MANAGEMENT REPORT

Year ended December 31, 1999

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

To fulfill its responsibility, the Corporation maintains systems of internal accounting 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, general partnership, as internal auditors. The external auditors, the Auditor General of Canada and Raymond Chabot Grant Thornton, general partnership, have audited the Corporation's financial statements and their report indicates the scope of their audit and their opinion on the financial statements.

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

ROD MORRISON
President and
Chief Executive Officer

J.R. PAQUETTE
Vice-President,
Planning and Finance,
and Treasurer

Montréal, Canada
February 9, 2000

AUDITORS' REPORT

TO THE MINISTER OF TRANSPORT

We have audited the balance sheet of VIA Rail Canada Inc. as at December 31, 1999 and the statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1999 and the results of its operations and its cash flows for the year then ended in accordance with generally accepted accounting principles. As required by the *Financial Administration Act*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

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

Raymond Chabot Grant Thornton

RAYMOND CHABOT GRANT THORNTON
General partnership
Chartered Accountants

Montréal, Canada
February 9, 2000

L. Denis Desautels

L. DENIS DESAUTELS, FCA
Auditor General of Canada

Ottawa, Canada
February 9, 2000

FINANCIAL STATEMENTS

As at December 31

BALANCE SHEET

(in thousands)

	Notes	1999	1998
Current assets			
Cash and term deposits		$ 3,846	$ 12,733
Accounts receivable, trade		11,262	7,668
Accounts receivable, other		15,682	3,645
Receivable from the Government of Canada		–	23,678
Temporary investments	6	50,039	33,563
Materials		16,535	16,111
		97,364	**97,398**
Long-term assets			
Properties	4	487,823	520,255
Asset renewal fund	5 and 6	28,260	9,682
		516,083	**529,937**
		$ 613,447	**$ 627,335**
Current liabilities			
Accounts payable and accrued liabilities		$ 86,965	$ 79,217
Deferred revenue		5,037	4,805
		92,002	**84,022**
Long-term liabilities			
Deferred pension	8	41,697	40,072
Network restructuring and reorganization charges	9	14,408	16,029
Other		5,539	5,989
		61,644	**62,090**
Deferred capital funding	10	**487,107**	**499,211**
Shareholder's deficiency			
Share capital	11	9,300	9,300
Contributed surplus	12	4,345	3,812
Deficit		(40,951)	(31,100)
		(27,306)	**(17,988)**
		$ 613,447	**$ 627,335**

See accompanying notes to financial statements

Signed on behalf of the Board,

ANTHONY FRIEND, Q.C.
Director and Chairman of the Audit Committee

MARC LEFRANÇOIS
Director and Chairman of the Board

Financial Statements

Year ended December 31

STATEMENT OF OPERATIONS AND DEFICIT

(in thousands)

	Notes	1999	1998
Revenue			
Passenger		$ 202,096	$ 185,861
Other		18,527	14,297
		220,623	**200,158**
Expenses			
Customer services		223,815	228,020
Equipment maintenance		77,459	75,840
Marketing and sales		25,909	28,928
Support services		38,643	35,196
General and administrative		21,812	16,101
Pension	8	1,625	43,244
Amortization		41,951	39,683
Reorganization charges		9,543	(5,538)
		440,757	**461,474**
Net operating loss before funding from the Government of Canada		**220,134**	**261,316**
Operating funding from the Government of Canada		170,000	178,413
Amortization of deferred capital funding		42,071	41,461
Net results of operations before taxes		**(8,063)**	**(41,442)**
Income and federal large corporation taxes		1,788	(1,165)
Net results of operations for the year		**(9,851)**	**(40,277)**
Retained earnings (deficit), beginning of year		(31,100)	9,177
Deficit, end of year		**$ (40,951)**	**$ (31,100)**

See accompanying notes to financial statements

Financial Statements

Year ended December 31

STATEMENT OF CASH FLOWS

(in thousands)

