

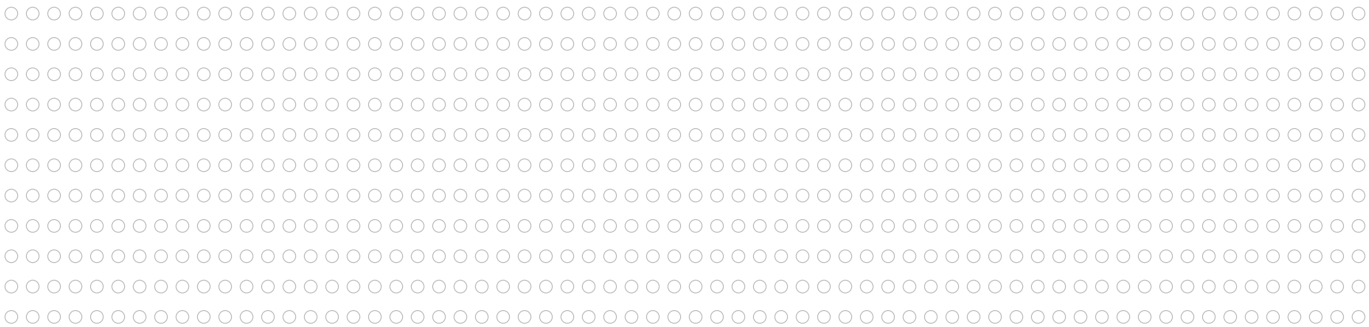
2010 ANNUAL REPORT

CONNECTION

TRANSFORMATION

EVOLUTION





LETTER TO THE MINISTER OF STATE (TRANSPORT)

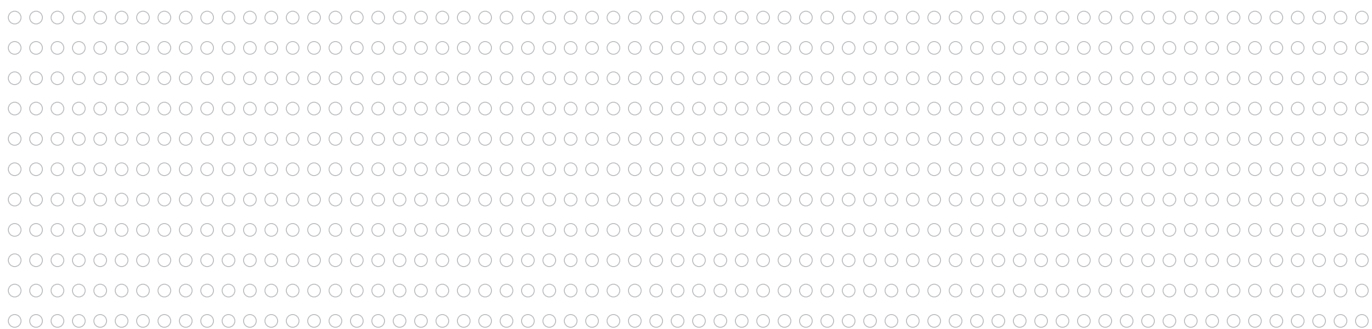
THE HONOURABLE ROB MERRIFIELD
Minister of State (Transport), Ottawa

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, 2010.

Paul G. Smith
Chairman of the Board

viarail.ca





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CORPORATE OVERVIEW

VIA Rail operates Canada's national passenger rail service on behalf of the Government of Canada. An independent Crown corporation established in 1977, VIA provides a safe, efficient and environmentally responsible service from coast to coast in both official languages. We operate up to 497 trains weekly on 12,500 kilometres of track, connecting over 450 Canadian communities. With approximately 2,900 employees, VIA carried 4.1 million passengers in 2010.

OUR VISION

We will offer the best travel experience in Canada.

OUR MISSION

We work together to exceed customer expectations every time.

OUR GUIDING PRINCIPLES

These principles guide the thinking and conduct of every VIA employee:

- I focus on the customer.
- I take action and am accountable.
- I am flexible and contribute to change.
- I make the difference.

OUR SERVICES

Rapid Intercity Travel

In the densely populated Ontario–Quebec corridor, 429 trains per week provide fast, convenient, downtown-to-downtown travel between major urban and suburban centres and communities.

Long-distance Travel and Tourism

In Western and Eastern Canada, VIA's trains attract travellers from around the world and support Canada's tourism industry. The *Canadian*[®], VIA's legendary western transcontinental, provides service three times per week between Vancouver and Toronto. In Eastern Canada, the *Ocean*[™] runs six times a week between Montreal and Halifax.

Mandatory Transportation in Outlying Regions

VIA operates 50 trains per week in rural and remote regions of Canada. Mandated by the Government of Canada to meet important transportation needs, these trains serve many communities where alternative, year-round transportation is limited or unavailable.

KEY OPERATING STATISTICS BY SERVICE GROUP, 2010

	Passenger-Miles (IN THOUSANDS)	Passenger Revenue (IN THOUSANDS)	Passengers (IN THOUSANDS)	Government Funding per Passenger Mile
Intercity Ontario-Quebec Corridor	625,157	197,806	3,780	\$0.21
Long-distance and Tourism				
The <i>Canadian</i> [®]	125,848	39,279	106	\$0.40
The <i>Ocean</i> [™]	60,611	13,091	127	\$0.60
Mandatory Services	34,503	8,022	140	\$1.30

THE YEAR AT A GLANCE

The following key financial indicators and operating statistics summarize the performance of the Corporation for the year 2010, with comparative data for the years 2006 to 2009. They exclude the financial results of the variable interest entity (Keewatin Railway Company) and all non-funded items.

	2010	2009	2008	2007	2006
KEY FINANCIAL INDICATORS (IN MILLIONS OF DOLLARS)					
Total passenger revenue (1)	258.2	250.3	282.9	268.8	266.6
Total revenue (2)	274.4	264.9	299.2	285.6	297.1
Total Cash operating expenses (3)	535.9	526.1	513.4	486.2	475.5
Cash operating loss	261.5	261.2	214.2	200.6	178.4
Government Operating Funding (4)	261.5	226.3	214.2	200.6	169.0
Capital expenditures	268.6	116.8	42.1	12.4	14.5
Government Capital Funding (5)	268.6	116.8	42.1	12.4	0.0
KEY OPERATING STATISTICS (6)					
Revenue/Cash operating expenses ratio	51.6	50.7	58.4	58.9	62.8
Total passengers carried (IN THOUSANDS)	4,153	4,229	4,605	4,181	4,091
Total passenger-miles (IN MILLIONS)	846	857	951	874	874
Total seat-miles (IN MILLIONS)	1,495	1,501	1,618	1,579	1,603
Government operating funding per passenger-mile (IN CENTS)	30.9	26.4	22.5	23.0	19.3
Yield (CENTS PER PASSENGER-MILE)	30.2	29.0	29.6	30.5	30.3
Train-miles operated (IN THOUSANDS)	6,668	6,660	6,746	6,658	6,665
Car-miles operated (IN THOUSANDS)	43,651	44,525	46,961	46,362	47,625
Average passenger load factor (%)	57	57	59	55	55
Average number of passenger-miles per train mile	127	129	141	131	131
On-time performance (%)	82	83	75	77	84
Number of employees at year-end	2,875	3,053	3,109	3,017	3,003

1) Excluding the revenues from the variable interest entity

2) Excluding the revenues from the variable interest entity and an unrealized gain

3) Cash operating expenses exclude amortization of property, plant and equipment (\$58M), unrealized gains on financial instruments (\$7M), pension and employee future benefits (\$20M) and the expenses from the variable interest entity (\$3M).

(4) Excludes internal funding from the Asset Renewal Fund (\$34.9M in 2009 and \$9.4 M in 2006).

(5) Excludes internal funding from the Asset Renewal Fund (\$14.5 M in 2006).

(6) Key operating statistics are unaudited.



MESSAGE FROM THE CHAIRMAN

THE TRANSFORMATION OF PASSENGER RAIL

Passenger rail is growing, both in Canada, and around the world, as a key player in public transportation. Already well established as the cornerstone of public transportation in Europe and Asia, it is attracting renewed interest and investment in countries on every continent. It is proving itself, day-in and day-out, as a practical, cost-effective investment to ease congestion on highways and airways, to support increasingly mobile populations, and reduce the impact of transportation on the environment.

In Canada, the Government is investing almost one billion dollars, including \$407 million from Canada's Economic Action Plan, to improve and expand the capacity of passenger rail. Launched in 2007, VIA's capital investment program made good progress in 2010. Rebuilt and modernized locomotives and passenger cars came out of the shop and into service. New station projects got underway across the country. Major construction projects to upgrade and expand track capacity are on target for completion.

As these projects progressed in 2010 the corporation renewed its focus on operational efficiency, eliminating waste and delivering the best possible value to customers and taxpayers. The Board believes that this focus goes hand-in-hand with the transformation of passenger rail through capital investment. I am confident that the entire VIA team will continue to achieve operational improvements throughout 2011 and beyond.



A handwritten signature in black ink, appearing to read 'Paul G. Smith', set against a light gray background.

Paul G. Smith
Chairman of the Board

VIA has brought new members to its management team, people with the expertise and experience necessary to manage the transformation of the corporation now underway. The Board would like to thank those who retired from VIA during 2010 for the lasting contribution they have made to VIA's success. The new management team, and VIA's employees, are building on a valuable legacy built over many years.

I would also like to express my personal appreciation, along with that of the entire Board of Directors, for the work of Donald A. Wright, who completed his term on the Board in 2010. During his four years of service as Chairman, the corporation successfully faced many critical challenges. His leadership during this time will have an impact on the future of VIA for many years to come.

Public interest in the future of passenger rail is higher today than ever before. Should that interest evolve into building dedicated, high speed rail services connecting key urban centres, its success will depend on the transformation of Canada's national passenger rail service now underway.

As the transformation progresses, VIA remains committed to offering a safe, reliable, cost-efficient and environmentally-responsible transportation option to Canadians from coast to coast.



MESSAGE FROM THE PRESIDENT

DELIVERING VALUE

When I joined VIA in 2010, I was already impressed by the quality of the organization, the dedication of its employees, and the potential of passenger rail to grow and respond to the needs of the future. I am even more impressed now, when I look back on what we achieved during the year.

With a full-scale transformation of our physical assets in progress, we devoted renewed energy to transforming the way we operate as a business. We implemented an approach called Lean management that focuses on operational excellence throughout the corporation. That means continuous improvements in operational efficiency and productivity, eliminating waste, identifying what our customers value most – and delivering that value consistently, every day.

It is an approach that calls on the efforts of every single employee. And by pulling together, we achieved real progress. Despite a drop in ridership and continued volatility in the marketplace, we increased total revenues significantly over 2009. We also cut operating expenses well below the budget for the year. And we improved cost-recovery for passenger rail, regaining the upward momentum VIA had achieved before the 2009 recession.

In short, we delivered more value to our shareholder, the Government of Canada, and to taxpayers.

Work on infrastructure projects created significant challenges for our services, affecting the on-time performance of some of our trains. But here too, we achieved significant results. Highly focused and coordinated efforts brought improvements on specific services, especially for Montreal-Ottawa-Toronto trains, and performance in Eastern Canada improved dramatically over 2010. As a whole, we managed to keep overall on-time performance even with the preceding year, while moving forward with the major track upgrades and construction projects.



Marc Laliberté
President and Chief Executive Officer

We also focused considerable efforts on improving the way we listen to and engage with our customers, the communities we serve, and the suppliers we work with. Lean management extends beyond the corporation. We reach out to our customers to better understand what they need and value, and to our suppliers to seek their support in delivering value efficiently.

In this regard, I would like to express VIA's appreciation to all of our suppliers, and especially the freight railways who own track used by our trains and the companies who are helping to rebuild and renew our locomotives and passenger cars. Our continued success in the years ahead depends very much on continued partnerships, and I look forward to strengthening those partnerships in 2011.

As our capital investment projects are completed, we will have new opportunities to deliver value to our customers, with better equipment, more attractive passenger facilities, faster and more reliable trip times and more frequent train services between major centres. We will face new financial and operational challenges during this time of transformation, as we work to attract new customers, introduce new services, and meet the changing needs of travellers.

I am confident that we will meet those challenges – by continuously focusing on operational excellence, and delivering the best value possible to every customer who boards our trains. We are committed to providing Canadian taxpayers with a national passenger rail service of which they can be proud.



THE YEAR IN REVIEW

OUR VISION FOR PASSENGER RAIL

Our vision for passenger rail is to deliver the best travel experience in Canada. In fact, we believe that passenger rail can become the first choice for intercity travel – not only leading the market for public transportation, but attracting a growing number of Canadians and international tourists who will choose to travel by train rather than by private automobile.

Making quality rail travel accessible and attractive to more Canadians has important social and economic benefits for the communities we serve, and for the country. Efficient public transportation between urban centres supports an increasingly mobile population, which is important for economic growth – and passenger rail is the most efficient and cost effective public transportation available. It is also the safest and most environmentally sustainable mode available, proven in countries around the world to attract significant traffic away from less efficient and less sustainable modes.

Our long-term goal is to transform passenger rail as a vital, core service connecting Canada and Canadians across the country. This means:

- Making passenger rail a primary transportation “backbone” between major urban centres.
- Offering fast, frequent and convenient service that equals or surpasses anything else available – with facilities and equipment that are welcoming, comfortable, and reliable year round.
- Integrating passenger rail with other modes and the transportation network as a whole, providing seamless interconnections with local, municipal and regional transportation services.

This is both an ambitious and a realistic long-term vision for passenger rail. In 2010 we continued to bring our vision closer to reality by:

- Transforming the passenger rail network – moving forward with a \$923 million capital investment in equipment, technology, stations and infrastructure. In the Ontario - Quebec corridor, this investment will give us the capacity to carry up to six hundred and fifty thousand more passengers per year.
- Transforming our operations – applying new management tools to streamline operations, deliver more value to the customer, while eliminating waste and reducing costs.
- Transforming our relationships – exploring better ways to listen and respond to our customers and the communities we serve, and to carry out our role as a socially responsible corporation.

We believe in the importance of delivering value to our customers so that passenger rail meets and exceeds their expectations for years to come.

