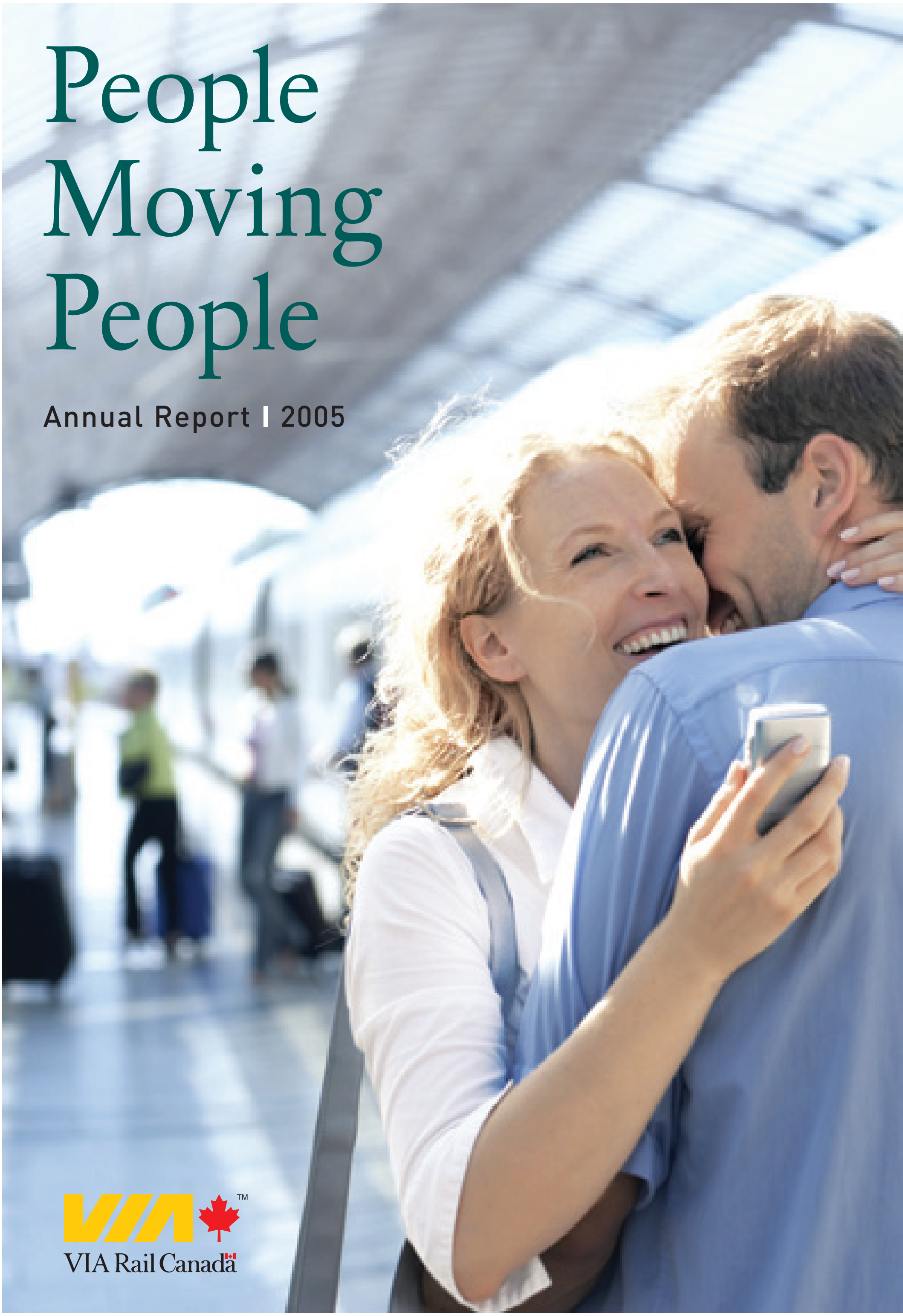
People Moving People

Annual Report | 2005



VIA Rail Canada

Letter to the Minister

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

Dear Minister:

In accordance with the provisions of the *Financial Administration Act*, we are pleased to submit VIA Rail Canada Inc.'s Annual Report for the year ending December 31, 2005.

Paul Côté
President and Chief Executive Officer

Table of Contents

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The Year at a Glance

The following key financial indicators and operating statistics summarize the performance of the Corporation for the year 2005 with comparative data for the years 2001 to 2004.