	1999	1998
Operating activities		
Net results of operations for the year	$ (9,851)	$ (40,277)
Non-cash charges (credits) to operations:		
Amortization of properties	41,100	40,988
Losses (gains) on write-off, retirement and disposal of properties	1,199	(952)
Amortization of investment tax credits	(348)	(353)
Amortization of deferred capital funding	(42,071)	(41,461)
Changes in non-cash working capital	18,727	22,802
Change in deferred pension	1,625	43,245
Change in network restructuring and reorganization charges	(1,621)	(13,059)
Change in other long-term liabilities	(102)	(832)
	8,658	**10,101**
Financing activities		
Capital funding from the Government of Canada	30,500	–
Receivable from the Government of Canada	–	2,944
	30,500	**2,944**
Investment activities		
Change in asset renewal fund	(18,578)	27,831
Change in temporary investments	(16,476)	(33,563)
Acquisition of properties	(10,910)	(18,332)
Proceeds from sale of properties	1,043	2,525
Change in accounts payable and accrued liabilities related to properties	(3,124)	(250)
	(48,045)	**(21,789)**
Cash and term deposits		
Decrease during the year	**(8,887)**	**(8,744)**
Balance, beginning of year	12,733	21,477
Balance, end of year	**$ 3,846**	**$ 12,733**
Represented by:		
Cash	$ (583)	$ 1,174
Term deposits, 5.06%, maturing in January, 2000 (1998: 5.1%)	4,429	11,559
	$ 3,846	**$ 12,733**

See accompanying notes to financial statements

Notes to Financial Statements

As at December 31, 1999

1. AUTHORITY AND OBJECTIVES

VIA Rail Canada Inc. is a Crown corporation named in Part I of Schedule III to the *Financial Administration Act*. It was incorporated in 1977, under the *Canada Business Corporations Act*. The Corporation's vision is to be the best passenger transportation company in Canada with a mission to provide high-quality, low-cost passenger service. 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 the *Income Tax Act* (Canada) and those of certain provinces.

2. ACCOUNTING POLICIES

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

a) Funding from the Government of Canada

Operating funding, which pertains to services, activities and other undertakings of the Corporation for the management and operation of railway passenger services in Canada, is recorded in the Statement of operations and deficit. The amounts are determined on the basis of operating costs less commercial revenues excluding non-cash transactions relating to properties, certain network restructuring and reorganization charges, and are based on the operating budget approved by the Government of Canada for each year.

Funding for depreciable properties is recorded on an accrual basis as deferred capital funding on the Balance sheet and amortized on the same basis and over the same periods as the related capital assets. Upon disposition of the funded depreciable properties, the Corporation recognizes into income all remaining deferred capital funding related to these properties. Funding for non-depreciable capital assets is recorded as contributed surplus.

b) Materials

Materials are valued at weighted average cost.

c) Properties

Properties acquired from Canadian National Railway and Canadian Pacific Limited at the start of operations in 1978 were recorded at the net transfer values while subsequent additions, including those acquired under capital leases, are recorded at cost.

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

Retired assets are written down to their net realizable value.

d) Amortization of properties

Amortization of properties is calculated on a straight-line basis at rates sufficient to write off the cost of properties, less their residual value, over their estimated useful lives, as follows:

Rolling stock	12 to 29 years
Maintenance buildings	25 years
Stations and Facilities	20 years
Infrastructure improvements	5 to 38 years
Leasehold improvements	5 to 20 years
Machinery and Equipment	4 to 15 years
Information systems	3 to 7 years
Other assets	3 to 10 years

No amortization is provided for projects in progress and retired assets.

e) Leases

Properties recorded under capital leases are amortized on a straight-line basis over 20 years, which is representative of their useful lives.

Rental payments under operating leases are expensed as incurred.

f) Deferred credits

Investment tax credits are amortized over the estimated useful lives of the related properties. The amortization of deferred investment tax credits is recorded as a reduction of the amortization of properties. These credits are included in other long-term liabilities

g) Pension plans

The Corporation has defined benefit pension plans, based on retirement age, compensation and length of service, covering all its permanent employees.

The cost to the Corporation is determined by actuarial valuations which allocate to each year, the accrued portion of the benefits based on projections of employees' compensation levels to the time of their retirement, prorated on employees' years of service.

Pension expense (Note 8) includes the cost of benefits attributable to services rendered during the current year, the amortization of past service costs, the amortization of experience gains and losses as well as the amortization of plan amendments. Amortization is calculated on a straight-line basis over the expected average remaining service lives of the active employee groups.

The difference between the accumulated pension expense and the employer's contributions to the pension funds (Deferred pension) is reflected in the Balance sheet as a long-term liability.

h) Employee termination and special benefits

Employee termination and special benefits provided for under labour agreements and special programmes relate to the restructuring and reorganization of the operations. These benefits are recognized when a decision has been approved by management and an estimate of future costs can be reasonably calculated.