BUILDING ON OUR SUCCESS

THE TRANSFORMATION OF PASSENGER RAIL NOW UNDERWAY BUILDS ON A SOLID TRACK RECORD OF IMPROVED PERFORMANCE. SINCE 1990, THE FIRST YEAR THAT VIA BEGAN OPERATING ITS CURRENT NETWORK, VIA HAS:

36%

REDUCED RELIANCE ON GOVERNMENT
OPERATING FUNDING BY 36%

92%

INCREASED
REVENUES
BY 92%

79%

IMPROVED COST
RECOVERY BY 79%

11%

INCREASED PASSENGER MILES
BY 11%



CAPITAL

INVESTMENT

TRANSFORMING OUR NETWORK

We are transforming the basic infrastructure and equipment we use to operate passenger rail services across Canada.

In 2007 the Government of Canada announced a five-year, \$516 million investment to strengthen passenger rail services. Another \$407 million was made available for capital projects in 2009, through the Government's economic stimulus funding program, Canada's Economic Action Plan.

With this investment, totalling \$923 million, VIA is expanding track capacity, building better traffic control systems, modernizing passenger facilities and stations, and renewing locomotives and rail cars. When these major capital projects are complete, we will be able to operate more trains, deliver faster and more reliable trip times, offer more frequent departures, and provide customers with a better quality of service than ever before.

CAPITAL INVESTMENT AND STIMULUS FUNDING

	Capital Investment	Economic Action Plan	Total
Equipment	\$224.8M	\$102.8M	\$327.6M
Infrastructure	\$247.2M	\$254.2M	\$501.4M
Stations, Technology and Other Projects	\$44.0M	\$50.0M	\$94.0M
TOTAL	\$516.0M	\$407.0M	\$923.0M

EXPANDING CAPACITY

VIA has allocated \$488.5 million to expand and improve the infrastructure in the Ontario - Quebec corridor, particularly in the Montreal-Ottawa-Toronto triangle, where the demand for passenger rail service is highest. In the past, our ability to meet growing demand has been limited by the capacity of the track itself, which is shared by both passenger and freight trains. To increase capacity, we are:

- Upgrading existing tracks to higher standards, which will allow passenger trains to operate at higher speeds.
- Building additional sidings to eliminate bottlenecks, allowing passenger trains to pass each other as well as slower freight trains with fewer delays.
- Adding a third line of track along major parts of the Montreal-Toronto line, which will significantly reduce congestion between passenger and freight traffic at key points on the route.

In addition, we are improving safety and security systems along the corridor network to ensure that faster, more frequent trains can operate safely. Grade-level crossings, where roads cross rail lines, are being improved and eliminated where possible. New signalling systems are being installed. We are expanding our Centralized Traffic Control (CTC) technology throughout the Ontario - Quebec corridor.

With these infrastructure improvements VIA will have the capacity to serve an estimated six hundred and fifty thousand additional passengers per year.

Work on these infrastructure projects is well underway.

Windsor to Toronto represents VIA's Southwestern Ontario (SWO) region.

Toronto to Quebec represents VIA's Corridor East region.



NEW STATIONS

VIA is upgrading and building new stations in communities across the country. New station designs will provide welcoming and attractive facilities for passengers, and make arrivals and departures an integral part of the exceptional travel experience offered by passenger rail. In 2010 we began work on six major station projects.

- In Belleville, Brockville, Cobourg and Oshawa, we progressed plans for new or upgraded stations which will feature new “island” boarding platforms to accommodate the addition of a third line of track, and the separation of passenger and freight rail.
- An overhead footbridge complex serviced by elevators and stairs will be built at Belleville, Cobourg and Oshawa to provide a connection to the new platforms.
- The existing heritage station at Cobourg will be upgraded to accommodate expansion. The new facilities will harmonize with the current heritage architecture.
- We are nearing completion on a new station in Smiths Falls, at a new location. The station is fully-accessible, with easy passenger access, ample parking and room for future growth. The new location reduces schedule conflicts between VIA passenger and Canadian Pacific freight trains which occurred at the old site, which was in the middle of a junction between four busy CP lines and VIA’s Smiths Falls line to Ottawa.
- We proceeded with plans for the construction of a new, larger passenger station in Windsor. The old station, built in the early 1960’s, can no longer meet current demand and passenger needs. The new facility will provide a more welcoming and accessible environment for passengers with convenient parking, passenger pick-up and drop-off facilities, efficient ticketing and baggage handling, and comfortable waiting areas.
- The ongoing revitalization of Toronto’s Union Station, which opened in 1927, will bring a number of benefits to VIA customers. These include a new, larger and more comfortable Panorama lounge for Business class passengers, more efficient baggage handling facilities and restored surfaces and rehabilitated washrooms in the VIA concourse area.

MORE EFFICIENT, RELIABLE LOCOMOTIVES

One of our top priorities in the capital investment program has been the renewal of our fleet of locomotives. The 20-year old F-40s, used in all parts of Canada, are being stripped down to their shells and rebuilt from the ground up, incorporating the latest locomotive technologies.

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

By the end of 2010, 23 of the locomotives were completed and in service. Their performance has met or exceeded expectations, reducing fuel consumption for the year by some 5.2 million litres. When the remaining locomotives are rebuilt in 2011-12, VIA will operate one of the most reliable and fuel-efficient motive power fleets of any passenger rail operator in North America.

VIA also began rebuilding six self-propelled rail diesel cars in 2010. The cars will be used on VIA services between Sudbury and White River in Ontario and between Victoria and Courtenay in British Columbia. Built in the 1950s, the six sturdy, stainless steel cars are structurally sound. Once the rebuild work is completed, the cars will provide another 15 to 20 years of safe, accessible and reliable service to Canadian travellers, with improved cost-effectiveness and passenger comfort. The contract is funded through the Government of Canada’s Economic Action Plan.

VIA'S WESTERN GATEWAYS

Pacific Central Station in Vancouver is an architectural and heritage landmark, as well as a multimodal transportation hub for the city. As the Western home for VIA's cross-Canada tourism service, the *Canadian*[®], it is also a gateway to Vancouver and the West for visitors from around the world.

VIA completed important repairs to the station in 2009 as part of the capital investment program. In 2010, we launched a program of major renovations to the station's masonry, roof and windows, paying strict attention to preserving features that mark the building as a Heritage site.

This project is funded from the Government of Canada's Economic Action Plan.

VIA is also completing major exterior and interior upgrades to its station in Winnipeg, the Western gateway for travellers from Toronto. This includes the installation of new roofing, a project funded from the Economic Action Plan, as well as new flooring, painting and improvements to heating and ventilation systems.

RENEWING OUR PASSENGER CARS

VIA continued a top-to-bottom overhaul of 98 LRC (Light, Rapid, Comfortable) passenger cars in 2010, with the first of the renewed cars to be completed in early 2011. The cars are used for both Business and Economy class service in the Ontario-Quebec corridor. Electrical and mechanical systems, lighting, heating and air conditioning systems are being improved to reduce energy consumption by 20 percent. The Business class cars will be reconfigured to feature newly upholstered double and single seating options. Brighter interior colours, new windows and individual curtains will give the LRCs a totally new look and a more pleasing overall experience for our customers. Twenty-six of the cars will have larger, fully-accessible washrooms, along with seating designed to accommodate customers with special needs travelling with a service animal or care provider.

A portion of the classic stainless steel cars used on our transcontinental services is also being renewed to enhance customers' experience. Work includes a major overhaul of mechanical systems, reconfiguration of sleeping accommodations, and updating the design of the dining and lounge cars. Modifications will also improve accessibility for travellers with special needs, with a newly designed large, fully-accessible bedroom and an onboard wheelchair lift on several Park cars.

Modifications to VIA's Renaissance cars – the most technologically advanced passenger cars in use in North America – will make them more convenient and accessible for people with restricted mobility. Modifications include the addition of improved accessible washrooms and sleeping accommodations.

IMPROVING TECHNOLOGY

In 2010 VIA invested \$12.6 million to modernize and secure its information technology infrastructure, providing new business solutions for the organization. Many technology projects have been initiated throughout 2010 including the modernization of VIA's reservation system, the

selection of a new revenue management system and the implementation of robust and reliable on board Wi-Fi system. These projects will add value to our customers' experience from the time they make their reservation to the moment they arrive at their destination.

RENEWING A CLASSIC

The first of VIA's rebuilt and upgraded transcontinental dining cars went into service in 2010. A complete overhaul of the classic stainless steel fleet is underway to increase passenger comfort, reduce energy consumption, and meet the highest standards for health and safety.

In the completed dining car, traditional lighting has been replaced with light emitting diodes that consume less energy. The kitchen has been dismantled and rebuilt. Ventilation systems have been improved. And all furnishings and décor, from upholstery to carpeting and wall coverings, have been upgraded.



OPERATIONAL EFFICIENCY

TRANSFORMING OUR BUSINESS

Capital investment in passenger rail carries with it high expectations for performance, in terms of value delivered to the customer, and improved financial results. To deliver a good return on that investment, we have to continually improve the way we operate as a business.

In 2010 we implemented a new approach for managing performance, to achieve continuous improvements in operational efficiency. Based on proven principles of Lean management, this approach streamlines daily operations and procedures, focusing on those activities that add value for our customer while eliminating waste – activities and procedures that do not add value. By simplifying our processes, we can put more energy into focusing on the things that are important to customers.

To measure our progress in improving operational efficiency, we have clearly defined six Key Performance Indicators with respect to employee productivity and attendance, safety, customer satisfaction, revenues and costs.

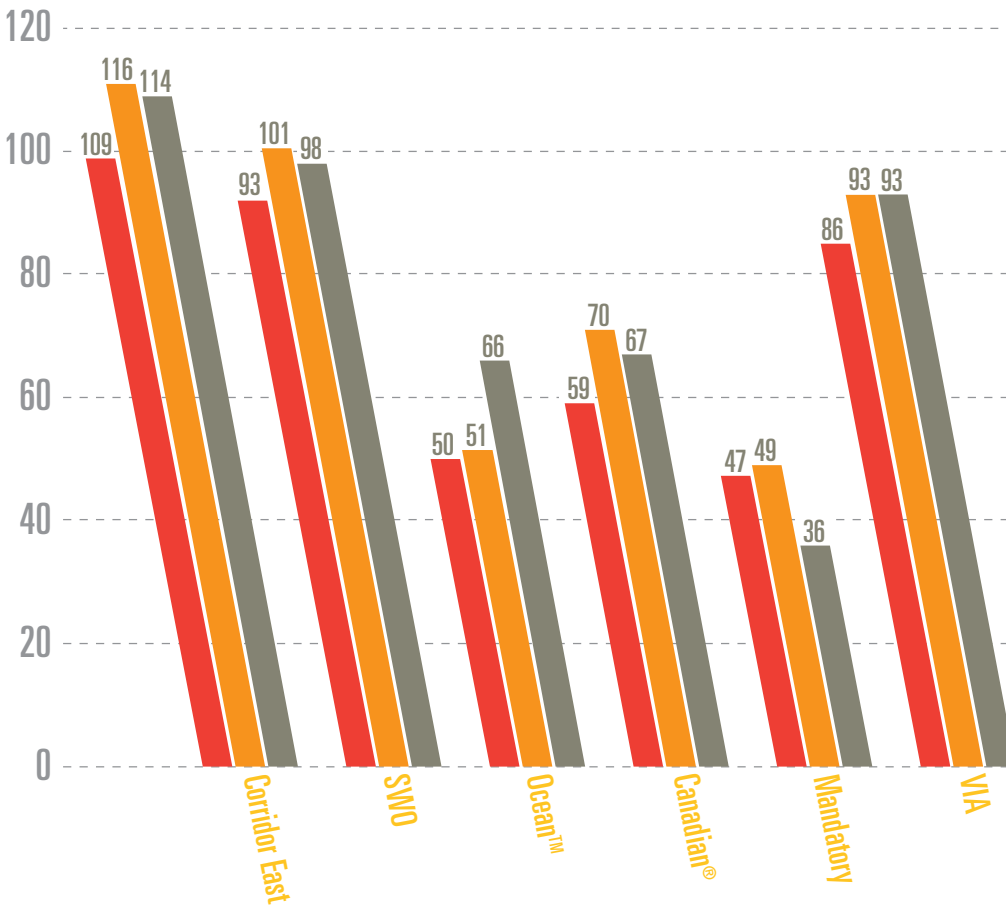
EMPLOYEE ENGAGEMENT AND PRODUCTIVITY

KEY PERFORMANCE INDICATORS

This measure is obtained by dividing our total revenues by the total number of full-time equivalent (FTE) employees. It is a good indicator of how well we are achieving the key goal of Lean management – producing more value.

We achieved our objective for 2010, increasing revenue per employee from \$86,000 in 2009 to \$93,000 per employee.

TOTAL REVENUE PER EMPLOYEE (FTE) (\$000's)



NOTE

Numbers have been rounded to the nearest whole number

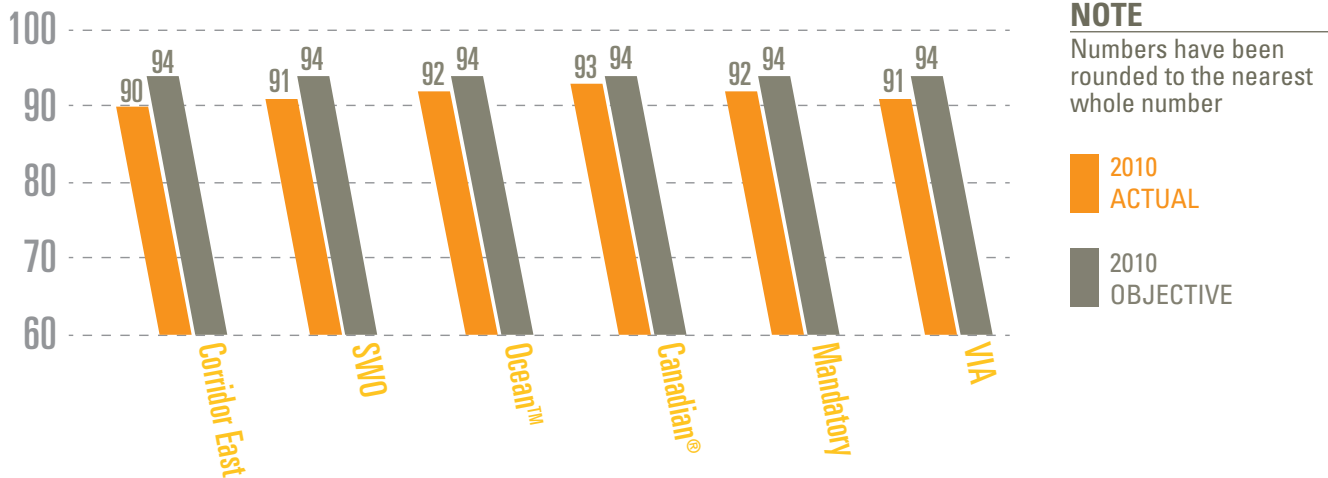
- 2009 ACTUAL
- 2010 ACTUAL
- 2010 OBJECTIVE

KEY PERFORMANCE INDICATORS

While some absences are unavoidable (for example, those due to an illness), employee attendance generally reflects how committed and engaged people are with their work, and is a good measure of our overall efficiency.

