TERM ASSETS		
Property, plant and equipment **(Note 6)**	**475,480**	487,905
Asset renewal fund **(Note 7)**	**56,734**	56,826
Accrued benefit asset **(Note 9)**	**332,514**	286,621
Derivative financial instruments **(Note 16)**	**4,973**	553
	869,701	831,905
	$ 940,208	$ 893,966
CURRENT LIABILITIES		
Accounts payable and accrued liabilities **(Notes 8)**	**$ 108,166**	$ 98,585
Derivative financial instruments **(Notes 16)**	**20,664**	1,153
Deferred revenues	**11,639**	11,812
	140,469	111,550
LONG-TERM LIABILITIES		
Accrued benefit liability **(Note 9)**	**26,164**	25,216
Future corporate taxes **(Note 10)**	**47,229**	41,042
Derivative financial instruments **(Note 16)**	**11,431**	694
Deferred investment tax credits	**1,602**	1,950
Other	**2,492**	652
	88,918	69,554
DEFERRED CAPITAL FUNDING (Note 11)	**480,384**	488,763
SHAREHOLDER'S EQUITY		
Share capital **(Note 12)**	**9,300**	9,300
Contributed surplus **(Note 12)**	**4,963**	4,963
Retained earnings **(Note 12)**	**216,174**	209,836
	230,437	224,099
	$ 940,208	$ 893,966

Commitments and Contingencies (Notes 13 and 19 respectively)

The notes are an integral part of the consolidated financial statements.

Approved on behalf of the Board,

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

Donald A. Wright
Director and Chairman of the Board

CONSOLIDATED STATEMENT OF OPERATIONS, COMPREHENSIVE INCOME AND RETAINED EARNINGS

YEAR ENDED DECEMBER 31
(IN THOUSANDS)

	2008	2007
REVENUES		
Passenger	**$ 283,062**	$ 268,959
Investment income	**578**	2,733
Other	**15,599**	15,607
	299,239	287,299
EXPENSES		
Compensation and benefits	**230,373**	218,927
Train operations and fuel	**141,319**	123,504
Stations and property	**32,524**	30,592
Marketing and sales	**30,171**	29,265
Maintenance material	**33,585**	30,852
On-train product costs	**18,036**	17,875
Operating taxes	**7,546**	7,132
Employee future benefits **(Note 9)**	**(35,045)**	(35,633)
Amortization and losses on write-down and disposal of property, plant and equipment	**54,466**	55,396
Unrealized loss on derivative financial instruments	**27,023**	1,349
Realized gain on derivative financial instruments	**(10,566)**	(6,667)
Other	**26,639**	19,172
	556,071	491,764
OPERATING LOSS BEFORE FUNDING FROM THE GOVERNMENT OF CANADA AND CORPORATE TAXES	**256,832**	204,465
Operating funding from the Government of Canada	**214,223**	200,596
Amortization of deferred capital funding **(Note 11)**	**50,857**	53,617
Income before corporate taxes	**8,248**	49,748
Corporate tax expense **(Note 10)**	**1,910**	6,208
NET INCOME AND COMPREHENSIVE INCOME FOR THE YEAR	**6,338**	43,540
Retained earnings, beginning of year	**209,836**	166,296
RETAINED EARNINGS, END OF YEAR	**$ 216,174**	$ 209,836

The notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31
(IN THOUSANDS)

	2008	2007
OPERATING ACTIVITIES		
Net income and comprehensive income for the year	**$ 6,338**	$ 43,540
Adjustments to determine net cash from (used in) operating activities:		
Amortization of property, plant and equipment	**53,846**	57,283
Losses (gains) on write-down and disposal of property, plant and equipment	**968**	(1,545)
Amortization of investment tax credits	**(348)**	(342)
Amortization of deferred capital funding	**(50,857)**	(53,617)
Future corporate taxes	-	5,171
Change in fair value of financial instruments	**2,610**	1,300
Unrealized net loss on derivative financial instruments	**27,023**	1,349
Change in non-cash working capital	**10,212**	(319)
Change in accrued benefit asset	**(45,893)**	(55,743)
Change in accrued benefit liability	**948**	739
Change in other long-term assets	-	220
Change in other long-term liabilities	**1,840**	(72)
	6,687	(2,036)
FINANCING ACTIVITIES		
Capital funding	**42,478**	12,138
	42,478	12,138
INVESTING ACTIVITIES		
Acquisition of investments in the Asset Renewal Fund	**(415,817)**	(526,086)
Proceeds from sale and maturity of investments in the Asset Renewal Fund	**413,099**	527,401
Acquisition of property, plant and equipment	**(42,478)**	(12,438)
Proceeds from disposal of property, plant and equipment	**89**	1,918
	(45,107)	(9,205)
CASH AND CASH EQUIVALENTS		
Increase during the year	**4,058**	897
Balance, beginning of year	**5,147**	4,250
BALANCE, END OF YEAR	**$ 9,205**	$ 5,147
REPRESENTED BY:		
Cash	**28**	2,265
Short-term investments, 1.50%, maturing in January 2009 (2007: 4.44%)	**9,177**	2,882
	$ 9,205	$ 5,147

The notes are an integral part of the consolidated financial statements.