Management recognizes changes in the liability from the original estimates based on the results of actual experiences.

i) VIA Préférence program

The incremental costs of providing travel awards under the Corporation's "VIA Préférence" frequent traveller reward program are accrued as the entitlements to such awards are earned and are included in accounts payable and accrued liabilities. The revenues from the sale of point credits to participating partners are recorded as revenue in the year in which the credits are sold.

j) Financial instruments

The estimated fair value of financial instruments, except for the asset renewal fund and temporary investments, approximates their carrying value due to their current nature.

The temporary investments are carried at the lower of cost and market.

The asset renewal fund is carried at cost.

k) Income taxes

The Corporation follows the future income tax method of accounting for income taxes.

l) Measurement uncertainty

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Network restructuring and reorganization charges, amortization of properties, pension charges and contingencies are the most significant items where estimates are used. Actual results could differ from those estimates.

3. 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 Statement of operations and deficit 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)

	1999	1998
Net results of operations for the year	(9.8)	(40.3)
Items not requiring (not providing) operating funds:		
Amortization and gains and losses on properties	42.3	40.0
Amortization of deferred capital funding	(42.1)	(41.4)
Reorganization charges to be funded in subsequent years	6.4	(8.8)
Payment of prior years' reorganization charges	(4.4)	(8.0)
Pension	1.6	43.3
Operating funding deficit for the year (see note 5)	**(6.0)**	**(15.2)**

4. PROPERTIES

(in millions of dollars)

	1999			1998		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Land	4.3	–	4.3	3.8	–	3.8
Rolling stock	510.4	267.6	242.8	512.9	246.8	266.1
Maintenance buildings	159.6	84.1	75.5	159.5	79.9	79.6
Stations and Facilities	34.0	14.2	19.8	35.1	13.1	22.0
Infrastructure improvements	92.9	31.7	61.2	92.9	29.2	63.7
Leasehold improvements	88.3	59.0	29.3	89.4	55.5	33.9
Machinery and Equipment	29.0	21.5	7.5	28.2	19.9	8.3
Information systems	59.2	48.5	10.7	50.7	42.1	8.6
Other assets	18.8	18.6	0.2	20.9	20.4	0.5
	996.5	**545.2**	**451.3**	**993.4**	**506.9**	**486.5**
Projects in progress			15.0			12.1
Retired assets (at net realizable value)			21.5			21.6
			487.8			**520.2**

On December 31, 1999 the gross value of assets under capital leases included above was $3.2 million (1998: $3.5 million) and related accumulated amortization thereon amounted to $2.2 million (1998: $2.3 million).

Projects in progress primarily consist of equipment and information systems.

5. ASSET RENEWAL FUND

The Corporation has been authorized by the Treasury Board of the Government of Canada to segregate proceeds from the sale or lease of surplus assets as well as the operating savings resulting from the rationalization of its maintenance activities, in a manner which ensures that these funds are retained for future capital projects.

During the year, the Corporation received $30.5 million from the Government of Canada as a replenishment of the Asset renewal fund. After Treasury Board approval, the Corporation drew down from the Asset renewal fund $5.6 million (1998: $15.2 million) for operating expenditures and $10.9 million (1998: $18.3 million) for capital expenditures.

6. TEMPORARY INVESTMENTS AND ASSET RENEWAL FUND

The investment decisions for the Temporary investments and Asset renewal fund are consistent with the *Minister of Finance of Canada Financial Risk Management Guidelines for Crown Corporations.*

The Temporary investments and Asset renewal fund include the following investment instruments:

(in millions of dollars)

	1999		1998	
	Cost	Market value	Cost	Market value
Canadian bonds and discount notes	30.3	30.6	20.8	22.5
Pooled equity unit trust	38.1	46.8	22.3	22.7
Cash and short-term investments	9.9	9.9	0.1	0.1
Balance, end of year	**78.3**	**87.3**	**43.2**	**45.3**
Represented by:				
Temporary investments	50.0	55.9	33.5	35.2
Asset renewal fund	28.3	31.4	9.7	10.1
	78.3	**87.3**	**43.2**	**45.3**

Canadian bonds and discount notes bear interest at rates varying between 4.00% and 11.25% (1998: 4.25% and 11.25%) and mature between January 2000 and December 2031.