The attendance rate is defined as the total hours of absences in a month divided by the total possible work hours. At 91 percent, we came close to our objective of 94 percent for 2010. Our new attendance policy, along with new tools to help supervisors and employees address attendance issues, will improve our performance in 2011.

EMPLOYEE ATTENDANCE (%)



IMPLEMENTING LEAN MANAGEMENT

Lean management is a proven approach to improving operational efficiency developed by the Japanese auto industry over the past 50 years, and now used by leading service and manufacturing industries around the world. We are implementing this approach at VIA not only as a set of management principles, but as a corporate culture involving the participation and engagement of every employee.

Put simply, this means that employees and managers are asked to:

- Define and understand the work they do in terms of the value that it produces for our customers.
- Eliminate the waste – the activities and time used that do not create customer value.
- Continuously review, streamline and improve those activities and procedures that do create value.

Our Key Performance Indicators regarding productivity, revenues, costs, and safety measure how successful these efforts are. They are also important tools for encouraging everyone's participation in the ongoing process of continuous improvement. The indicators are published monthly on VIA's Intranet, and regular information sessions are held between managers and employees to discuss VIA's performance. As a result, employees are aware of the key measurements and how their individual actions contribute to VIA's success.

TRAINING AND DEVELOPMENT

VIA supports an active learning culture with a wide range of tools and training programs to help employees develop skills for performance and career development. These include classroom and on-the-job courses and E-Learning modules available online. For example, safety training modules were delivered to all VIA employees during the year.

In 2010 we launched a new program, as a pilot project, to train new locomotive engineers. All employees with at least five years experience were invited to apply. This is a first for VIA – in the past, we have always hired fully qualified engineers externally, usually those who received training from CN.

Ten employees began the 24 month training program in the fall of 2010.

INFORMATION TECHNOLOGY

In 2010 we continued to evolve and refine iVIA, our intranet, giving employees easy access to information on corporate goals and performance, news bulletins, procedures and policies, as well as access to online training and development tools. The intranet has quickly become a basic tool for employees, giving them access to information when and where they need it.

In 2010 we launched a new project to provide network access and communication to staff on board our trains, who do not have easy access to desktop computers on the job. Employees began testing BlackBerry smart phones to access information that is essential to their work, such as passenger lists, and to communicate more efficiently with colleagues. On board employees will also be able to transmit data such as incident reports, product inventories and work time sheets, reducing the amount of paper to print, fill out and manage. Once the initial testing is done, all on board employees from Vancouver to Halifax will be equipped with the smart phones.

REALIGNING OUR STRUCTURE

In 2010, we completed a thorough review of our organizational structure, and realigned the organization to better reflect this streamlined focus on customer value. As part of this exercise, we reduced management and non-unionized staff by 12 percent. The goal of this realignment was to retain our focus on the customer and concentrate on boosting revenues, all while ensuring that we deliver on the promised benefits of the capital investment program.

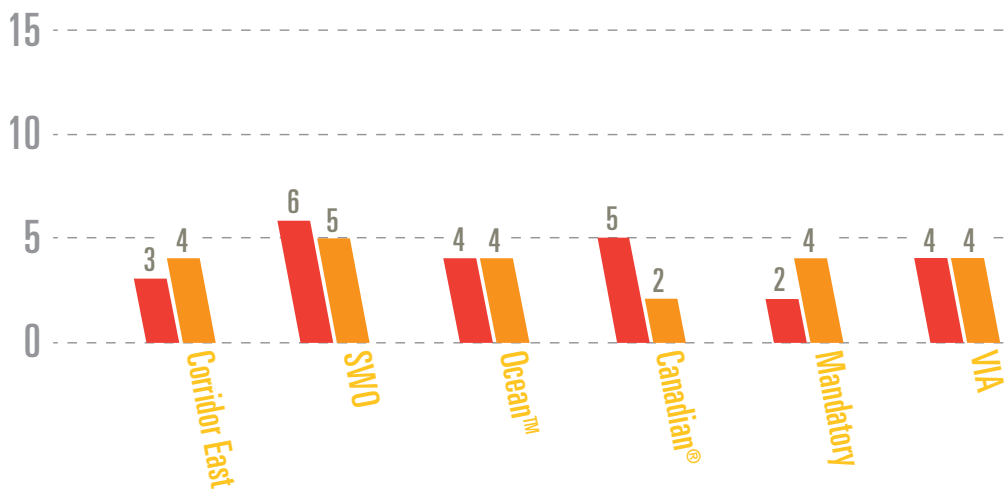
SAFETY

KEY PERFORMANCE INDICATOR

This measure tracks the number of safety-related incidents involving train operations. It does not include accidents involving road and rail crossings or people trespassing on tracks, which are beyond our control.

Our objective is always to achieve zero safety incidents involving train operations. There were 25 incidents in 2010.

TRAIN INCIDENTS PER MILLION TRAIN-MILES



NOTE

Numbers have been rounded to the nearest whole number

2009 ACTUAL
2010 ACTUAL

OUR SAFETY MANAGEMENT SYSTEM

VIA 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 our subject matter experts. Safety issues are also monitored by Health and Safety Policy committees, Work Place committees and Health and Safety representatives at all major VIA locations across Canada. These committees and representatives 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.

In 2010 we began implementing a new risk-based approach to safety management. As part of our continuous efforts to ensure the highest standards for all of our processes, we re-visited our health and safety target setting and performance indicators to ensure that all activities continue to remain relevant. We also developed a new Business Continuity Management Plan, which consolidates our emergency preparedness measures, passenger safety measures during a crisis, and our local business continuity plans under an integrated framework.

In the fall of 2010, we completed a major software upgrade for our security, environmental and safety management systems, with funding from the Government of Canada's Economic Action Plan. The new system centralizes our security, environment, health and safety data collection, event reporting and analysis throughout the coast-to-coast network, and streamlines the process for analyzing data. It also provides managers real time statistical performance data for trend and risk analysis.

HEALTH AND SAFETY POLICY COMMITTEES

In compliance with the Canada Labour Code Part II – Occupational Health and Safety, VIA has established Health and Safety Policy Committees comprised of both management and unionized employees. In April 2010, VIA made changes to the make-up of the Health and Safety Policy Committees to include executive level managers among the committee members in order to ensure a strong focus on enhancing VIA's safety culture, setting appropriate targets, recommending policy improvements and managing high risk environments effectively. Bureaucratic obstructions are eliminated through the collaboration of senior management and union partners, allowing VIA to address issues of concern more efficiently.

MANAGING ENVIRONMENTAL RISKS

Our Environmental Management System (EMS) is a corporate-wide framework for tracking, evaluating and communicating environmental performance. In 2009 the Office of the Auditor General issued a report identifying a number of ways we could improve the system.

We agreed with the recommendations, and completed the improvements in 2010. We developed a methodology for evaluating risks which has been integrated with the EMS, along with updates to the EMS and corporate risk registries. In addition to existing internal audit procedures for maintenance facilities, we have also developed new environmental audit procedures for non-maintenance facilities, and a site contamination management program for sites that deal with potential environmental contaminants.



ROAD AND TRESPASSING INCIDENTS

Most accidents involving trains occur when people trespass on rail property, or take unnecessary risks when crossing tracks. As part of our capital investment program to upgrade the rail infrastructure, we are taking measures to reduce or eliminate dangerous situations. This includes the installation of new security fencing at key locations, and a program to eliminate wherever possible grade-level intersections between rail lines and roads.

VIA also introduced a Crossing Closure initiative to eliminate as many farm and private crossings as possible in order to reduce the occurrence of crossing incidents. By the end of the year, forty-nine out of a possible ninety-eight farm crossings along the Alexandria, Smiths Falls and Chatham subdivisions had been slated to close. Work on the program remains ongoing with the closures expected to be completed in 2011.

We also engage in an active program of public education and awareness initiatives. These include participation in and support for Operation Lifesaver activities, visits to schools, and preparing curriculum materials for use by educators. In addition, we work with municipal law enforcement and emergency response agencies to coordinate efforts in dealing with trespassing safety issues.

LOCOMOTIVE ENGINEER SAFETY WORKSHOP

In April, VIA held a safety workshop for locomotive engineers and management to investigate ways in which they could continue to improve upon operational safety. The group examined every action undertaken by locomotive engineers from the moment they report for work to the time the train arrives at its destination. Using Lean techniques, the group developed an action plan to implement best practices for standards, processes, procedures and instructions. By using employees' firsthand experience and expertise to address operational procedures, VIA found an efficient way to implement improvements and ensure the highest standards for safety.



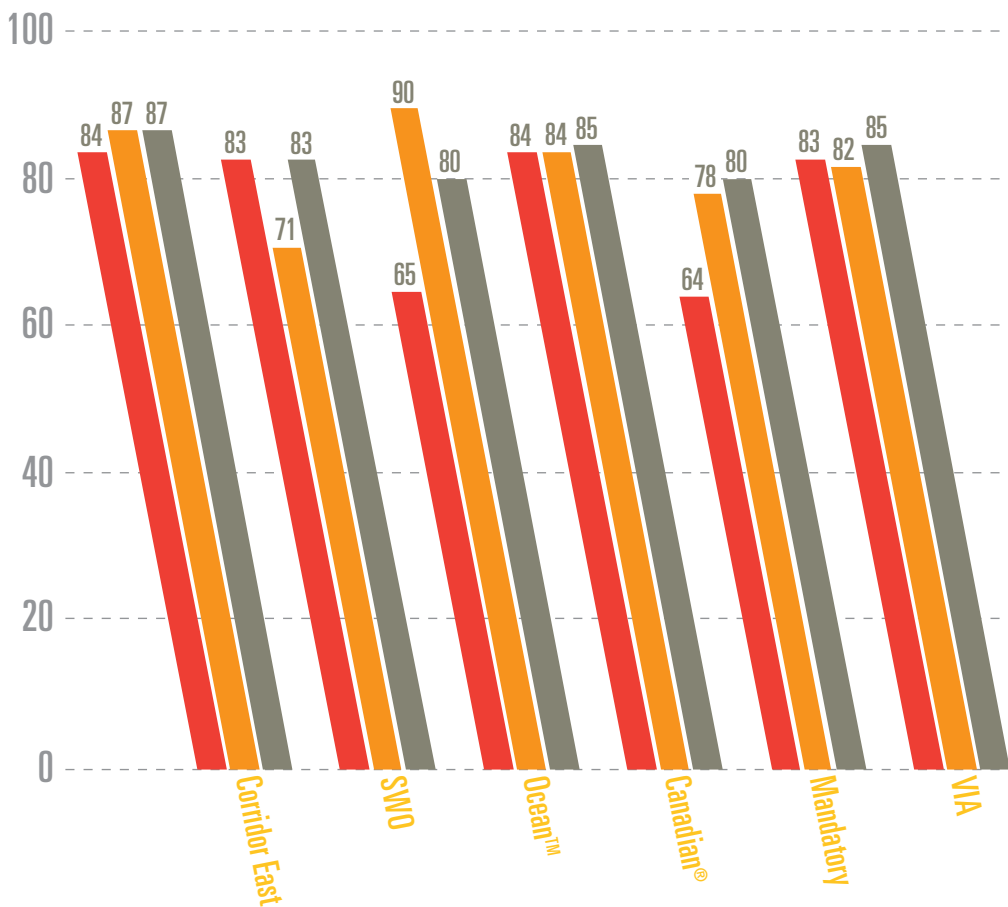
CUSTOMER SATISFACTION

KEY PERFORMANCE INDICATOR

This measure indicates how often our trains arrive at their destination at the scheduled time. On-time performance is the single most important factor driving customer satisfaction, and an area where improvement is a top priority for VIA.

We did not meet our objective for improvement in 2010, mainly because train services were often delayed by infrastructure construction projects underway. However, significant improvements were achieved for some routes, including dramatic improvements in Eastern Canada.

ON-TIME PERFORMANCE



NOTE

Numbers have been rounded to the nearest whole number

- 2009 ACTUAL
- 2010 ACTUAL
- 2010 OBJECTIVE

ON-TIME PERFORMANCE

Major infrastructure projects in Southwestern Ontario caused frequent train delays early in the year, which affected our overall on-time performance results for 2010. However, in Eastern Canada, where track work by freight railways seriously affected performance in 2009, on-time performance improved dramatically and surpassed our objectives.

In the Montreal-Ottawa-Toronto triangle, we developed a new approach to improving performance. In 2010, VIA launched an initiative focusing on a select number of high priority trains such as express trains, and trains used by a high number of intercity commuters. The team meets every day to review the previous day's performance. Even a slight delay is considered a problem to be analysed and solved in partnership with CN, CP, or other infrastructure owners and key partners.

The results of this approach have been very positive, with consistent improvements in on-time performance every month compared with 2009. As performance issues are resolved, and improvements can be maintained on a regular basis, the task force will begin using the same focused approach to improving performance for other trains in 2011.

CUSTOMER FEEDBACK

We regularly seek feedback from customers concerning their expectations of VIA, and how our performance measures up to those expectations. Views expressed by customers, either through formal surveys or through informal discussions, help us to resolve problems, improve services, and develop new services that customers value.

For example, in the fall of 2009, we discontinued hot meal service on our Montreal-Gaspé train during the off-season, between October and June, because of low demand. However, our customers made it clear that hot meals were important to them. By making new arrangements with a catering service, we found a cost-effective way to return the hot meal service during the off season without the need for a chef, while maintaining the on-board chef service during the peak summer season only.

Customer feedback has also been invaluable as we improve services such as on-board Wi-Fi access, which we are redesigning to become faster and more reliable.

VIA – TOP CHOICE OF TRAVEL AGENTS IN 2010

VIA was the top choice of travel agents in the Agent's Choice Awards – a distinction we've received eight times since the award was first created nine years ago. The Agents' Choice Awards are managed by the Canadian Travel Press and Travel Courier magazine. Both publications explained their decision to award VIA the top prize by praising its outstanding customer service.