Notes to Consolidated Financial Statements

AS AT DECEMBER 31, 2008

1. AUTHORITY AND OBJECTIVES

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

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

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

2. CHANGES IN ACCOUNTING POLICIES

On January 1, 2008, the Corporation adopted CICA accounting handbook section 1400, *General Standards of Financial Statement Presentation*, section 1535, *Capital disclosures*, section 3031, *Inventories*, section 3862, *Financial Instruments – Disclosures* and section 3863 *Financial Instruments – Presentation*.

Section 1400, *General Standards of Financial Statement Presentation*, has been amended and include a requirement that management make an assessment of an entity's ability to continue as a going concern when preparing financial statements. These changes, including the related disclosure requirements, came into effect on January 1, 2008 and did not impact our financial statements.

Section 1535, *Capital Disclosures* requires disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital. This new requirement is for disclosure only and does not impact the financial results of the Corporation.

Section 3031, *Inventories* specifies the measurement of inventory at the lower of cost and net realizable value with the possibility of reversing previous write downs. It provides more extensive guidance on the determination of cost including allocation of overhead, and narrows the permitted cost formula to apply for the recognition to expense as well as expanding disclosure requirements. The adoption of these recommendations has been applied retrospectively and has not resulted in a restatement nor a reclassification of spare parts inventory as Property, Plant and Equipment in the Consolidated Balance Sheet.

Section 3862, *Financial Instruments – Disclosures* and Section 3863, *Financial Instruments – Presentation* replace Section 3861, *Financial Instruments – Disclosure and Presentation.* These new sections require enhanced disclosure on the nature and extent of risks arising from financial instruments and how the entity manages those risks. This new requirement is for disclosure only and does not impact the financial results of the Corporation. The new disclosures are included in notes 3 l) and 15.

3. SIGNIFICANT ACCOUNTING POLICIES

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

A | VARIABLE INTEREST ENTITIES

These consolidated financial statements include the financial statements of the Corporation and as required by Accounting Guideline AcG-15, Consolidation of Variable Interest Entities (AcG-15), the financial statements of the Keewatin Railway Company (KRC), a variable interest entity (VIE). AcG-15 requires the consolidation of VIEs if a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is exposed to a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party is exposed to a majority of the VIE's losses), or both (the primary beneficiary). Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and non-controlling interests at fair value at the date the enterprise became the primary beneficiary (See Note 14). The Corporation revises its initial determination of the accounting for VIEs when certain events occur, such as changes in governing documents or contractual arrangements.

B | FUNDING FROM THE GOVERNMENT OF CANADA

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

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

C | CASH EQUIVALENTS

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

D | ASSET RENEWAL FUND

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

E | REVENUE RECOGNITION

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

F | FOREIGN CURRENCY TRANSLATION

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

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

G | MATERIALS

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

H | PROPERTY, PLANT AND EQUIPMENT

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

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

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

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

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

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

I | CORPORATE TAXES

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

J | INVESTMENT TAX CREDITS

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

K | EMPLOYEE FUTURE BENEFITS

The Corporation accrues obligations under its employee future benefit plans.

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

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

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

Past service costs are amortized on a straight-line basis over the expected average remaining service lives of the active employee groups at the date of the amendment.

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

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

L| FINANCIAL INSTRUMENTS

(I) FINANCIAL ASSETS AND LIABILITIES HELD FOR TRADING (HFT)

Financial instruments are classified as HFT 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. Other financial instruments may be designated as held for trading upon initial recognition.

The Corporation has classified its cash and cash equivalents as held for trading since they could be reliably measured at fair value due to their short-term maturity.

Financial assets and financial liabilities classified as HFT are measured at fair value with changes in those fair values recognized in 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, loans, 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.

(III) OTHER FINANCIAL LIABILITIES

Other financial liabilities represent liabilities that are not classified as HFT. 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, accounts payable are carried at the original invoice amount.

M| 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 HFT. Changes in fair value of derivative financial instruments are recorded in the consolidated statement of operations, comprehensive income and retained earnings. 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 liabilities.