	2005	2004	2003	2002	2001
Key financial indicators (IN MILLIONS OF DOLLARS)					
Total revenue	**289.8**	258.7	250.3	270.8	253.8
Cash operating expenses (1)	**465.7**	443.8	431.4	424.2	416.9
Capital expenditures	**21.2**	20.2	77.4	98.4	146.7
Government funding:					
Operating	**169.0**	177.4	181.1	153.7	163.3
Capital	**0.7**	20.2	82.4	103.4	151.7
Total Government funding (2)	**169.7**	197.6	263.5	257.1	315.0
Key operating statistics (3)					
Revenue/Cash operating expenses ratio (%) (1)	**62.4**	58.8	58.5	64.5	61.5
Total passengers carried (IN THOUSANDS)	**4,097**	3,887	3,789	3,981	3,865
Total passenger-miles (IN MILLIONS)	**888**	851	857	948	921
Government operating funding per passenger-mile (IN CENTS)	**19.0**	20.8	21.1	16.2	17.7
Yield (CENTS PER PASSENGER-MILE)	**28.6**	28.0	26.8	26.6	25.3
Train-miles operated (IN THOUSANDS)	**6,740**	6,771	6,780	6,770	6,665
Car-miles operated (IN THOUSANDS)	**48,614**	48,396	48,682	48,262	46,102
Average passenger load factor (%)	**55**	53	53	57	57
Average number of passenger-miles per train-mile	**132**	126	126	140	138
On-time performance (%)	**81**	70	73	84	85
Number of employees at year-end	**3,059**	3,027	3,051	3,054	3,013

1 | Cash operating expenses used in the calculation of the Revenue/Cash operating expenses ratio, exclude amortization of Property, plant and equipment, reorganization charges, accounting accrual for compensation, unrealized gains on derivative financial instruments, pension and employee future benefits.

2 | Excludes internal funding from the Asset Renewal Fund of $27.4 million in 2005 and $7.7 million in 2004 and includes a capital funding contribution to the Asset Renewal Fund of $5 million in 2001, 2002 and 2003.

3 | Key operating statistics are unaudited.

Corporate Overview

VIA Rail operates Canada's national passenger rail service on behalf of the Government of Canada. An independent Crown Corporation established in 1977, we provide Canadians with a safe, efficient and environmentally responsible passenger service, operating year-round to over 450 communities, both large and small, including many where rail travel is the only transportation service available. We do this by delivering quality service to our customers, by maximizing revenues and controlling costs, and by building on the market strengths of passenger rail – one of the safest, most reliable and environmentally sustainable modes of transportation available.

OUR SERVICES, COAST TO COAST

We operate up to 492 trains weekly on 12,500 kilometres of track, connecting over 450 Canadian communities. With approximately 3,000 employees, VIA carried 4.1 million passengers over 888 million passenger-miles in 2005.

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

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

In Eastern Canada, the *Ocean*™ runs six times a week between Montreal and Halifax, offering its friendly *Easterly*™ class service from May to October. The *Chaleur*™ makes three trips each week from Montreal through the Gaspé Peninsula.

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

VIA's Strategic Plan... Moving Forward

OUR VISION

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

OUR MISSION

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

OUR VALUES

CUSTOMER FOCUS

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

RESPECT

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

PASSION

We are passionate about passenger rail and the role that it can play in the social, economic, and environmental development of Canada.

moving forward

Message from the Board of Directors

VIA is one of the most trusted passenger services in Canada today. An independent survey ranked it number one in the transportation industry in 2005 – higher than every other company, passenger or freight, in the country.[1]

This trust reflects VIA's ability to provide good value for money to paying customers, to the Canadian taxpayer, and to its shareholder, the Government of Canada. Passenger rail served a record number of travellers across Canada in 2005, and VIA achieved the highest annual revenue growth in its history. We are recognized for our excellent customer service, with 40 per cent of customers reporting that we exceeded their expectations. And despite rising charges for fuel and operations, VIA improved cost-recovery once again – the overall revenue/cost ratio in 2005 was 62 per cent, up from 59 per cent in 2004.

VIA's performance in 2005 confirms that there is a real need for the kind of transportation alternative that rail provides. No other mode of transportation can deliver the same kind of safe, year-round, comfortable travel option for Canadian travellers.

This option is becoming increasingly important to Canadians who are concerned about traffic congestion, highway safety, and the environmental consequences of their transportation choices. Passenger rail is simply the safest, the most efficient, and the most environmentally responsible choice for travel in Canada today.

However, without clear direction from the Government of Canada and a commitment of adequate resources, we must raise serious concerns about the continued success of passenger rail.

[1] As reported in the Leger and Leger Corporate Reputation Study, May 2005.

Investment in passenger rail infrastructure and equipment are critical if the Corporation is to continue serving Canadians well. VIA and its shareholder, the Government of Canada, continue to explore how to best serve this need. The level and nature of any such investment requires decisions with respect to the role of passenger rail, and clear choices about how VIA can best serve Canada in the future.