INCREASING REVENUES

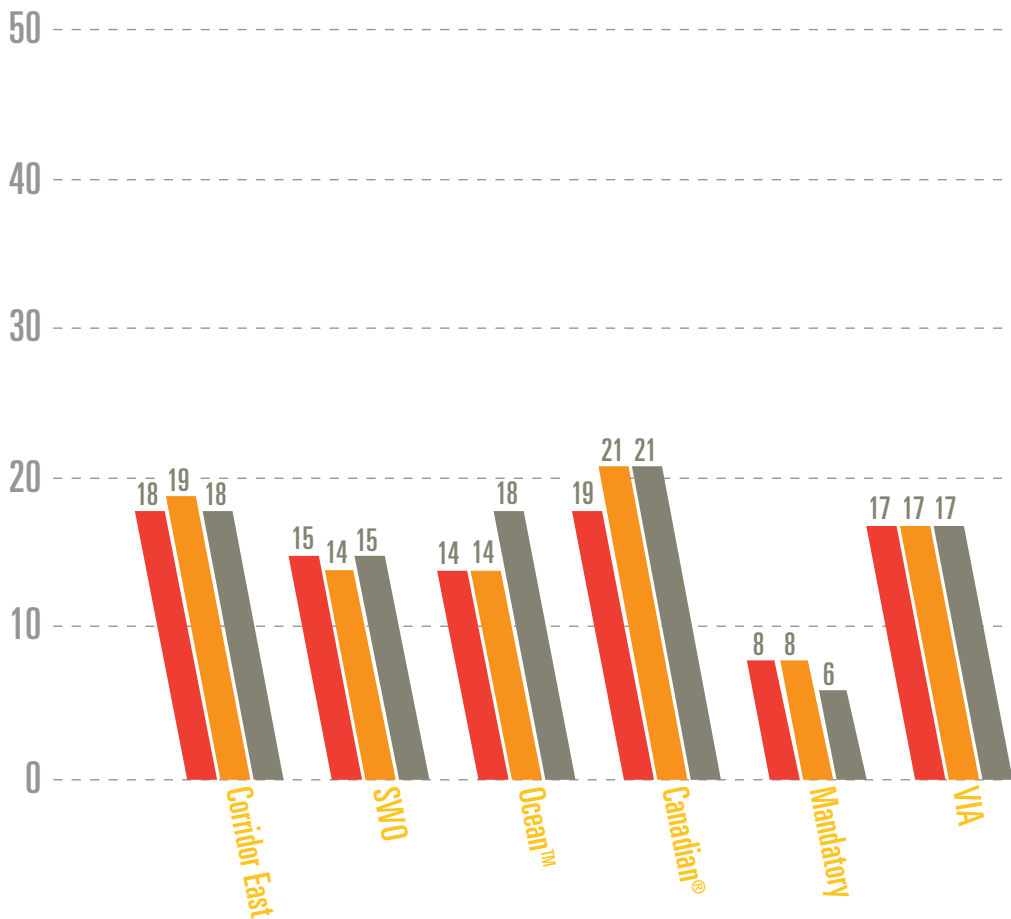
KEY PERFORMANCE INDICATOR

This measure is obtained by dividing total passenger revenues by seat-miles available for sale. A seat-mile (literally, one seat travelling one mile) is the simplest unit to measure what we sell. By dividing revenues by available seat-miles, we can

make a fair comparison of profitability across all regions and services.

With improved fleet and revenue management, passenger revenues per seat-mile increased by 0.5 cent per mile in 2010.

PASSENGER REVENUES PER AVAILABLE SEAT-MILE (CENTS)



NOTE

Numbers have been rounded to the nearest whole number

2009 ACTUAL

2010 ACTUAL

2010 OBJECTIVE

IMPROVED REVENUE MANAGEMENT

VIA developed a new revenue management strategy in 2010 that increased total revenues significantly. The strategy sets the optimal price for a train seat at any given time for individual train services. This requires finding the right balance between getting the highest price possible in a given market, and using fare discounts or promotions to attract more customers and avoid operating trains with empty seats.

Our revenue management team monitors close to 500 trains per week, analyzing advance sales, available capacity and historical trends in order to determine how many discount seats should be offered on each train. We expect that revenue management alone will generate up to \$40 million in increased revenues over the next five years.

MARKETING AND PROMOTION

Effective marketing and promotion of VIA services helped to maintain ridership and attract new customers throughout the year.

For example, following the 2009 recession customers showed continued caution in purchasing tickets early in the year, and tended to take longer when making holiday plans. We launched an advertising campaign early in the spring targeting those planning summer vacations, and partnered with the Canadian Tourism Commission to extend the reach of this campaign to a broader audience. The early campaign was successful, helping to increase both ridership and revenues for the second and third quarters of 2010.

We also introduced a permanent, year-round discount program for members of the Canadian Armed Forces and their families. Over the last few years seasonal discount programs for members of the Armed Forces proved to be very popular, attracting thousands of first-time customers and increasing revenues. Making the program permanent is not only good for VIA, but our gesture of appreciation for those who serve Canada.

IMPROVED SCHEDULES AND TRIP TIMES

In April we made schedule changes for trains between Quebec City and Montreal, offering customers more convenient arrival times and faster service. We shortened trip times by as much as 20 minutes, while arrival and departure times were changed to better suit customer needs. For example, we changed a morning departure from Quebec City that used to arrive in Montreal after 9:00am, so that it would arrive before the normal start of a business day.

We made similar changes for services between Montreal and Ottawa. The new arrival and departure times on certain trains fit better with our customers' travel needs. For example, a train now departs Ottawa at 6:38am, arriving in Montreal at 8:30am, shaving off nearly 15 minutes from the total travel time.

We will continue to adjust schedules and reduce trip times throughout the Ontario-Quebec corridor as infrastructure and equipment improvements are completed.

NEW MONTREAL-OTTAWA-TORONTO OPTIONS

We began testing two new Ottawa "through trains" for customers travelling between Montreal and Toronto in June. This gives customers the option of a route through Ottawa, with a short stop at Ottawa Station. It also provides some communities with a new direct service to Montreal or Toronto. By applying Lean principles we are able to increase choice and flexibility for customers without adding new frequencies, using our existing resources more effectively and efficiently to increase ridership and revenues. The tests were successful, and four more Ottawa through trains will be added in 2011.

INTERMODAL PARTNERSHIPS

We continue to attract customers and revenue opportunities through intermodal partnerships, which make it easier for customers to plan their travel and make connections between different modes of transportation. In May, VIA partnered with Communauto, a car sharing service that promotes ecologically sound travel, to offer fare discounts to its members. In November, we extended this partnership to include VRTUCAR, an Ottawa-based car sharing organization. With a single ticket, members can now travel by train between Montreal and Ottawa, pick up a car at the station for local transportation, and drop the car off at the train station when making the return journey home.

Additionally, we are in the process of selling our Guelph station to the City of Guelph, who will develop it as a new multimodal facility to accommodate various modes of transportation. This will give our customers better connections between VIA trains and inter-city and city bus services, as well as other transportation options that are planned for the region.

NEW PRODUCTS AND SERVICES

VIA was one of the first passenger services in North America to provide on-board Wi-Fi access to customers. Internet access while travelling has proven to be exceptionally attractive to customers, who appreciate the opportunity to use their travel time productively. To improve the service, we are building a new wireless infrastructure that will offer the fastest, most reliable “in motion” Wi-Fi access in North America today. When it is fully implemented, VIA will have the ability to allow customers the opportunity to stay connected with work but also be able to enjoy feature films, television series and documentaries from the comfort of their seats, using their own laptops.

We also launched a number of new gift and souvenir products to generate additional revenues. For example, VIA gift cards can now be purchased in \$50 and \$100 denominations in over 500 retailers across Canada, as well as at VIA stations. Souvenirs and gifts available on board and online through a brand new website include a wide variety of items, from coffee mugs and t-shirts to books, videos and luggage.

OTTAWA STATION COMMERCIAL DEVELOPMENT

We have invited real estate developers to present proposals for the commercial development of our Ottawa Station land holdings. Developments of this kind not only increase the revenues generated by our land assets, but can also increase passenger ridership and revenues. Similar development partnerships have already proven successful in Vancouver, Winnipeg and Quebec City. While the Ottawa project is still in the early exploratory stage, a suitable development of the infrastructure around the station could have substantial benefits for VIA and for customers.

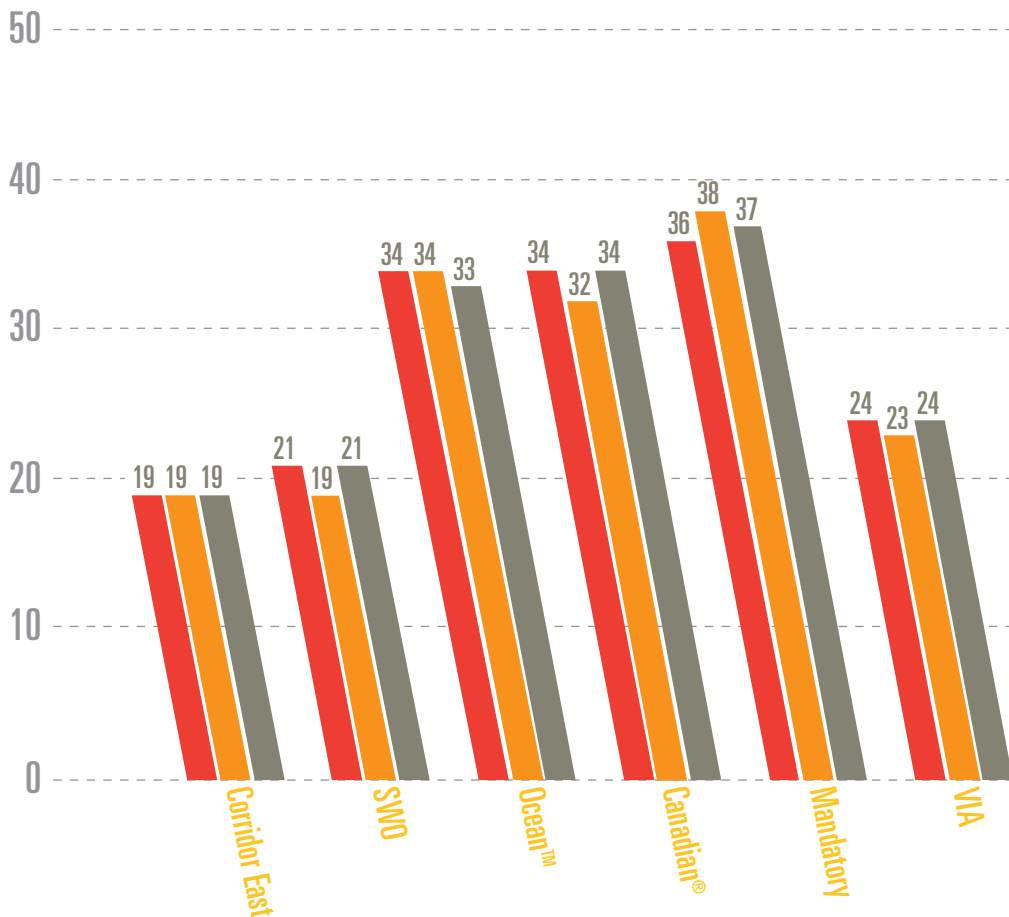
REDUCING COSTS

KEY PERFORMANCE INDICATOR

This measure is obtained by dividing direct operating costs by total available seat-miles (the number of seats available for sale multiplied by the number of miles travelled). This gives us a comparison of costs across all regions and services.

We reduced costs by 0.7 cent per available seat-mile thanks to effective cost controls and strong performance in Southwestern Ontario and Western Canada.

DIRECT COSTS PER AVAILABLE SEAT-MILE (CENTS)



NOTE

Numbers have been rounded to the nearest whole number

- 2009 ACTUAL
- 2010 ACTUAL
- 2010 OBJECTIVE

IMPROVED TRAIN MANAGEMENT

We reduced costs significantly in 2010 by managing the cars and locomotives for each train service in a new way. Traditionally, we have adjusted the size of each train on demand, adding or removing cars as circumstances required. This often involved a great deal of time and labour – the kind of waste targeted by Lean management.

Our new approach of instituting a planned consist, the total number of cars on any given train, based on historical data and trends, is far more efficient. Equipment and other resources are allocated in advance, greatly reducing the amount of resources expended before and after the departure of each train.

STREAMLINED WORK PROCESSES

One of the most effective tools for implementing Lean management is the Kaizen – where a small group of people from all levels of an organization come together, examine a work process, and find ways to improve productivity and eliminate waste.

For example, a Kaizen at our Montreal Maintenance Centre focused on work flow through the Wheel Shop. Six unionized employees and six management staff examined the work environment and flow of materials, looked for ways to do things better, and came up with better ways of organizing the work. Changes resulted in reducing the movement of materials by 50 percent, speeding up the process of wheel maintenance, and making operations both safer and more efficient.

A second Kaizen based at the Montreal Maintenance Centre focused specifically on inventory management. Members of this group identified excess materials which they could sell to reduce obsolete inventory, improve overall efficiency and generate revenues.

REDUCED FUEL CONSUMPTION

VIA's capital investment program to rebuild the fleet of F-40 locomotives is designed to produce better-than-new equipment that meets the most stringent environmental standards. As a result, the rebuilt equipment will be far more fuel efficient than before.

Twenty-three of the rebuilt locomotives are now in service, and the improved efficiency has already had a significant impact on costs. Fuel consumption is much lower. As well as generating fewer greenhouse gas emissions, this reduction was a major source of lower costs in 2010.



COMMUNICATION

TRANSFORMING OUR RELATIONSHIPS

Our success as a business depends on building strong relationships with our customers. That means, first and foremost, that we must deliver what we promise to our customers and the communities we serve, and conduct our business with honesty and integrity.

It also means that we have to listen to our customers, try to understand what they value, what they are concerned about, and how we can provide a more rewarding experience for those who board our trains.

DELIVERING BETTER VALUE TO OUR CUSTOMERS

Customer surveys are important tools for opening communication, and for measuring how relevant our activities are to customer needs.

In 2010 we reviewed our methods of conducting surveys and measuring customer satisfaction. Working with an independent service provider, we believe that the procedures we have developed will give us more accurate, timely and meaningful feedback, and help us to deliver better value, more consistently, to our customers.