N | MEASUREMENT UNCERTAINTY

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

O | *VIA PRÉFÉRENCE* PROGRAM

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

P | NON-MONETARY TRANSACTIONS

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

4. FUTURE ACCOUNTING CHANGES

A | GOODWILL AND INTANGIBLE ASSETS

In February 2008, the CICA issued section 3064, *Goodwill and Intangible Assets* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The standard is effective for fiscal years beginning on or after October 1, 2008, and requires retrospective application to prior period financial statements. The Corporation is in the process of evaluating the impact of this new standard for adoption on January 1, 2009.

B | INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the Canadian Accounting Standards Board confirmed January 1, 2011 as the changeover date for Canadian publicly accountable enterprises to start using International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures. The Corporation is currently evaluating the impact of the adoption of IFRS on its future consolidated financial statements.

5. MATERIALS

The cost of its materials recorded as an expense during the year amounted to $29.8 million (2007: $27.1 million). As at December 31, 2008 the Corporation has no significant expense related to write-down of the value of its materials for 2008 and 2007.

6. PROPERTY, PLANT AND EQUIPMENT

(IN MILLIONS OF DOLLARS)

	2008			2007		
	COST	ACCUMULATED AMORTIZATION	NET	COST	ACCUMULATED AMORTIZATION	NET
Land	**5.7**	**-**	**5.7**	5.7	-	5.7
Rolling stock	**775.3**	**517.7**	**257.6**	777.2	484.7	292.5
Maintenance buildings	**182.3**	**149.9**	**32.4**	181.8	141.5	40.3
Stations and facilities	**45.7**	**32.3**	**13.4**	45.3	30.4	14.9
Infrastructure improvements	**153.4**	**61.7**	**91.7**	148.5	57.9	90.6
Leasehold improvements	**116.3**	**95.4**	**20.9**	116.4	93.0	23.4
Machinery and equipment	**37.9**	**31.3**	**6.6**	36.3	30.3	6.0
Information systems	**53.4**	**48.9**	**4.5**	51.1	45.9	5.2
Other property, plant and equipment	**20.5**	**19.8**	**0.7**	20.5	19.6	0.9
	1,390.5	**957.0**	**433.5**	1,382.8	903.3	479.5
Projects in progress			**41.6**			8.1
Retired property, plant and equipment (at net realizable value)			**0.3**			0.3
			475.4			487.9

Projects in progress as at December 31, 2008, primarily consist of rolling stock, improvements to infrastructure and information systems for $33.0 million (2007: $6.0 million).

7. ASSET RENEWAL FUND

A | ASSET RENEWAL FUND

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

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

(IN MILLIONS OF DOLLARS)

	2008	2007
	CARRYING VALUE AND FAIR VALUE	CARRYING VALUE AND FAIR VALUE
Federal and provincial notes	**26.6**	-
Bankers' acceptances	**39.4**	33.3
Commercial Paper	**8.6**	41.2
Balance at end of year	**74.6**	74.5
Less: Short-term portion	**17.9**	17.7
Long-term portion	**56.7**	56.8

During the year ended December 31, 2008, the Treasury Board of Canada Secretariat approved the use of the Asset Renewal Fund to fund a maximum of $0.2 million of the 2008 capital expenditures.

Of the December 31, 2008 total balance in the Asset Renewal Fund, the Corporation has received approval by the Treasury Board of Canada Secretariat to use up to $17.9 million (2007: $17.7 million) to fund future working capital requirements. This amount is presented in the short-term portion of the Asset Renewal Fund.

The weighted average effective rate of return on short-term investments as at December 31, 2008, was 1.55 per cent (2007: 4.74 per cent) excluding non-bank sponsored Asset-Backed Commercial Paper. The weighted average term to maturity as at December 31, 2008, is two months (2007: two months) excluding non-bank sponsored Asset-Backed Commercial Paper.

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

The Asset Renewal fund is invested in 19 short-term instruments (2007: 20) that have a rating of "R-1 low" or higher. The diversification in short-term instruments is provided 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 of the Asset Renewal Fund. The Corporation minimizes its credit risks by adhering to the *Minister of Finance of Canada Financial Risk Management Guidelines for Crown Corporations* and the Corporate Investment Policy and by investing in high quality financial instruments.

B | CHANGES IN THE ASSET RENEWAL FUND

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

(IN MILLIONS OF DOLLARS)

	2008	2007
Balance at beginning of year	**74.5**	77.1
Proceeds from sale or lease of surplus assets	**0.2**	1.5
Investment Income	**2.5**	3.2
Change in fair value	**(2.6)**	(1.3)
Less: Cash drawdown during the year	**-**	(6.0)
Balance at end of year	**74.6**	74.5

C | ASSET-BACKED COMMERCIAL PAPER (ABCP)

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

The Corporation has recorded an additional unrealized loss based on an estimated change in fair value of $2.6 million in 2008 (2007: $1.3 million) as a reduction of Investment Income in the Consolidated Statement of Operations, Comprehensive Income and Retained Earnings. The impairment amount on the ABCP is $3.9 million as at December 31, 2008 which is equivalent to 45% of their face value.