Pending such decisions, VIA has drawn on limited reserves to fund the equipment and infrastructure needs which are most critical to the continued viability of its passenger services. At the same time, it has become impossible to replenish these reserves, given unforeseen negative market conditions, rising operating costs, and operating funding levels that have not been adjusted for inflation for many years.

With delays in capital investment, the Corporation now has almost no resources to address infrastructure and equipment needs, or to cover operating shortfalls over the coming years.

Both VIA's Board of Directors and VIA management are fully committed to working with the Government of Canada to achieve its policy objectives for the role of passenger rail in public transportation.

Notwithstanding the above challenges, VIA is well prepared to move forward. Travel markets across the country show signs of improving, and the Corporation has an exceptional management team and exceptional people – people who have proven their extraordinary capacity to provide the best possible service to customers and to the taxpayers of Canada.

The Government appointed nine new members to the Board in 2005. We welcome them and extend our thanks to the seven members whose terms ended the same year.

We are confident that VIA will continue to earn the trust of Canadians, and to meet their high expectations for national passenger rail service.

Message from the President

The people of VIA Rail Canada strive to be leaders in service excellence in passenger transportation. Despite challenges early in the year, VIA's performance in 2005 was one of the best yet for the passenger rail service.

As we entered the year, the Canadian travel industry was still struggling to recover from the market downturn that began in 2003. Despite this, by the end of 2005 we had increased revenues by $31 million. We reversed the decline in on-time performance with one of the best year-over-year improvements ever achieved. And we carried more customers than ever – with ridership passing the four million mark for the first time in the current network's history.

Everyone at VIA helped to make these results possible. Early in the year we developed a new Strategic Plan to align all of VIA's people, energy and resources with what we do best – serving our customers. We found new and innovative ways to deliver a service that goes beyond business-as-usual, providing a travel experience that anticipates and exceeds the high expectations of our customers. We brought new entrepreneurial energy to running the business of passenger rail, increasing productivity and value-for-money. We renewed our fundamental commitment to provide Canadians with a passenger service that is safe, secure, and environmentally sustainable.

Results in 2005 demonstrate the remarkable fit between rail and the demands of travel today. While every mode has its place in the public transportation system, Canadians are choosing to travel by rail in record numbers because it provides a unique alternative to travel by other modes – efficient and high quality service, comfort and security, and year-round reliability, at a reasonable cost.

That service will continue to depend on the talents of VIA's people. Our Strategic Plan includes a new focus on those talents, transforming the way we manage human resources. This transformation involves a comprehensive review of training programs, compensation and performance incentives, and hiring and succession planning to ensure that we have the right people, with the right talents, to take passenger rail into the future.

Of course, the future of passenger rail also depends on policy direction from the Government of Canada. VIA's management and Board of Directors are actively addressing the long-term role of passenger rail in Canada. It is hoped that these concerns will be addressed through clear policy decisions with respect to operating funding and investment in rail infrastructure and equipment by our shareholder.

The Board has expressed its confidence in VIA's management, and a commitment to provide sound oversight and a strategic, long-term direction for the Corporation.

We believe in the value of the service we provide. We believe in the potential of passenger rail for the future. And we are committed to delivering the best possible service to Canadians, now and in the years ahead.

The Year in Review

In 2005, VIA re-established Canada's national passenger rail service as a leader in passenger transportation. With a strategic plan more precisely focused on customer service than ever before, the Corporation made dramatic improvements in ridership, revenues and cost-recovery over 2004, matching or exceeding growth in key markets and recapturing the year-over-year momentum that rail achieved in recent years. This once again allowed the Corporation to return exceptional value to Canadian taxpayers.

VIA's momentum was seriously undermined in 2003, when domestic and foreign travel in Canada declined significantly due to SARS and a series of natural disasters. Recovery for the travel industry as a whole was slow and sporadic at best in 2004, and attracting and retaining customers throughout the industry continues to be a very high priority. Nevertheless, in 2005, VIA fared well in all regions of the country.

While it achieved strong year-end performance, the Corporation entered 2005 facing major challenges. Revenues were lower than anticipated and there were jumps in key operating costs, such as fuel, that were beyond the Corporation's control. VIA also began the year with grave concerns about the capacity of the rail infrastructure to sustain efficient train service, and faced continuing uncertainty about capital investment, about operating funding, and about the long-term policy direction for operating the national passenger rail service.

MOVING FORWARD IN 2005

Early in 2005, VIA's President and senior executives met with employees to discuss these challenges, and to develop a clear strategy for moving forward. These discussions identified the need to focus on VIA's key strength in the marketplace – customer service – and to align every aspect of the Corporation's mission, vision and values with this focus on the customer.

Some 2,100 employees took part in meetings and discussions on VIA's new Strategic Plan, entitled *Moving Forward* (see page 3). The *Moving Forward* plan provides a renewed focus on customer service, drawing on the creative energy, innovation and passion of the entire organization.