MORE INTERACTIVE COMMUNICATION

We also try to develop an informed and personal relationship with our customers, through programs like our award winning customer loyalty program, VIA Preference.

In 2010 we made significant improvements to our VIA Preference members' web site. The online experience is now automatically customized to each member's needs when they log in, based on unique data such as the member's city of residence, membership level and points balance. In effect, the site is custom-created to suit each member's relationship with VIA.

This is one of the first sites of its kind for a loyalty program. It allows customers to receive timely and relevant offers based on member profiles, and adds value to each time they visit. It also lets members know when they have enough points to redeem for the reward travel of their choice and sends relevant redemption offers and suggestions directly to them.

We are also developing new ways to communicate with and interact with customers through popular social media services, such as Twitter. These services will help us deliver timely information to our customers, while providing a forum for customers to comment, ask questions, and raise any concerns they might have.

VIA'S REPUTATION TOPS THE LIST

In March, 2010, VIA was given top place among transportation companies in Léger Marketing's report on the most admired companies in Quebec. Coming in at 42 in the list of 150 most admired corporations, VIA outranks CN (56th place), West Jet (64th place) and Orléans Express (106th place).

WORKING WITH COMMUNITIES

We have an active community outreach program, recognizing that our services play an important role in the economic and social life of the communities we serve. For example, in 2010 we established a VIA-Gaspé working group, working with community leaders from the Gaspé region, to study ways of enhancing service on the Montreal-Gaspé line and promoting local tourism.

We believe it is especially important to talk with and listen to communities who are impacted by our capital investment construction projects. As we move forward with new station, equipment and infrastructure improvements across our network, we consult with regional officials and communicate with First Nations communities and local residents. Our goal is to not only relay key project dates and details, but also to minimize any potential construction inconveniences as much as possible.

For example, VIA held several community meetings with the Mohawks of the Bay of Quinte (Ontario) to discuss the construction of a bridge over the Salmon River which runs through their territory. These discussions have led to the establishment of an outreach agreement which will see VIA support community programs such as post secondary scholarships, the purchase of library books and potable water distribution while at the same time promoting passenger rail and enhancing VIA's visibility within the community.

ACCESSIBILITY

We work hard to ensure the comfort and safety of customers with restricted mobility and other special needs when they board our trains. In 2009-2010 we worked closely with the Council of Canadians with Disabilities and the Canadian Transportation Agency to find ways to improve the level of service available on our equipment.

As a result, we are reconfiguring 59 of our Renaissance passenger cars. Modifications include improved washrooms, sleeping accommodations, and safety features. We are making similar modifications to selected cars used on our Western transcontinental service.

These modifications enhance other initiatives that are already in place, such as free companion tickets for disabled travellers, adapted sleeping cabins and priority boarding.



GOVERNANCE AND ACCOUNTABILITY

THE BOARD OF DIRECTORS

The Board of Directors consists of the Chairperson, the President and Chief Executive Officer and other directors appointed by the Government of Canada. The Board is responsible for overseeing the strategic direction and management of the Corporation, and reports on VIA's operations to Parliament.

The Corporation and its Board of Directors are committed to implementing principles and best practices of good governance. 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.

In 2010, there were 8 Board of Directors meetings and, 25 Board Committee meetings.

In 2010, the Government of Canada appointed Mr. Paul G. Smith as Chairman of the Board.

ACCESS TO INFORMATION

VIA believes that openness and transparency are the starting point in building a trusted relationship with customers, and with the public in general. VIA receives and responds promptly to information requests under the Access to Information Act and the Privacy Act, and has been given top marks for transparency among federal agencies.

In 2010, VIA received 37 requests under the Access to Information Act. The total number of Access to Information Requests received in 2010 is subject to change, as the 2010 reporting extends from April 1, 2010 to March 31, 2011, as defined by the Office of the Information Commissioner.

OFFICIAL LANGUAGES

VIA is committed to the principles of the Official Languages Act. VIA employees share this commitment with customers through the "active offer" – demonstrating a willingness to provide service in either English or French. Our Official Languages policies apply to all communications, whether on the telephone, in a station, or on board our trains. We also maintain a work environment where employees can speak the language of their choice, in regions designated bilingual. All internal and external communications are written in French and in English, and VIA uses both languages in its business practices.

In 2010 we continued to promote our official language policies throughout the organization, as well as developed a plan for consulting with communities interested in collaborating with VIA to support Canada's linguistic duality. We discussed this program, and our action plan for 2011, with the Commissioner of Official Languages. The Commissioner praised the plan, indicating that it met and exceeded the basic criteria used to evaluate progress in implementing official languages policies. The Commissioner also noted that the number of complaints we receive is remarkably low, given that VIA welcomes over four million customers every year.



MANAGEMENT DISCUSSION & ANALYSIS

MANAGEMENT DISCUSSION AND ANALYSIS

This discussion and analysis presents data and comments on the Corporation's financial position and results for the year 2010. It should be read in conjunction with the Consolidated Financial Statements that follow, and the Year at a Glance on page 3.

	2010	vs Budget		vs 2009	
(in millions of dollars)	\$	\$	%	\$	%
Passenger revenues	258.2	2.2	0.8	7.9	3.2
Total revenues	274.4	3.7	1.4	9.5	3.6
Operating expenses	535.9	16.8	3.0	(9.8)	(1.9)
Operating loss	261.5	20.5	7.3	(0.3)	(0.1)
Passenger-miles	846.1	(18.6)	(2.1)	(10.8)	(1.3)

OVERVIEW

Travel markets throughout 2010 showed a slow and uneven recovery from the 2009 recession. While there were encouraging signs of growth for some passenger rail services, particularly in Western Canada, VIA's overall ridership, as measured by passenger-miles, declined slightly to 846.1 million, 1.3 percent lower than 2009. Despite this decline, VIA achieved higher yields and revenues-per-passenger. Passenger revenues for the year increased by almost \$8 million, 3.2 percent higher than 2009.

A renewed management focus on operational efficiency raised productivity and controlled costs. While total operating expenses were higher than in 2009, they were \$16.8 million lower than budget. Together with VIA's revenue growth, this kept VIA's operating loss in line with 2009, increasing by just 0.1 percent.

VIA's capital investment program, made possible by \$923 million in capital funding from the Government of Canada, continued to proceed well during the year. Infrastructure and equipment upgrade projects will begin to have positive impact on performance in 2011.

KEY OPERATING STATISTICS BY SERVICE GROUP, 2010				
	Passenger-Miles (IN THOUSANDS)	Passenger Revenue (IN THOUSANDS)	Passengers (IN THOUSANDS)	Government Funding per Passenger Mile
Intercity Ontario-Quebec Corridor	625,157	197,806	3,780	\$0.21
Long-distance and Tourism				
The <i>Canadian</i> [®]	125,848	39,279	106	\$0.40
The <i>Ocean</i> [™]	60,611	13,091	127	\$0.60
Mandatory Services	34,503	8,022	140	\$1.30

REVENUES AND RIDERSHIP

Overall ridership, as measured by passenger-miles, declined slightly in 2010, while revenues grew slightly, reflecting VIA's efforts to improve revenues-per-passenger. Yield per passenger mile improved, and passenger revenues grew by 3.2 percent.

In Western Canada, ridership increased more than anticipated, with a better than expected jump in demand from both domestic and international tourism markets. In Eastern Canada, however, leisure and tourism markets struggled throughout the year, resulting in a decline in both ridership and revenues. In the Ontario-Quebec corridor, ridership challenges were addressed through effective marketing and promotions, along with schedule changes for key train services which provided more convenient departure and arrival times for business travellers, and faster total trip times.

Pricing and revenue management strategies were the main drivers behind revenue growth. VIA responded to market conditions with flexible pricing strategies throughout the year. In the Ontario-Quebec corridor, VIA applied new revenue management strategies designed to increase the actual fares per seat by seeking an optimal balance between regular fares, discounts and promotions, and seat availability. VIA also undertook a number of initiatives to maximize the financial return on assets such as real estate holdings. Revenues in addition to passenger revenues, such as concession fees, investment income and other service fees, increased by 11 percent (\$1.6 million) over 2009.

OPERATING EXPENSES

Efforts to increase productivity and reduce costs were very successful in 2010. Cost savings brought total operating expenses for the year to \$535.9 million, 3 percent below the budget set for 2010.

Significant savings were achieved following a reorganization that better aligned operations with VIA's strategic goals, and reduced management and non-unionized positions by 12 percent. In addition, fuel costs were significantly reduced, as F-40 locomotives were upgraded and rebuilt through the capital investment program. The rebuilt locomotives are considerably more fuel efficient, reducing fuel consumption by 9 percent. Other savings were achieved by exercising tight control over all discretionary spending.

Cost savings were achieved despite significant cost increases in some areas. Regulations required a \$9 million increase for past service contributions to the unionized employees pension plan.

CAPITAL EXPENDITURES

The Government of Canada is investing \$923 million of capital in passenger rail over five years, including \$516 million announced in 2007 and \$407 million through the 2009 Economic Action Plan.

In 2010 capital spending totaled \$268.6 million, with work proceeding to rebuild and renew VIA's locomotives and passenger cars, major infrastructure projects started throughout the Ontario-Quebec corridor, and station improvements underway in all parts of VIA's network. There were some delays in infrastructure projects in the Montreal-Ottawa-Toronto triangle, as well as in some equipment projects, due to contractors' set-up and production learning curves. Benefits from these projects, in terms of improved level and quality of service, are already being realized, and will increase incrementally over the next few years.

Capital expenditures 2007-2010	
Equipment renewal	\$112.1 million
Major infrastructure improvements	\$248.6 million
Stations, Information Technology, and other projects	\$79.2 million
Total	\$439.9 million

ON-TIME PERFORMANCE

Overall, on-time performance decreased by 0.4 percent, from 82.7 in 2009 to 82.3 in 2010, but there were significant differences in performance for different parts of the network.

The Eastern services (Montreal-Halifax) performed extremely well this year, with on-time performance reaching 90.4 percent compared with 64.6 percent in 2009. The improvement is due primarily to fewer delays caused by track conditions and slow orders on CN and other third party infrastructure.

On-time performance for Western services between Vancouver and Toronto remained stable at 84 percent.

Trains between Montreal-Toronto achieved 87 percent on-time performance, despite major infrastructure work programs on CN's Kingston subdivision. Montreal-Quebec and Montreal-Ottawa services both achieved close to 90 percent on-time performance for the year.

Southwestern Ontario services faced significant operating challenges due to third party and CN slow orders from track conditions and freight train traffic. As a result, on-time performance fell to 70.6 percent.

In 2010 VIA initiated a "target train" approach to focus attention on particular trains and prioritize actions to improve on-time performance. Trains targeted in the Montreal-Ottawa-Toronto triangle have improved performance as a result. As performance issues are resolved, and improvements can be maintained on a regular basis, this approach will be extended to other trains.

MAJOR RISKS AND MITIGATION MEASURES

The Corporation is facing risks and implements mitigation strategies.

○ **Operating Funding**

VIA continues to face operational funding challenges. The Corporation is developing and implementing a range of initiatives to reduce its deficit by reducing costs and increasing revenues. At the same time, VIA continues to work with Transport Canada to address the challenge of operating loss and develop sustainable funding solutions.

○ **Capital Funding**

VIA will need to continue investing in equipment, stations, maintenance systems, facilities, and information technology after 2011, when the current investment program is completed. The Corporation is working with Transport Canada to address ongoing capital funding requirements, and to ensure that VIA has the capital funding it requires to deliver on its mandate.

○ **Passenger Revenues**

Since 2008, passenger rail has experienced a substantial decrease in ridership and revenue. VIA is implementing initiatives to mitigate the impact of slow growth in passenger revenues. These include optimizing train services between Montreal, Ottawa and Toronto, and generating additional revenues from real estate projects and through information technology improvements that support revenue management initiatives.

○ **Pension Plans**

Pension plans liabilities represent a significant risk to the Corporation due to their size (\$1.6B). Adverse investment returns and changes in interest rates can materially impact the funding status of the plans, and directly amplify the volatility in annual funding requirements. In recent years, the Corporation has implemented measures to mitigate this risk such as adjusting certain management practices and by aggressively reducing pension administrative expenses. The Corporation continues to actively explore means of further reducing this significant corporate risk.

○ **Fuel Cost Fluctuations**

Fuel is a major cost for passenger rail operations, and costs could vary significantly from VIA's estimates due to the uncertainty and volatility of fuel prices. VIA's proven hedging strategy adds certainty to future fuel costs and can delay the impact of fuel price fluctuations. Given that contracts used to hedge fuel prices are denominated in U.S. dollars, VIA also hedges against foreign exchange risks.

○ **Capital Investment Projects**

Major delays in infrastructure or equipment projects, or an increase in project costs, would adversely affect VIA's financial performance. VIA's managers monitor the progress of all projects closely in order to mitigate this risk, adjusting production timelines as needed to keep projects on track. In addition, VIA's Executive Capital Steering Committee meets regularly to discuss the status of all capital investment projects.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

With the fiscal year beginning January 1, 2011, VIA has chosen to adopt International Financial Reporting Standards (IFRS) as the basis for corporate accounting. VIA believes that these standards provide the most appropriate basis to meet the needs of those who use the Corporation's financial statements.

The transition from current Canadian Generally Accepted Accounting Principles (GAAP) to IFRS is a significant undertaking that will materially affect the Corporation's reported financial position and results of operations. Balance sheet items such as Property, Plant & Equipment, Accrued Benefit Assets, Deferred Capital Funding, Future Corporate Tax and Deferred Revenues will be significantly impacted by the new standards.

VIA completed planning for its transition to IFRS accounting in 2010, and is currently implementing the action plan necessary to create new accounts and a financial statements model, system changes and process changes.

OUTLOOK FOR 2011

VIA is confident that it will continue to achieve revenue growth, higher productivity, and reduced costs in 2011. Efforts in 2011 will focus on restoring ridership growth. The slow and uneven recovery from the 2009 recession had an understandable impact on passenger numbers however as the economy recovers, VIA anticipates that passenger numbers will as well. Furthermore, fluctuating gas prices and airport congestion are expected to positively impact VIA's passenger growth in 2011.

Planned service improvements and enhancements, such as the implementation of an improved Wi-Fi service in the Ontario-Quebec corridor, are already attracting market attention, and the introduction of more attractive train schedules are showing good results. Improved on-time performance, along with incremental enhancements in products and services, will attract renewed interest in passenger rail. VIA will introduce new marketing, promotion and pricing strategies to build on this interest and achieve real market growth over the year. Revenues will continue to grow as we refine and extend the revenue management strategies which proved to be effective in 2010.