The Corporation's estimate of the fair value of its investment in ABCP was based on a valuation model developed internally from information provided by the Pan-Canadian investors' committee and market information on similar structures that were still pricing at year-end, which reflect credit conditions as at December 31, 2008. Other assumptions were used to adjust for the lack of liquidity of the non-bank ABCP holdings, increased default potential on some of the structure receivables and to reflect a potential drop in expected yield resulting from the restructuring effort.

The Corporation's estimate of the fair value of its non-bank sponsored ABCP notes is subject to significant risks and uncertainties, including the timing and amount of future cash flows, despite the implementation of the Montreal Proposal in January of 2009, market liquidity, the quality of the underlying assets and financial instruments as well as changes in default rates and credit spread levels. Accordingly, there can be no assurance that the Corporation's assessment of the fair value of its ABCP holdings will not change materially in subsequent periods. The Corporation has sufficient cash to fund all its ongoing liquidity and capital expenditure requirements.

As a result of the implementation of the Montreal Proposal, the Corporation has received in January 2009 long-term floating rate notes as replacement for the ABCP. These notes have maturity dates varying from 2013 to 2056.

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The Accounts payable and accrued liabilities include the following:

(IN MILLIONS OF DOLLARS)

	2008	2007
Accrued liabilities	**26.9**	22.9
Wages payable and accrued	**38.9**	32.5
Trade payables	**28.4**	33.3
Capital tax, income tax and other taxes payable	**9.8**	9.3
Government of Canada	**3.8**	-
Current portion of network restructuring and reorganization accrual	**0.4**	0.4
Other	**-**	0.1
	108.2	98.5

9. EMPLOYEE FUTURE BENEFITS

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

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

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

The latest actuarial valuation for the post-retirement unfunded plan was carried out as at July 31, 2007. The next actuarial valuation will be carried out as at January 1, 2010.

The latest actuarial valuation for the post-employment unfunded plan was carried out as at July 31, 2007. The next actuarial valuation will be carried out as at January 1, 2010.

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

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

The actuarial valuation of the Supplemental Executive Retirement Plan is carried out annually. The last actuarial valuation was carried out as at December 31, 2008.

The actuarial valuation of the Supplemental retirement plan for management employees (SRP), with respect to retired members is carried out annually. The latest actuarial valuation was carried out as at December 31, 2008. The latest actuarial valuation for active members of the SRP was carried out December 31, 2006, and the next actuarial valuation will be carried out no later than December 31, 2009.

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

(IN MILLIONS OF DOLLARS)

	PENSION PLANS		OTHER BENEFIT PLANS	
	2008	2007	**2008**	2007
ACCRUED BENEFIT OBLIGATION:				
Balance at beginning of year	**1,479.3**	1,532.8	**31.8**	29.7
Current service cost	**23.3**	25.5	**4.6**	4.4
Employee contributions	**10.1**	9.7	**-**	-
Interest cost	**80.1**	78.5	**1.8**	1.5
Benefits paid	**(101.4)**	(97.0)	**(6.1)**	(5.6)
Net transfer in	**-**	12.6	**-**	-
Actuarial (gains) losses	**(325.5)**	(82.8)	**(4.3)**	1.8
Balance at end of year	**1,165.9**	1,479.3	**27.8**	31.8
FAIR VALUE OF PLAN ASSETS:				
Balance at beginning of year	**1,762.0**	1,777.2	**-**	-
Actual return on plan assets	**(320.0)**	45.9	**-**	-
Employer contributions	**3.6**	13.6	**6.1**	5.6
Employee contributions	**10.1**	9.7	**-**	-
Net transfer in	**-**	12.6	**-**	-
Benefits paid	**(101.4)**	(97.0)	**(6.1)**	(5.6)
Balance at end of year	**1,354.3**	1,762.0	**-**	-

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

Asset categories:	**2008**	2007
Equity securities (public market)	**44.3%**	53.4%
Fixed income securities (public market)	**44.0%**	34.0%
Private equity, hedge funds and other	**11.7%**	12.6%
	100.0%	100.0%

(IN MILLIONS OF DOLLARS)