The fair value of Canadian bonds, discount notes and pooled equity unit trust is equivalent to the market value based on the current bid price at the balance sheet date.

The Corporation is not encountering any significant market, cashflow or interest rate risk related to these investments.

7. INCOME AND FEDERAL LARGE CORPORATION TAXES

The Corporation has net timing differences of $75.7 million (1998: $70.5 million) resulting from items not deducted for income tax purposes, the benefit of which has not yet been recognized in the financial statements. These timing differences generally result from the accrual of pension costs and network restructuring and reorganization charges. The Corporation has unused tax losses in the amount of $9.7 million which will expire in the year 2005.

8. PENSION PLANS

The latest actuarial valuations of the pension plans were carried out as at December 31, 1998 by external actuaries who are members of the Canadian Institute of Actuaries. Based on these valuations and actuarial projections for 1999, the accumulated plan benefits as at December 31, 1999 are $981.8 million (1998: $961.2 million). The net assets available to provide for these benefits at actuarial adjusted market values as at that date amount to $1,123.8 million (1998: $1,027.5 million).

(in millions of dollars)

	1999	1998
Pension Expense:		
Current service cost	9.0	9.0
Past service amortization	24.2	24.0
Amortization of experience gains	(34.5)	(30.5)
Plan amendment for early retirement program	–	39.4
Interest charges on accrued liabilities	2.9	1.3
	1.6	**43.2**
Deferred pension:		
Balance, beginning of year	40.1	(3.1)
Pension expense	1.6	43.2
Balance, end of year	**41.7**	**40.1**

Notes to Financial Statements

As at December 31, 1999

9. NETWORK RESTRUCTURING AND REORGANIZATION CHARGES

The Corporation has incurred expenses related to approved plans for the restructuring of its transportation network on October 4, 1989 as well as subsequent reorganizations.

The present value of the projected cost is recorded as a liability. As at December 31, 1999 a provision of $21.0 million (1998: $25.2 million), of which $14.4 million (1998: $16.0 million) is reflected as a long-term liability, has been recorded to provide for the on-going costs of severance payments and employment security benefits governed by labour agreements, special programmes and arbitration decisions which may extend over several years.

10. DEFERRED CAPITAL FUNDING

(in millions of dollars)

	1999	1998
Balance, beginning of year	499.2	540.6
Asset Renewal Fund replenishment	30.5	-
Government Funding for depreciable capital assets	-	-
Government Funding for land investment transferred to Contributed Surplus	(0.5)	-
Amortization of deferred capital funding	(42.1)	(41.4)
Balance, end of year	**487.1**	**499.2**

An amount of $2.2 million of the asset renewal fund replenishment of $30.5 million was used to finance capital assets in 1999. The remaining balance of $28.3 million is not being amortized.

11. SHARE CAPITAL

The authorized share capital of the Corporation is comprised of an unlimited number of common shares of no par value. As at December 31, 1999 and 1998, 93,000 shares at $100 per share are issued and fully paid.

12. CONTRIBUTED SURPLUS

Contributed Surplus represents the Capital Funding from the Government of Canada of $4.3 million (1998: $3.8 million) for investments in land.

Notes to Financial Statements

As at December 31, 1999

13. COMMITMENTS

a) The future minimum payments relating to operating leases mainly for real estate and computer equipment are as follows:

(in millions of dollars)

2000	12.8
2001	11.8
2002	7.7
2003	7.2
2004	5.8
Subsequent years up to 2047	23.9
	69.2

b) Effective January 1, 1989 as well as in 1998 and 1999, the Corporation entered into a train service agreement and other agreements for the use of tracks and control of train operations. These agreements expire up to December 31, 2008.

c) The Corporation has issued letters of credit totalling approximately $9.7 million (1998: $8.2 million) to various provincial government workmen's compensation boards as security for future payment streams.

14. RELATED PARTY TRANSACTIONS

The Corporation is related in terms of common ownership to all Government of Canada created departments and agencies, and enters into transactions with these entities in the normal course of business on trade terms applicable to all individuals and enterprises and are recorded at exchange value.

15. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. Although the change in date has occurred, it is not possible to conclude that all aspects of the Year 2000 issue that may affect the entity, including those related to customers, suppliers, or other third parties, have been fully resolved.