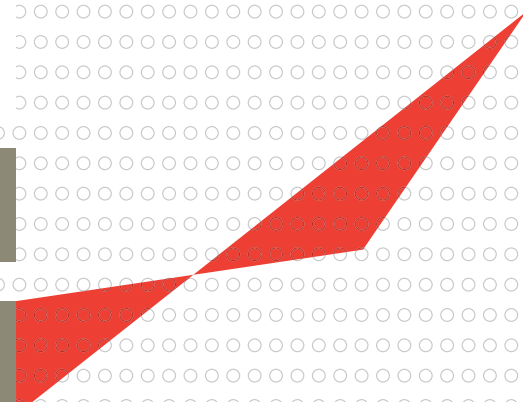
VIA's management focus on operational efficiency will remain critical to meet financial challenges in 2011. A Lean management framework, supported by the use of new key performance indicators will help the Corporation achieve continuous improvement in productivity, eliminate waste, and deliver more value to customers.

As capital investment in equipment and infrastructure is completed, VIA will continue to transform the way passenger rail services are delivered in Canada. With modernized equipment and the capacity to offer faster, more frequent service, VIA expects more Canadians to experience a passenger rail service that is reliable, efficient, and financially sustainable for the future.

CONSOLIDATED

FINANCIAL

STATEMENTS





MANAGEMENT'S RESPONSIBILITY STATEMENT

YEAR ENDED DECEMBER 31, 2010

Management of the Corporation is responsible for the preparation and fair presentation of the consolidated financial statements contained in the Annual Report. These consolidated financial 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 financial statements present fairly the financial position of the Corporation and 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, 2010, 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 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.



Marc Laliberté
President and Chief Executive Officer



Robert St-Jean, CA
Chief Financial and Administration Officer

Montréal, Canada
February 25, 2011



Auditor General of Canada
Vérificatrice générale du Canada

INDEPENDENT AUDITOR'S REPORT

To the Minister of Transport, Infrastructure and Communities

Report on the Consolidated Financial Statements

I have audited the accompanying consolidated financial statements of Via Rail Canada Inc., which comprise the consolidated balance sheet as at 31 December 2010, and the consolidated statement of operations and comprehensive income, consolidated statement of retained earnings and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these consolidated financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the

purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In my opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Via Rail Canada Inc. as at 31 December 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Report on Other Legal and Regulatory Requirements

As required by the *Financial Administration Act*, I report that, in my opinion, Canadian generally accepted accounting principles have been applied on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of Via Rail Canada Inc. that have come to my notice during my audit of the 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 the by-laws of Via Rail Canada Inc.

Sheila Fraser

Sheila Fraser, FCA auditor
Auditor General of Canada

25 February 2011
Montréal, Canada

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET

As at December 31 (IN THOUSANDS)	2010	2009
CURRENT ASSETS		
Cash and cash equivalents	\$ 77,084	\$ 4,775
Accounts receivable, trade	8,096	7,725
Prepays, advances on contracts and other receivables	14,558	10,632
Receivable from the Government of Canada	17,069	6,833
Derivative financial instruments (NOTE 17)	3,769	1,497
Materials (NOTE 5)	21,302	24,592
Asset Renewal Fund (NOTE 8)	15,295	25,295
Future corporate tax assets (NOTE 11)	12,189	2,802
	169,362	84,151
NON-CURRENT ASSETS		
Property, plant and equipment (NOTE 6)	725,630	523,920
Intangible assets (NOTE 7)	17,444	9,464
Asset Renewal Fund (NOTE 8)	25,645	23,120
Accrued benefit asset (NOTE 10)	374,864	354,758
Derivative financial instruments (NOTE 17)	880	1,578
	1,144,463	912,840
	\$ 1,313,825	\$ 996,991
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (NOTE 9)	\$ 154,662	\$ 132,339
Deferred government funding	51,000	-
Derivative financial instruments (NOTE 17)	996	6,699
Deferred revenues	12,928	11,998
	219,586	151,036
NON-CURRENT LIABILITIES		
Accrued benefit liability (NOTE 10)	27,198	27,136
Future corporate tax liabilities (NOTE 11)	55,039	40,511
Derivative financial instruments (NOTE 17)	205	354
Deferred investment tax credits	909	1,302
Other non-current liabilities	1,124	1,500
	84,475	70,803
DEFERRED CAPITAL FUNDING (NOTE 12)	751,927	541,145
SHAREHOLDER'S EQUITY (NOTE 13)		
Share capital	9,300	9,300
Retained earnings	248,537	224,707
	257,837	234,007
	\$ 1,313,825	\$ 996,991

Commitments and Contingencies (Notes 14 and 20, respectively)

Approved on behalf of the Board,



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

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



Paul G. Smith
 Director and Chairman of the Board

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME

Year ended December 31 (IN THOUSANDS)	2010	2009
REVENUES		
Passenger	\$ 258,342	\$ 250,478
Investment income	1,305	862
Other	18,277	16,438
	277,924	267,778
EXPENSES		
Compensation and benefits	224,181	224,902
Train operations and fuel	118,497	118,714
Stations and property	34,344	33,819
Marketing and sales	29,304	28,797
Maintenance material	39,108	37,076
On-train product costs	14,735	16,233
Operating taxes	8,863	9,735
Professional services	6,339	5,588
Employee future benefits (NOTE 10)	11,511	(1,065)
Amortization and losses on write-down and disposal of property, plant and equipment and intangible assets (NOTES 6 AND 7)	58,292	60,203
Unrealized gain on derivative financial instruments	(7,426)	(18,077)
Realized loss on derivative financial instruments	6,244	15,677
Other	25,992	20,379
	569,984	551,981
OPERATING LOSS BEFORE FUNDING FROM THE GOVERNMENT OF CANADA AND CORPORATE TAXES	292,060	284,203
Operating funding from the Government of Canada	261,521	226,280
Amortization of deferred capital funding (NOTE 12)	57,124	56,453
Income (loss) before corporate taxes	26,585	(1,470)
Corporate tax expense (recovery) (NOTE 11)	4,780	(4,018)
NET INCOME AND COMPREHENSIVE INCOME FOR THE YEAR	\$ 21,805	\$ 2,548

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

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

Year ended December 31 (IN THOUSANDS)	2010	2009
BALANCE, BEGINNING OF YEAR	\$ 224,707	\$ 221,137
Net income and comprehensive income for the year	21,805	2,548
Funding from the Government of Canada for the acquisition of non-depreciable capital assets	2,025	1,022
BALANCE, END OF YEAR	\$ 248,537	\$ 224,707

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

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (IN THOUSANDS)	2010	2009
OPERATING ACTIVITIES		
Net income and comprehensive income for the year	\$ 21,805	\$ 2,548
Adjustments to determine net cash from (used in) operating activities:		
Amortization of property, plant and equipment and intangible assets	54,068	52,733
Losses on write-down and disposal of property, plant and equipment and intangible assets	4,617	7,770
Amortization of investment tax credits	(393)	(300)
Amortization of deferred capital funding	(57,124)	(56,453)
Future corporate taxes	5,141	(3,333)
Change in fair value of financial instruments	(810)	(238)
Unrealized gain on derivative financial instruments	(7,426)	(18,077)
Net change in non-cash working capital items	38,876	(7,733)
Increase in accrued benefit asset	(20,106)	(22,244)
Increase in accrued benefit liability	62	972
Decrease in other non-current liabilities	(376)	(992)
Net cash provided by (used in) operating activities	38,334	(45,347)
FINANCING ACTIVITIES		
Capital funding received	273,185	111,775
Net cash provided by financing activities	273,185	111,775
INVESTING ACTIVITIES		
Acquisition of investments in the Asset Renewal Fund	(177,684)	(359,704)
Proceeds from sale and maturity of investments in the Asset Renewal Fund	185,969	386,161
Disbursements for property, plant and equipment and intangible assets	(248,915)	(97,336)
Proceeds from disposal of property, plant and equipment and intangible assets	1,420	21
Net cash used in investing activities	(239,210)	(70,858)
CASH AND CASH EQUIVALENTS		
Increase (decrease) during the year	72,309	(4,430)
Balance, beginning of year	4,775	9,205
BALANCE, END OF YEAR	\$ 77,084	\$ 4,775
REPRESENTED BY:		
Cash	\$ 3,728	\$ (135)
Short-term investments, 1.04%, maturing in January 2011 (2009: 0.26%)	73,356	4,910
	\$ 77,084	\$ 4,775

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



NOTES TO THE CONSOLIDATED

FINANCIAL STATEMENTS

DECEMBER 31, 2010

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 offer the best travel experience in Canada with a mission to work together to exceed customer expectations every time. 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. 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

As required by Accounting Guideline AcG-15, *Consolidation of Variable Interest Entities* (AcG-15), the assets, liabilities and results of activities of the Keewatin Railway Company (KRC), a variable interest entity (VIE), have been included in these Consolidated Financial Statements. 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 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 15). 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 (see Note 4 for reconciliation). The amounts are determined on the basis of operating expenses less commercial revenues excluding unrealized gains and losses on financial instruments, realized gains and losses on financial instruments following a modification in the terms of the original instruments, employee future benefits and non-cash transactions relating to property, plant and equipment, intangible assets 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 and intangible assets 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 and intangible assets. Upon disposal or write-off of the funded depreciable property, plant and equipment and intangible assets, the Corporation recognizes into income all remaining deferred capital funding related to the relevant assets. Funding for the acquisition of land is recorded as retained earnings.

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 Provincial treasury bills and/or promissory notes and bankers' acceptances which may be liquidated promptly and have original maturities of three months or less. It also includes Master Asset Vehicle (MAV) notes which may not be liquidated in the near future and have legal maturities from 2013 to 2056. Changes in fair value are recorded in 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 that include third-party revenues are recognized as they are earned. The changes in fair value of the financial instruments held for trading other than derivative financial instruments are 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 and Comprehensive Income.

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.

The cost incurred to improve both owned infrastructure and lease infrastructure improvements are capitalized if they are incurred to improve service levels of our passenger trains.

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
Owned Infrastructure	5 to 40 years
Infrastructure improvements	5 to 40 years
Leasehold improvements	2 to 20 years
Machinery and equipment	4 to 15 years
Computer hardware	3 to 7 years
Other property, plant and equipment	3 to 10 years

No amortization expense is recorded for projects in progress or for retired property, plant and equipment.

I) INTANGIBLE ASSETS

Intangible assets are recorded at cost. This cost includes expenses directly associated with activities to develop or obtain computer software for internal use.

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

Software and licences	3 to 7 years
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J) IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is assessed by comparing the carrying amount of an asset with its expected future net undiscounted cash flows from its use and eventual disposal. If such assets are considered impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value, determined on a discounted expected cash flow basis. The impairment will result in a write down of the related assets and the corresponding expense will be recorded under amortization and losses on write-down and disposal of property plant and equipment and intangible assets.

K) 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.

L) INVESTMENT TAX CREDITS

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

M) EMPLOYEE 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 were 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.

N) ENVIRONMENTAL COSTS

The Corporation provides for estimated costs to meet Government standards and regulations when such costs can be reasonably estimated. Estimates of the anticipated future costs for remediation work are based on the Corporation's prior experience. Provisions for environmental remediation costs are recorded in "Other non-current liabilities", except for the current portion, which is recorded in "Accounts payable and accrued liabilities".

O) ASSET RETIREMENT OBLIGATIONS

Liabilities are recognized for statutory, contractual or legal obligations, when incurred, associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development and/or normal operation of the assets. The obligations are measured initially at fair value, determined using present value methodology, and the resulting costs are capitalized into the carrying amount of the related asset. In subsequent periods, the liability is adjusted for the unwinding of the discount caused by the passage of time and any changes in the amount or timing of the estimated underlying future cash flows. The capitalized asset retirement cost is depreciated on the same basis as the related asset and the unwinding of the discount is included in determining the results of operations.

P) FINANCIAL INSTRUMENTS

Financial assets and financial liabilities, including derivative financial instruments, are initially measured at fair value. Subsequent to initial recognition, financial assets and financial liabilities are measured based on their classification: held-for-trading, loans and receivables or other financial liabilities.

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 a recent actual pattern 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.

Financial assets and financial liabilities classified as HFT except for derivative financial instruments (see Note 2 q) are measured at fair value with changes in those fair values recognized in investment 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 and 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 any 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 are 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.

Q) 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, covering 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 the fair value of derivative financial instruments are recorded in unrealized loss (gain) on derivative financial instruments. Derivative financial instruments with a positive fair value are presented as assets and derivative financial instruments with a negative fair value are presented as liabilities.

R) 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, including the potential environmental 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 lives of property, plant and equipment and intangible assets. Actual results could differ from these estimates and such differences could be material.

S) VIA PRÉFÉRENCE PROGRAM

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

T) 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 the related goods or services are provided by third parties.

3. FUTURE ACCOUNTING CHANGES

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 some significant differences in recognition, measurement and disclosure requirements.

In December 2009, the Public Sector Accounting Board (PSAB) issued an amendment to the Introduction to Public Sector Accounting Standards of the PSA Handbook. This amendment eliminated the Government Business Type Organizations (GBTO) classification and entities currently classified as a GBTO are required to re-assess their classification.

Under the revised introduction, the Corporation is classified as an Other Government Organization (OGO). As an OGO, the Corporation has determined the most appropriate basis of accounting to meet the needs of the users of its financial statements to be the International Financial Reporting Standards. The Corporation will adopt the IFRS for its fiscal year beginning January 1, 2011.

The Corporation has completed the planning and diagnosis activities of its transition plan and has substantially completed the analysis and design of accounting policies phase. The Corporation is currently implementing the action plan developed in the analysis and design of accounting policies phase that involves the creation of new accounts and financial statements model, system changes and process changes. The transition from current Canadian GAAP to IFRS is a significant undertaking that will materially affect the Corporation's reported financial position and results of operations.

4. RECONCILIATION OF NET RESULTS OF OPERATIONS TO GOVERNMENT FUNDING BASIS

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

(in millions of dollars)	2010	2009
Net income and comprehensive income for the year	21.8	2.5
Items not requiring (not providing) operating funds:		
Amortization and losses on write-down and disposal of property, plant and equipment and intangible assets	58.7	60.5
Amortization of deferred capital funding	(57.1)	(56.5)
Employee future benefits to be funded in subsequent years	(19.9)	(21.2)
Unrealized gain on derivative financial instruments	(7.4)	(18.1)
Deferred corporate tax expense (recovery)	5.2	(3.3)
Adjustment for accrued compensation	(0.2)	0.8
Increase in investment fair value	(0.8)	(0.2)
Other	(0.3)	0.5
Operating funding deficit for the year	-	(35.0)

The operating deficit of 2009 was funded by the Asset Renewal Fund.