	PENSION PLANS		OTHER BENEFIT PLANS	
	2008	2007	**2008**	2007
RECONCILIATION OF THE FUNDED STATUS:				
Fair value of plan assets	**1,354.3**	1,762.0	**-**	-
Accrued benefit obligation	**1,165.9**	1,479.3	**27.8**	31.8
Funded status of plans - surplus (deficit)	**188.4**	282.7	**(27.8)**	(31.8)
Unamortized net actuarial losses (gain)	**295.4**	187.3	**(1.4)**	3.1
Unamortized past service costs	**1.9**	2.2	**0.3**	0.4
Unamortized transitional (asset) obligation	**(153.2)**	(185.6)	**3.2**	3.7
	332.5	286.6	**(25.7)**	(24.6)
Network restructuring long-term liability	**-**	-	**(0.4)**	(0.6)
Accrued benefit asset (liability)	**332.5**	286.6	**(26.1)**	(25.2)

(IN MILLIONS OF DOLLARS)

	PENSION PLANS		OTHER BENEFIT PLANS	
	2008	2007	**2008**	2007
ELEMENTS OF DEFINED BENEFIT COSTS RECOGNIZED IN THE YEAR:				
Current service cost	**23.3**	25.5	**4.6**	4.4
Interest cost	**80.1**	78.5	**1.8**	1.5
Actual return on plan assets	**320.0**	(45.9)	**-**	-
Actuarial (gains) losses	**(325.5)**	(82.8)	**(4.3)**	1.8
Elements of employee future benefits costs (income) before adjustment to recognize the long-term nature of these costs	**97.9**	(24.7)	**2.1**	7.7
ADJUSTMENTS TO RECOGNIZE THE LONG-TERM NATURE OF EMPLOYEE FUTURE BENEFITS COSTS:				
Differences between:				
• Expected return and actual return on plan assets for the year	**(435.2)**	(75.3)	**-**	-
• Actuarial loss (gain) recognized for the year and the actual actuarial loss on accrued benefit obligation for the year	**327.0**	89.7	**4.5**	(1.8)
• Amortization of past service costs for the year and the actual plan amendments for the year	**0.4**	0.5	**0.1**	-
• Amortization of transitional (asset) obligation	**(32.3)**	(32.4)	**0.5**	0.7
Defined benefit (income) costs recognized	**(42.2)**	(42.2)	**7.2**	6.6

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

	PENSION PLANS		OTHER BENEFIT PLANS	
	2008	2007	**2008**	2007
WEIGHTED-AVERAGE OF SIGNIFICANT ASSUMPTIONS:				
Accrued benefit obligation as at December 31:				
Discount rate	**7.50%**	5.50%	**7.50%**	5.50%
Rate of compensation increase	**3.00%**	3.00%	**3.00%**	3.00%
Benefit costs for the year ended December 31:				
Discount rate	**5.50%**	5.00%	**5.50%**	5.00%
Expected long-term rate of return on plan assets	**6.75%**	7.00%	-	-
Rate of compensation increase	**3.00%**	3.25%	**3.00%**	3.25%
Assumed health care cost trend rates as at December 31:				
Initial health care cost trend rate	-	-	**7.78%**	7.78%
Cost trend rate declines to	-	-	**3.66%**	3.66%
Year ultimate rate is reached	-	-	**2014**	2014

Sensitivity analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2008:

(IN THOUSANDS OF DOLLARS)

	INCREASE	DECREASE
Total service and interest cost	38	(29)
Accrued benefit obligation	185	(166)

10. CORPORATE TAXES

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

(IN MILLIONS OF DOLLARS)

	2008	2007
Current tax expense	**1.9**	1.0
Future corporate tax expense	**-**	5.2
Corporate tax expense	**1.9**	6.2

In 2008, the Corporation recorded a current income tax expense of $1.9 million resulting from the Federal and Ontario harmonization of corporate taxes. The Corporation has a cash tax payable of $1.9 million that is payable over a five year period beginning in 2010. This amount is included in Other Long-term liabilities.

Corporate tax expense on net income for the year differs from the amount that would be computed by applying the combined Federal and provincial statutory income tax rates of 30.2 per cent (2007: 32.4 per cent) to income before corporate taxes. The reasons for the differences are as follows:

(IN MILLIONS OF DOLLARS)

	2008	2007
Computed tax expense - statutory rates	**2.4**	16.1
Permanent difference:		
Large corporate tax expense (recovery)	**(0.3)**	(0.5)
Non-taxable portion of capital and accounting losses (gains) and others	**0.4**	(0.2)
Change in valuation allowance	**(1.0)**	1.9
Effect of statutory tax rate substantively enacted during the year	**-**	(4.8)
Effect of tax rate changes on future income taxes	**(1.3)**	(4.0)
Future income tax expense (recovery) relating to changes in temporary differences	**1.7**	(4.1)
Other	**-**	1.8
	1.9	6.2

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

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

(IN MILLIONS OF DOLLARS)

	2008	2007
Future corporate tax assets:		
Property, plant and equipment	**(25.1)**	(23.1)
Contingencies, other liabilities and net amounts	**(4.5)**	(4.3)
Accrued benefit liability	**(6.6)**	(6.4)
Unrealized loss on derivative financial instruments	**(6.5)**	-
Loss carry-forward	**(10.8)**	(10.3)
	(53.5)	(44.1)
Less the valuation allowance	**8.7**	9.7
	(44.8)	(34.4)
Future corporate tax liabilities:		
Accrued benefit asset	**85.9**	74.0
Unrealized gain on derivative financial instruments	**-**	1.5
	85.9	75.5
Net future corporate tax liabilities	**41.1**	41.1
Presented in the consolidated balance sheet as:		
Future income tax assets – short-term	**(6.2)**	-
Future income tax liabilities – long-term	**47.3**	41.1
Net future corporate tax liabilities	**41.1**	41.1

The Corporation has $42.0 million of unused federal non-capital tax losses carried forward and their related year of expiry are as follows:

(IN MILLIONS OF DOLLARS)

2010	**0.7**
2014	**3.3**
2015	**14.4**
2026	**18.8**
2028	**4.8**
	42.0

11. DEFERRED CAPITAL FUNDING

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

(IN MILLIONS OF DOLLARS)

	2008	2007
Balance, beginning of year	**488.7**	530.2
Government funding for depreciable property, plant and equipment	**42.5**	12.1
Amortization of deferred capital funding	**(50.8)**	(53.6)
Balance, end of year	**480.4**	488.7

12. CAPITAL

The authorized share capital of the Corporation is comprised of an unlimited number of common shares with no par value. As at December 31, 2008 and 2007, 93,000 shares at $100 per share are issued and fully paid.

The Corporation defines its capital as share capital, contributed surplus 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 contract debt instruments. This being the case, 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.

13. COMMITMENTS

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

(IN MILLIONS OF DOLLARS)

2009	**21.3**
2010	**15.1**
2011	**15.3**
2012	**15.6**
2013	**15.0**
Subsequent years proportionately to 2049	**191.1**
	273.4

Included in the above commitments is a contract extension for an estimated amount of $51 million.

B| As at December 31, 2008, the Corporation has outstanding purchase commitments amounting to $109.8 million (2007: $108.4 million) consisting mainly of advertising as well as the maintenance and completion of rolling stock projects. The Corporation expects to make payments under these commitments over the next 6 years.

C| The Corporation has entered into train service agreements for the use of tracks and control of train operations expiring on December 31, 2008. The Corporation is currently negotiating a new Train service agreement. In the meantime the terms of the existing agreement continue to apply.

D| The Corporation has issued letters of credit totalling approximately $22.0 million (2007: $20.0 million) to various provincial government workers' compensation boards as security for future payment streams.

14. VARIABLE INTEREST ENTITIES

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

In 2008, the financial contribution provided by the Corporation to KRC amounted to $2.5 million (2007: $1.9 million).

KRC received $1.9 million for the maintenance of their infrastructure from the Government of Canada in 2008 (2007: $0.4 million).

The liabilities recognized as a result of consolidating KRC do not represent additional claims on the Corporation's assets; rather, they represent claims against the specific assets of KRC. Conversely, assets having a net book value of $7.4 million (2007: $8.4 million) recognized as a result of consolidating KRC do not represent additional assets that could be used to satisfy claims against the Corporation's assets. Additionally, the consolidation of the KRC VIE did not result in any change in the underlying tax, legal or credit exposure of the Corporation.

15. FINANCIAL INSTRUMENTS

A | CLASSIFICATION OF FINANCIAL INSTRUMENTS

The financial instruments are classified as follows:

	December 31, 2008		December 31, 2007	
	CARRYING VALUE		CARRYING VALUE	
	HFT	L&R	HFT	L&R
FINANCIAL ASSETS:				
Cash and cash equivalent	**9.2**	**-**	5.1	-
Accounts receivables	**-**	**6.2** [1]	-	6.5 [1]
Derivative financial instruments	**10.0** [2]	**-**	6.8 [2]	-
Asset renewal fund	**74.6** [3]	**-**	74.5 [3]	-
	HFT	OTHER LIABILITY	HFT	OTHER LIABILITY
FINANCIAL LIABILITIES:				
Accounts payable and accrued liabilities	**-**	**79.0** [4]	-	70.0 [4]
Derivative financial instruments	**32.1** [2]	**-**	1.8 [2]	-

HFT – Held for trading
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 HFT and derivative financial instruments approximates their carrying value due to their current nature. HFT financial instruments and derivatives are carried at fair value.