5. MATERIALS

The materials expensed during the year amounted to \$30.6 million (2009: \$30.4 million). The Corporation had no significant write-down of its materials in 2010 or 2009.

6. PROPERTY, PLANT AND EQUIPMENT

(in millions of dollars)	2010			2009		
	COST	ACCUMULATED AMORTIZATION	NET	COST	ACCUMULATED AMORTIZATION	NET
Land	9.2	-	9.2	6.6	-	6.6
Rolling stock	806.5	558.0	248.5	781.0	537.9	243.1
Maintenance buildings	172.1	151.8	20.3	169.3	144.5	24.8
Stations and facilities	61.0	38.1	22.9	52.3	36.0	16.3
Owned infrastructures	151.7	58.2	93.5	135.2	56.8	78.4
Infrastructure improvements	30.5	11.9	18.6	28.7	8.9	19.8
Leasehold improvements	72.1	50.2	21.9	66.4	48.2	18.2
Machinery and equipment	40.6	28.8	11.8	36.0	26.8	9.2
Computer hardware	11.3	8.6	2.7	8.7	7.4	1.3
Other property, plant and equipment	14.6	13.6	1.0	14.4	13.4	1.0
	1,369.6	919.2	450.4	1,298.6	879.9	418.7
Projects in progress			275.1			104.9
Retired property, plant and equipment (at net realizable value)			0.1			0.3
			725.6			523.9

Projects in progress as at December 31, 2010 primarily consist of rolling stock and improvements to infrastructure and stations.

The amortization expense of property, plant and equipment was \$51.4 million in 2010 (2009: \$50.3 million).

7. INTANGIBLE ASSETS

(in millions of dollars)	2010			2009		
	COST	ACCUMULATED AMORTIZATION	NET	COST	ACCUMULATED AMORTIZATION	NET
Software and licences	51.0	42.5	8.5	44.5	39.7	4.8
Projects in progress			8.9			4.7
			17.4			9.5

The amortization expense of intangible assets in 2010 was \$2.7 million (2009: \$2.4 million).

8. ASSET RENEWAL FUND

A) ASSET RENEWAL FUND

The Corporation has been authorized by the Treasury Board of Canada Secretariat to set aside funds in a manner which ensures that these funds are retained for future capital projects. However, the Treasury Board of Canada Secretariat could approve the use of the Asset Renewal Fund to finance operating deficits.

The investments in the Asset Renewal Fund include the following:

(in millions of dollars)	2010	2009
	CARRYING VALUE AND FAIR VALUE	CARRYING VALUE AND FAIR VALUE
Bankers' acceptances	28.2	20.3
Provincial Treasury bills and/or promissory notes	7.8	23.6
Master Asset Vehicle (MAV) notes	4.9	4.5
Balance at end of year	40.9	48.4
Less: Current portion	15.3	25.3
Non-current portion	25.6	23.1

The Treasury Board of Canada Secretariat has authorized the Corporation to use up to \$15.3 million (2009: \$25.3 million) of the Asset Renewal Fund to meet future working capital requirements. This amount is presented in the current portion of the Asset Renewal Fund.

The weighted average effective rate of return on short-term investments as at December 31, 2010 was 1.09 per cent (2009: 0.24 per cent) excluding MAV notes. The weighted average term to maturity as at December 31, 2010 is one month (2009: two months) excluding MAV notes.

The fair value of short-term investments is based on the current bid price at the Consolidated Balance Sheet date, except for the MAV notes as described in Note 8 c).

Apart from the MAV notes, the Asset Renewal Fund is invested in 14 short-term instruments (2009: 12) that have a rating of "R-1 low" or higher. Diversification in the short-term instruments is achieved by limiting to 10 per cent or less the percentage of the market value of the Asset Renewal Fund assets invested in instruments of a single issuer.

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

B) CHANGES IN THE ASSET RENEWAL FUND

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

(in millions of dollars)	2010	2009
Balance at beginning of year	48.4	74.6
Proceeds from sale or lease of surplus assets	1.5	0.1
Investment income	0.2	0.9
Change in fair value	0.8	0.2
Less: Cash drawdown during the year	(10.0)	(27.4)
Balance at end of year	40.9	48.4

C) MASTER ASSET VEHICLE (MAV) NOTES

On March 17, 2008, the Pan-Canadian Investors Committee (the "Committee") for Asset Backed Commercial Paper (ABCP) filed proceedings for a plan of compromise and arrangement (the "Plan") under *the Companies' Creditors Arrangement Act* (Canada) ("CCAA") with the Ontario Superior Court. At the meeting of ABCP note holders on April 25, 2008, note holders approved the Plan by the required majorities. On June 5, 2008, the Court issued a sanction order and reasons for the decision approving the Plan as amended. On August 18, 2008, that decision was upheld by the Ontario Court of Appeal and, on September 19, 2008, the Supreme Court of Canada denied leave to the appeal. On December 24, 2008, the Committee announced that an agreement had been reached with all key stakeholders, including the governments of Canada, Quebec, Ontario and Alberta to provide additional margin facilities to support the Plan and finalized certain enhancements to the Plan.

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

The new notes, now referred to as Master Asset Vehicle (MAV) notes, have legal maturities ranging from 2013 to 2056 and have remained somewhat illiquid since issued. In the absence of a truly liquid secondary market, management has developed a discounted cash flow valuation model to estimate the fair value of the MAV notes received. The valuation model incorporates assumptions for interest rate, required market yield and effective maturity, some of which are derived from observable market indicators. In 2010, \$0.4 million of capital was received (\$0.8 since the restructuring), leaving an outstanding face value as at December 31, 2010 of \$7.8 million. The estimated fair value of the outstanding notes is \$4.9 million as at December 31, 2010 (2009: \$4.5 million) representing 63 per cent of their face value.

The Corporation's estimated fair value for its MAV notes is subject to significant risks and uncertainties, including the timing and amount of future cash flows, the potential for deterioration in the credit quality of the underlying assets and financial instruments as well as changes in interest rates and credit spreads. Accordingly, the Corporation's assessment of the fair value of its MAV notes holdings could change significantly in the future.

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The Accounts payable and accrued liabilities balance includes the following:

(in millions of dollars)	2010	2009
Accrued liabilities	65.6	42.5
Wages payable and accrued	36.9	38.4
Trade payables	39.5	37.2
Capital tax, income tax and other taxes payable	8.6	10.8
Current portion of network restructuring and reorganization accrual	0.4	0.4
Other	3.7	3.0
	154.7	132.3

10. 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.

DEFINED BENEFIT PENSION PLANS

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

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

The latest actuarial valuations of the pension plans were carried out as at December 31, 2009. The next actuarial valuation will be carried out subsequent to year-end with a measurement date as at December 31, 2010.

The actuarial valuation of the Supplemental Executive Retirement Plan is carried out annually. The latest actuarial valuation was carried out as at December 31, 2010.

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, 2010. The latest actuarial valuation for active members, of the SRP was carried out as at December 31, 2009, and the next actuarial valuation will be carried out subsequent to year-end with a measurement date as at December 31, 2010.

The defined benefit costs recognized in 2010 includes a curtailment loss of \$5.8 million for members affected by a restructuring of the Corporation's activities.

OTHER BENEFIT PLANS

The latest actuarial valuation for the post-retirement unfunded plan was carried out as at May 1, 2010. The next actuarial valuation will be carried out subsequent to year-end with a measurement date as at May 1, 2013.

The latest actuarial valuation for the post-employment unfunded plan was carried out as at December 31, 2010.

The latest actuarial valuation for the self-insured workers' compensation was carried out as at December 31, 2009. The next actuarial valuation will be carried out subsequent to year-end with a measurement date as at December 31, 2012.

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	
	2010	2009	2010	2009
ACCRUED BENEFIT OBLIGATION:				
Balance at beginning of year	1,328.3	1,165.9	31.2	27.8
Current service cost	18.0	13.0	5.1	4.6
Employee contributions	10.1	10.1	-	-
Interest cost	87.6	85.0	1.8	2.1
Benefits paid	(89.9)	(102.8)	(7.6)	(6.2)
Net transfer in	-	7.5	-	-
Plan amendment	-	-	0.8	-
Increase in obligation due to curtailment	5.8	-	-	-
Actuarial losses	233.6	149.6	3.0	2.9
Balance at end of year	1,593.5	1,328.3	34.3	31.2
FAIR VALUE OF PLAN ASSETS:				
Balance at beginning of year	1,481.0	1,354.3	-	-
Actual gains from return on plan assets	163.1	198.1	-	-
Employer contributions	23.8	13.8	7.6	6.2
Employee contributions	10.1	10.1	-	-
Net transfer in	-	7.5	-	-
Benefits paid	(89.9)	(102.8)	(7.6)	(6.2)
Balance at end of year	1,588.1	1,481.0	-	-

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

Asset categories:	2010	2009
Equity securities (public market)	51.2%	50.7%
Fixed income securities (public market)	42.1%	43.3%
Private equity, hedge funds and other	6.7%	6.0%
	100.0%	100.0%

(in millions of dollars)	PENSION PLANS		OTHER BENEFIT PLANS	
	2010	2009	2010	2009
RECONCILIATION OF THE FUNDED STATUS:				
Fair value of plan assets	1,588.1	1,481.0	-	-
Accrued benefit obligation	1,593.5	1,328.3	34.3	31.2
Funded status of plans - (deficit) surplus	(5.4)	152.7	(34.3)	(31.2)
Unamortized net actuarial losses	467.9	321.5	4.2	1.5
Unamortized past service costs	1.0	1.5	1.0	0.3
Unamortized transitional (asset) obligation	(88.6)	(120.9)	2.3	2.7
	374.9	354.8	(26.8)	(26.7)
Network restructuring long-term liability	-	-	(0.4)	(0.4)
Accrued benefit asset (liability)	374.9	354.8	(27.2)	(27.1)

(in millions of dollars)	PENSION PLANS		OTHER BENEFIT PLANS	
	2010	2009	2010	2009
ELEMENTS OF DEFINED BENEFIT COSTS RECOGNIZED IN THE YEAR:				
Current service cost	18.0	13.0	5.1	4.6
Interest cost	87.6	85.0	1.8	2.1
Actual gains from return on plan assets	(163.1)	(198.1)	-	-
Plan amendment	-	-	0.8	-
Curtailment loss	5.8	-	-	-
Actuarial losses	233.6	149.6	3.0	2.9
Elements of employee future benefits costs before adjustment to recognize the long-term nature of these costs	181.9	49.5	10.7	9.6
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	69.1	109.9	-	-
■ Actuarial loss (gain) recognized for the year and the actual actuarial loss on accrued benefit obligation for the year	(215.4)	(135.8)	(2.7)	(3.0)
■ Amortization of past service costs for the year and the actual plan amendments for the year	0.4	0.4	(0.7)	0.1
Amortization of transitional (asset) obligation	(32.3)	(32.3)	0.5	0.5
Defined benefit costs (income) recognized	3.7	(8.3)	7.8	7.2

	PENSION PLANS		OTHER BENEFIT PLANS	
	2010	2009	2010	2009
WEIGHTED-AVERAGE OF SIGNIFICANT ASSUMPTIONS:				
Accrued benefit obligation as at December 31:				
Discount rate	5.50%	6.50%	4.75%	5.25%
Rate of compensation increase	3.00%	3.00%	3.00%	3.00%
Benefit costs for the year ended December 31:				
Discount rate	6.50%	7.50%	5.25%	7.50%
Expected long-term rate of return on plan assets	6.50%	6.75%	-	-
Rate of compensation increase	3.00%	3.00%	3.00%	3.00%
Assumed health care cost trend rates as at December 31:				
Initial health care cost trend rate	-	-	7.43%	7.39%
Cost trend rate declines to	-	-	4.37%	4.03%
Year ultimate rate is reached	-	-	2025	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 2010:

(in thousands of dollars)	INCREASE	DECREASE
Total service and interest cost for the current year	29	(26)
Accrued benefit obligation as at the end of the year	210	(182)

11. CORPORATE TAXES

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

(in millions of dollars)	2010	2009
Current corporate tax recovery	(0.4)	(0.7)
Future corporate tax expense (recovery)	5.2	(3.3)
Corporate tax expense (recovery)	4.8	(4.0)

The overall corporate tax expense (recovery) for the year differs from the amount that would be computed by applying the combined Federal and provincial statutory income tax rates of 28.4 per cent (2009: 29.8 per cent) to income before corporate taxes. The reasons for the differences are as follows:

(in millions of dollars)	2010	2009
Computed corporate tax expense (recovery) - statutory rates	7.2	(0.5)
Permanent differences:		
Large corporate tax recovery	(0.4)	(0.3)
Non-taxable portion of capital and accounting losses (gains) and others	-	(0.3)
Change in valuation allowance	(1.8)	(0.3)
Effect of statutory tax rate substantively enacted during the year	0.9	(3.4)
Effect of tax rate changes on future corporate taxes	(1.1)	0.4
Future corporate tax expense relating to changes in temporary differences	-	0.4
	4.8	(4.0)

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

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

(in millions of dollars)	2010	2009
Future corporate tax assets:		
Government funding	(12.0)	-
Property, plant and equipment	(24.6)	(24.5)
Contingencies, other liabilities and net amounts	(4.8)	(4.3)
Accrued benefit liability	(6.3)	(6.3)
Unrealized loss on derivative financial instruments	(0.3)	(2.0)
Loss carry-forward	(5.4)	(18.0)
	(53.4)	(55.1)
Less: valuation allowance	6.6	8.4
	(46.8)	(46.7)
Future corporate tax liabilities:		
Accrued benefit asset	88.4	83.6
Unrealized gain on derivative financial instruments	1.2	0.8
	89.6	84.4
Net future corporate tax liabilities	42.8	37.7
Presented in the Consolidated Balance Sheet as:		
Future corporate tax assets – current	(12.2)	(2.8)
Future corporate tax liabilities – non-current	55.0	40.5
Net future corporate tax liabilities	42.8	37.7

The Corporation has \$22.6 million of unused federal non-capital tax losses carried forward which expire in the year 2029.