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 maintains cash and cash equivalents, accounts receivables, crude swaps and accounts payable and accrued liability in U.S. dollars (USD) and is therefore exposed to currency risks on these balances as follows:

(IN MILLIONS OF DOLLARS)

	2008	2007
Assets:		
Cash and cash equivalents	**-**	0.5
Derivative financial instruments	**10.0**	6.8
Liabilities:		
Accounts payables and accrued liabilities	**1.0**	1.8
Derivative financial instruments	**32.1**	1.8

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 enters into certain foreign exchange forward contracts. Theses contracts are utilized by the Corporation in the management of its exposure to the changes in value of the USD 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 exposure to foreign exchange variation of 5% 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 of the financial instrument. The carrying amount of financial assets is $100.0 million (2007: 92.9 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 the financial asset. The Corporation minimizes credit risk on cash and cash equivalents, investments, Asset Renewal Fund and derivative financial instruments by depositing or engaging in those financial instruments with only reputable and high quality financial institutions. The Corporation exposure on account receivables is reduced by applying a credit policy restricting the concentration of risk, assessing and monitoring counterparty credit risk and setting credit limits, as needed. Only Canadian government departments and agencies, Crown Corporations issuing government travel warrants and International Air Transport Association (Billing and Settlement Plan /Airline Reporting Corporation) Travel Agents are exempt from the credit investigation process.

As at December 31, 2008, approximately 10.5% (2007: 11.5 %) of trade accounts receivable were over 90 days past due, while approximately 77.4% (2007: 75.6%) of accounts receivable were current (under 30 days).

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

As at December 31, 2008, the allowance for bad debt was $0.4 million (2007: $0.5 million) a decrease of $0.1 million (2007: $0.2 million increase). The allowance for bad debt is based on account age and customer standing. An account by account analysis is performed.

F| FUEL PRICE RISK

In order to manage its exposure to fuel and heating oil prices and minimize volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries. A fluctuation in heating oil or fuel of 10% would not have a significant impact on the consolidated 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 and receives funding from the Government of Canada. The classification of accounts payable and accrued liabilities and derivative financial instruments in item a) above for a total of $111.1 million (2007: $71.8 million) represents the maximum exposure for the Corporation and generally has contractual maturities of six months or less.

H| INTEREST RISK

Interest rate risk is defined as the Corporation's exposure to a loss on earnings or a loss to the value of its financial instruments as a result of the fluctuations in interest rates. The Corporation is exposed to interest rate risk associated with cash equivalents and the Asset Renewal Fund for a total of $83.8 million (2007: $79.6 million). A variation of 5% in the interest rates would affect the investment income but would not have a significant impact on the consolidated financial statements.

16. DERIVATIVE FINANCIAL INSTRUMENTS

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

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

DESCRIPTION	PERIOD	FIXED PRICE PER US GALLON (USD)	NOTIONAL QUANTITY (000'S OF US GALLONS)	FAIR VALUE CAD (000'S)	
	(NOTE 1)			**2008**	2007
Crude swap	2008	1.457 to 2.481	10,080	-	6,260
Crude swap	2009	2.092 to 2.368	2,016	-	551
Crude swap	2011	1.868	1,008	**91**	-
				91	6,811

Note 1 – These financial instruments have a monthly settlement schedule.

DESCRIPTION	PERIOD	FORWARD RATE CAD / USD	NOTIONAL AMOUNT (USD) (000'S)	FAIR VALUE CAD (000'S)	
	(NOTE 1)			**2008**	2007
Foreign Exchange Foward	2008	0.991	2,501	-	2
Foreign Exchange Foward	2009	0.994 to 1.061	26,071	**5,067**	2
Foreign Exchange Foward	2010	0.996 to 1.050	16,006	**2,809**	-
Foreign Exchange Foward	2011	1.037	7,479	**1,210**	-
Foreign Exchange Foward	2012	1.036	5,610	**863**	-
				9,949	4
				10,040	6,815

Note 1 – These financial instruments have a monthly settlement schedule.

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

DESCRIPTION	PERIOD	FORWARD RATE CAD / USD	NOTIONAL AMOUNT (USD) (000'S)	FAIR VALUE CAD (000'S)	
	(NOTE 1)			**2008**	2007
Foreign Exchange Foward	2008	0.992 to 1.150	18,577	-	(1,153)
Foreign Exchange Foward	2009	0.994 to 1.061	7,527	-	(181)
Foreign Exchange Foward	2010	1.033	5,609	-	(157)
Foreign Exchange Foward	2011	1.037	7,479	-	(209)
Foreign Exchange Foward	2012	1.036	5,609	-	(147)
				-	(1,847)

Note 1 – These financial instruments have a monthly settlement schedule.

DESCRIPTION	PERIOD	FIXED PRICE PER US GALLON (USD)	NOTIONAL QUANTITY (000'S OF US GALLONS)	FAIR VALUE CAD (000'S)	
	(NOTE 1)			**2008**	2007
Crude swap	2009	2.092 to 3.991	12,096	**(20,664)**	-
Crude swap	2010	2.325 to 3.639	8,064	**(10,341)**	-
Crude swap	2011	2.409	2,016	**(1,090)**	-
				(32,095)	-
				(32,095)	(1,847)

Note 1 – These financial instruments have a monthly settlement schedule.

The fair value of the derivative financial instruments is estimated as the discounted unrealized gain or loss calculated based on the market price at December 31, 2008, which generally reflects the estimated amount that the Corporation would receive or pay to terminate the contracts at the consolidated balance sheet date. The fair value of the derivative financial instruments is provided to the Corporation by the chartered banks that are the counterparties to the transactions.

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

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

17. 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 applicable to all individuals and enterprises and these transactions are recorded at exchange value. Other than disclosed elsewhere in these consolidated financial statements, related party transactions are not significant.

18. NON-MONETARY TRANSACTIONS

The Corporation recorded a revenue from non-monetary transactions of approximately $1.0 million (2007: $1.2 million) as "Passenger revenue" in the Consolidated Statement of Operations, Comprehensive Income and Retained Earnings for the year ended December 31, 2008. The Corporation also recorded non-monetary expenses of $1.2 million (2007: $1.3 million) in the Consolidated Statement of Operations, Comprehensive Income and Retained Earnings, mainly as "Marketing and sales" and other expenses resulting from non-monetary transactions. The nature of non-monetary transactions is mainly related to advertising exposure.

19. CONTINGENCIES

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

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

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

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

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

The Corporation has performed a review of all of its operations and of all of its sites and facilities at risk in order to determine the potential environmental risks. The sites and the facilities for which environmental risks were identified were or will be the subject of thorough studies and corrective actions were or will be taken if necessary in order to eliminate or to attenuate these risks. The continuous risk management process that is in place allows the Corporation to monitor its activities and properties under normal operating conditions as well as monitor accidents that occur. The 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.

New environmental laws were passed in 2008 and the Corporation is currently assessing any potential impact these may have on the current corporate environmental plans or projects.

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

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

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

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

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

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

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

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

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

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

20. ASSET RETIREMENT OBLIGATION

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

21. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the 2008 presentation.

Corporate Directory

AS AT DECEMBER 31, 2008

BOARD OF DIRECTORS

D. Hayward Aiton
Saint John, New Brunswick

France Bilodeau
Quebec City, Quebec

Jeffrey R. Clarke
Ottawa, Ontario

Paul Côté
President and Chief Executive Officer
Montreal, Quebec

Denis Durand
Montreal, Quebec

Angela Ferrante
Toronto, Ontario

Jean-Louis Hamel
Montreal, Quebec

David Hoff
Vancouver, British Columbia

Wendy A. King
Vancouver, British Columbia

Margaret L. MacInnis
Halifax, Nova Scotia

Donald Mutch
Toronto, Ontario

Anthony Perl
Vancouver, British Columbia

Paul G. Smith
Toronto, Ontario

Eric L. Stefanson
Winnipeg, Manitoba

William M. Wheatley
Regina, Saskatchewan

Donald A. Wright
Chairman of the Board
Toronto, Ontario

OFFICERS

Paul Côté
President and Chief Executive Officer

Steve Del Bosco
Chief Customer Officer

Christena Keon Sirsly
Chief Strategy Officer

Carole Mackaay
General Counsel and Secretary

John Marginson
Chief Operating Officer

Denis Pinsonneault
Chief People Officer

Robert St-Jean
Chief Financial and
Administration Officer

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

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

The Board wishes to thank the following outgoing members for their important contribution:
Michel Crête, Steven Cummings and Leo Housakos.

COMMITTEES OF THE BOARD

Audit and Risk Committee

Eric L. Stefanson, Chairman
Denis Durand
Jean-Louis Hamel
Wendy A. King
Paul G. Smith

Human Resources Committee

Angela Ferrante, Chairman
France Bilodeau
David Hoff
Wendy A. King
Margaret L. MacInnis
Anthony Perl

Investment Committee

Donald Mutch, Chairman
D. Hayward Aiton
France Bilodeau
Denis Durand
Jean-Louis Hamel
William M. Wheatley

Corporate Governance Committee

Jean-Louis Hamel, Chairman
D. Hayward Aiton
Angela Ferrante
Margaret L. MacInnis
William M. Wheatley

Planning and Finance Committee

Paul G. Smith, Chairman
Jeffrey R. Clarke
David Hoff
Anthony Perl
Eric L. Stefanson

Real Estate and Environment Committee

Jeffrey R. Clarke, Chairman
D. Hayward Aiton
Jean-Louis Hamel
William M. Wheatley

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