12. DEFERRED CAPITAL FUNDING

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

(in millions of dollars)	2010	2009
Balance, beginning of year	541.1	480.4
Government funding for property, plant and equipment and intangible assets (excluding the cost of land)	267.9	117.2
Amortization of deferred capital funding	(57.1)	(56.5)
Balance, end of year	751.9	541.1

13. 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, 2010 and 2009, 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 issue debt instruments. Accordingly, the Corporation does not have access to external financing and does not have a flexible capital structure.

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

14. COMMITMENTS

A) The Corporation has operating leases in place mainly for facilities, maintenance of way and computer equipment. The future minimum payments relating to these operating leases are as follows:

(in millions of dollars)	
2011	22.7
2012	22.2
2013	20.5
2014	15.2
2015	9.6
Subsequent years proportionately to 2049	170.6
	260.8

B) As at December 31, 2010, the Corporation has outstanding major contract commitments amounting to \$339.3 million (2009: \$498.8 million) consisting mainly of maintenance and completion of rolling stock projects. In 2009, the corporation initiated important investments related to the Federal Government's economic stimulus package and reliability program. The Corporation expects to make payments under these commitments over the next 4 years.

C) As mentioned in note 1, the Corporation uses the roadway infrastructure of other railway companies. The Corporation has entered into train service agreements for the use of tracks and the control of train operations that expire on December 31, 2018.

D) The Corporation has issued letters of credit totalling approximately \$26.3 million (2009: \$25.5 million) to various provincial government workers' compensation boards as security for future payment streams.

15. 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 agreed to contribute an annual amount to KRC to fund a significant portion of its operating expenditures. 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 2010, the financial contribution provided by the Corporation to KRC amounted to \$2.4 million (2009: \$2.4 million).

KRC received \$1.4 million for the maintenance of their infrastructure from the Government of Canada in 2010 (2009: \$1.5 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 value of \$11.4 million (2009: \$10.8 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.

16. FINANCIAL INSTRUMENTS

A) CLASSIFICATION OF FINANCIAL INSTRUMENTS

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

(in millions of dollars)	DECEMBER 31, 2010		DECEMBER 31, 2009	
	CARRYING VALUE		CARRYING VALUE	
	HFT	L&R	HFT	L&R
FINANCIAL ASSETS:				
Cash and cash equivalents	77.1	-	4.8	-
Accounts receivables	-	8.4 ⁽¹⁾	-	7.3 ⁽¹⁾
Derivative financial instruments	4.6 ⁽²⁾	-	3.1 ⁽²⁾	-
Asset Renewal Fund – MAV notes	4.9	-	4.5	-
Asset Renewal Fund – Other investments	36.0 ⁽³⁾	-	43.9 ⁽³⁾	-
	HFT	OTHER LIABILITY	HFT	OTHER LIABILITY
FINANCIAL LIABILITIES:				
Accounts payable and accrued liabilities	-	126.8 ⁽⁴⁾	-	105.5 ⁽⁴⁾
Derivative financial instruments	1.2 ⁽²⁾	-	7.1 ⁽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.

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

The assumptions used in the valuation model at December 31, 2010 include:

CRITERIA	ASSUMPTIONS	
	2010	2009
Expected term to maturity	5.5 years	6.3 years
Discount Rates	8.6% to 43.6%	9.8% to 33%
Coupon rates	CDOR swap - 50bps to CDOR swap + 30bps	CDOR swap - 50bps to CDOR swap + 30bps

If these assumptions were to change, the fair value of the MAV notes could change significantly. A 1.0 per cent increase (decrease) in the discount rate would decrease (increase) the fair value of the MAV notes by approximately \$0.2 million.

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

Level 1 –

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

Level 2 –

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

Level 3 –

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

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

(in millions of dollars)	DECEMBER 31, 2010	LEVEL 1	LEVEL 2	LEVEL 3
Assets:				
Asset Renewal Fund – MAV notes	4.9	-	-	4.9
Asset Renewal Fund – Other investments	36.0	36.0	-	-
Derivative financial instruments	4.6	-	4.6	-
Liabilities:				
Derivative financial instruments	1.2	-	1.2	-

(1) – There have been no significant transfers between Level 1 and Level 2 during the year

(in millions of dollars)	DECEMBER 31, 2009	LEVEL 1	LEVEL 2	LEVEL 3
Assets:				
Asset Renewal Fund – MAV notes	4.5	-	-	4.5
Asset Renewal Fund – Other investments	43.9	43.9	-	-
Derivative financial instruments	3.1	-	3.1	-
Liabilities:				
Derivative financial instruments	7.1	-	7.1	-

(1) – There have been no significant transfers between Level 1 and Level 2 during the year

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

(in millions of dollars)	2010	2009
Asset Renewal Fund – MAV notes:		
Opening balance	4.5	4.7
Total gains in net income ⁽¹⁾	0.8	0.2
Sales	(0.4)	(0.4)
Closing balance	4.9	4.5

(1) A gain of \$0.7 million (2009: \$0.1 million) is included in this amount and attributable to assets still held at year-end.

C) RISK MANAGEMENT

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

D) FOREIGN EXCHANGE RISK

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

(in millions of dollars)	2010	2009
Asset		
Derivative financial instruments	4.6	3.1
Liabilities:		
Accounts payables and accrued liabilities	1.2	1.6
Derivative financial instruments	1.2	7.1

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

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

E) CREDIT RISK

Credit risk is the risk that one party to a financial instrument might not meet its obligations under the terms and conditions of the agreement. The carrying amount of financial assets is \$131.0 million (2009: \$63.6 million) and represents the Corporation's maximum exposure to credit risk. The Corporation does not use credit derivatives or similar instruments to mitigate this risk and, as such, the maximum exposure is the full carrying value or face value of its financial assets. The Corporation minimizes credit risk on cash and cash equivalents, investments, Asset Renewal Fund and derivative financial instruments by dealing only with reputable and high quality financial institutions. The Corporation's exposure to credit risks on trade accounts receivable is reduced by applying a credit policy that establishes limits on the concentration of risk, requires assessing and monitoring of counterparty credit risk and sets credit limits. Only Canadian Government departments and agencies, Crown corporations issuing government travel warrants and travel agents who are members of the International Air Transport Association (Billing and Settlement Plan /Airline Reporting Corporation) are exempt from the Corporation's credit approval process.

As at December 31, 2010, approximately 19.8 per cent (2009: 17.8 per cent) of trade accounts receivable were over 90 days past due, while approximately 69.9 per cent (2009: 70.8 per cent) of trade accounts receivable were current (under 30 days).

As at December 31, 2010, the allowance for bad debt was \$0.8 million (2009: \$0.5 million). The allowance for bad debt is based on an account by account analysis that considers the ageing of the account and the current credit-worthiness of the customer.

F) FUEL PRICE RISK

In order to manage its exposure to changes in fuel and heating oil prices and minimize volatility in operating cash flows, the Corporation enters into derivative contracts with financial intermediaries. A fluctuation of 10 per cent in the USD price of heating oil or fuel 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 to service and receives regular funding from the Government of Canada.

The reported financial liabilities in item a) above totaling \$128.0 million (2009: \$ 112.6 million) represent the maximum liquidity risk exposure for the Corporation.

The following table summarizes the contractual maturities for the derivative and non-derivative financial liabilities as at December 31, 2010:

(in millions of dollars)	LESSTHAN 3 MONTHS	3TO 6 MONTHS	6 MONTHS TO 1YEAR	1TO 2YEARS	OVER 2YEARS	TOTAL
Accounts payable and accrued liabilities	123.2	-	-	1.8	1.8	126.8
Derivative financial liabilities	0.3	0.2	0.5	0.2	-	1.2

H) INTEREST RATE RISK

Interest rate risk is defined as the Corporation's exposure to a loss of earnings or a loss in the value of its financial instruments as a result of fluctuations in interest rates. The Corporation is exposed to interest rate risk associated with cash equivalents and the Asset Renewal Fund for a total of \$118.0 million (2009: \$53.2 million). A variation of 100bps in the interest rates would affect the investment income but would not have a significant impact on the Consolidated Financial Statements.

17. DERIVATIVE FINANCIAL INSTRUMENTS

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

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

Description	PERIOD	FIXED PRICE PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
				2010	2009
	(1)	2010	2010	2010	2009
Crude swap	2010	-	-	-	1,497
Crude swap	2011	1.670 to 2.410	10,080	3,769	1,178
Crude swap	2012	1.957 to 2.250	3,024	880	139
				4,649	2,814

(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)	
				2010	2009
	(1)	2010	2010	2010	2009
Foreign Exchange Forward	2011	-	-	-	136
Foreign Exchange Forward	2012	-	-	-	125
				-	261
				4,649	3,075

(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	FIXED PRICE PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
				2010	2009
	(1)	2010	2010	2010	2009
Crude swap	2010	-	-	-	(5,990)
Crude swap	2011	-	-	-	(159)
				-	(6,149)

(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)	
				2010	2009
	(1)	2010	2010	2010	2009
Foreign Exchange Forward	2010	-	-	-	(709)
Foreign Exchange Forward	2011	1.005 to 1.037	41,045	(996)	(195)
Foreign Exchange Forward	2012	1.015 to 1.036	17,856	(205)	-
				(1,201)	(904)
				(1,201)	(7,053)

(1) – These financial instruments have a monthly settlement schedule.

The fair values of the derivative financial instruments are estimated as the discounted unrealized gain or loss calculated based on the market price at December 31, 2010, 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 values of the derivative financial instruments are provided to the Corporation by the chartered banks that are the counterparties to the transactions.

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

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

18. RELATED PARTY TRANSACTIONS

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

19. NON-MONETARY TRANSACTIONS

The Corporation recorded revenue from non-monetary transactions of approximately \$1.4 million for the year ended December 31, 2010 (2009: \$1.3 million) under "Passenger revenue" in the Consolidated Statement of Operations and Comprehensive Income. The Corporation also recorded expenses from non-monetary transactions of approximately \$1.4 million (2009: \$1.6 million) mainly under "Marketing and sales" and "Other expenses" in the Consolidated Statement of Operations and Comprehensive Income. The nature of non-monetary transactions is mainly related to advertising activities.

20. 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 of Canada 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 mitigate these risks. The continuous risk management process that is in place allows the Corporation to monitor its activities and properties under normal operating conditions as well as monitor accidents that occur. The properties likely to be contaminated or the activities or property, plant and equipment likely to cause a contamination are addressed, at the moment of their observation, by the development of an action plan according to the nature and the importance of the impact and the applicable requirements.

When remediation costs can be reasonably estimated, an accrual is recorded based on the anticipated future costs (see Note 21).

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

- (I) the lack of specific technical information available with respect to many sites;
- (II) the absence of any third-party claims with respect to particular sites;
- (III) the uncertainty regarding the ability to recover costs from any third parties with respect to particular sites;
- (IV) the fact that the environmental responsibility has not been clearly attributed.

There can thus be no assurance that material liabilities or costs related to environmental matters will not be incurred in the future, or will not have a material adverse effect on the Corporation's financial position.

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

D) On April 30, 2010 the Province of Manitoba filed a Statement of Claims against Keewatin Railway Company Ltd. (KRC) to recover the costs of extinguishing a wildfire that occurred on or about May 27, 2008 that they are holding KRC liable for. The judgment is in the amount of \$3.9 million plus costs. KRC has filed a Third Party Claim against Hudson Bay Railway Company for all costs relating to the Provinces' claims. In addition KRC has insurance coverage for these purposes. As of February 25, 2011 nothing further has progressed on these claims and the outcomes or potential impact cannot be reasonably estimated.

21. ENVIRONMENTAL COSTS

A new environmental law came into force in June 2008 for Petroleum Storage Equipment that requires registration of existing and new tank systems. The Corporation has assessed the impact and a preliminary action plan has been prepared to ensure compliance with the law by 2012. The Corporation has made a provision of \$0.8 million (2009: \$0.8 million) for environmental costs, which is recorded in accounts payable and accrued liabilities.

A provision has also been recorded for an environmental liability of \$0.9 million (2009: \$0.9 million) in accounts payable and accrued liabilities that has been established by Keewatin Railway Company for environmental clean-up and decontamination of certain areas of their rail infrastructure.

22. ASSET RETIREMENT OBLIGATION

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

23. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the 2010 presentation

CORPORATE DIRECTORY

AS AT DECEMBER 31, 2010

BOARD OF DIRECTORS:

Paul G. Smith
Chairman of the Board
Toronto, Ontario

Thom A. Bennett
Nepean, Ontario

France Bilodeau
Quebec City, Quebec

Jeffrey R. Clarke
Ottawa, Ontario

Denis Durand
Montréal, Québec

Angela Ferrante
Toronto, Ontario

David Hoff
Vancouver,
British Columbia

Wendy King
Vancouver,
British Columbia

Marc Laliberté
President and Chief
Executive Officer
Montreal, Quebec

Jean-Martin Masse
Saint-Lazare, Quebec

Donald Mutch
Toronto, Ontario

Anthony Perl
Vancouver,
British Columbia

Eric Stefanson
Winnipeg, Manitoba

William M. Wheatley
Regina, Saskatchewan

OFFICERS:

Paul G. Smith
Chairman of the Board
Toronto, Ontario

Marc Laliberté
President and Chief
Executive Officer

Yves Desjardins-Siciliano
General Counsel
and Secretary

Yves Bourbonnais
Chief Information Officer

Laurent Caron
Chief People Officer

Steve Del Bosco
Chief Marketing and
Sales Officer

John Marginson
Chief Operating Officer,
Operations

Denis Pinsonneault
Chief Customer
Experience Officer

Robert St-Jean
Chief Financial and
Administration Officer

COMMITTEES OF THE BOARD

Audit and Risk Committee

**Eric Stefanson,
Chairman**

Thom Bennett
Denis Durand
Wendy King

Human Resources/ Corporate Governance Committee

**Angela Ferrante,
Chair**

Thom Bennett
France Bilodeau
David Hoff
Wendy King
Jean-Martin Masse
Anthony Perl

Investment Committee

**Donald Mutch,
Chairman**

Thom Bennett
France Bilodeau
Denis Durand
William Wheatley

Planning and Finance Committee

**Eric Stefanson,
Acting Chairman**

Jeffrey Clarke
David Hoff
Anthony Perl

Real Estate and Environment Committee

**Jeffrey Clarke,
Chairman**

France Bilodeau
Jean-Martin Masse
William Wheatley

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