Based on VIA's vision, mission and values, the plan identifies specific strategic goals with respect to safety, people, service, growth, entrepreneurship and the environment. These goals confirm VIA's commitment to the long-term sustainability of passenger rail, reinforcing its dedication to improving rail service and meeting measurable performance objectives.

Success in addressing each of these goals was critical to VIA's success in 2005.

Safety

We will provide a safe and secure environment for our customers, ourselves and the general public.

Safety and security have become a primary concern for travellers. Heavy traffic and congestion on highways, especially surrounding urban areas, have heightened concerns about the risks of road travel, and many Canadians are exploring safer alternatives. World events have brought security to the forefront of public attention, as Canadians seek assurances that their personal security – and the transportation system itself – are well protected from the threat of terrorist or criminal activity.

Passenger rail is widely recognized as a very safe mode of public transportation. VIA and all its employees recognize a fundamental obligation to protect the safety and security of every customer and every community served by passenger rail.

WORKPLACE HEALTH AND SAFETY

VIA's commitment to safety is present everywhere in the organization.

Management, unions and employees work together to ensure that VIA provides all employees with a safe work environment. Health and Safety committees monitor safety issues and performance at all locations, inspecting facilities, identifying and addressing potential safety hazards, and maintaining a high level of safety awareness.

In 2005, VIA's Eastern Services Equipment Maintenance team marked a safety milestone that sets an example for the entire organization: eight years without a single work-related injury requiring time off from the job. VIA also addresses health concerns through national health initiatives. At the request of employees, VIA conducted an influenza immunization program in the fall of 2005, making flu shots universally available on a voluntary basis, free of charge.

VIA'S SAFETY MANAGEMENT SYSTEM

VIA developed and implemented a comprehensive Safety Management System in 2001. The System defines specific rules, procedures, and responsibilities for maintaining a safe work environment for employees, and a safe passenger service for customers. Since its inception, it has passed three audits by Transport Canada, confirming that the Corporation and its employees are following good safety management practices.

Employees at all levels were actively involved in reviewing the Safety Management System in 2005, providing essential feedback for continually monitoring and refining safety procedures. Safety targets and performance measures have been aligned with and integrated into VIA's business strategy. Health and Safety committees review annual safety reports and Safety Management System performance data to establish specific objectives for improving workplace safety, and to identify issues that require the attention of senior management.

In addition, VIA's management and unions have established two Safety Policy committees which provide a national safety perspective, reviewing and recommending action on all safety-related activities, national trends and concerns. These committees also help to develop and implement VIA's safety training and awareness programs throughout the Corporation.

As part of the Safety Management System, VIA developed a Hazard Assessment and Risk Control Strategy database, which is consulted by managers to identify, eliminate or mitigate situations involving risk to employees, customers or communities. This database system was thoroughly reviewed and redesigned in 2005. The new version will be launched in 2006 and will provide quality assurance for various risk assessments, better reports and improved information-sharing throughout the Corporation. VIA has also developed a new training program for managers and for Health and Safety committees to support the new database.

PUBLIC SAFETY AWARENESS

VIA works regularly with the railway industry and communities to raise awareness of the need for caution around railway tracks and at level crossings.

In 2005, VIA collaborated with CN police to hold the Officer on Board program, in which a train equipped with track cameras carried new police recruits between Montreal and Quebec City, giving them a direct view of the kinds of situations locomotive engineers deal with and sensitizing these future police officers to rail safety issues. Through the Operation Lifesaver program, VIA's locomotive engineers and managers visited communities across the country, providing information to a wide variety of public interest groups, educational institutions and organizations concerning railway safety.

SECURING THE TRANSPORTATION SYSTEM

As tragic events in recent years have shown, transportation systems have been targets for terrorist activity in other parts of the world. While no incidents have taken place in Canada, public concern about transportation security remained high during 2005.

In working and coordinating with various law enforcement agencies, VIA has implemented a wide range of new and enhanced security measures since 2001. These include measures to tighten security at train stations, such as the use of closed-circuit television surveillance, more controlled access, and the use of police and canine patrols. Employee security training and awareness received particular emphasis in 2005, with information campaigns, posters and other tools reminding all employees to remain vigilant.

VIA's Keep an Eye Open program provides front line staff with techniques for identifying security risks, while the RCMP's Jetway program, used at Canadian airports, has been adapted with the RCMP's assistance to improve the observation skills and awareness of VIA employees.

VIA introduced regular security announcements warning passengers at stations not to leave baggage unattended, and to alert VIA staff if they should notice unattended baggage. In addition, a baggage inspection program has been implemented at all staffed passenger rail stations, and passengers are informed that their baggage may be inspected at any time.

To further enhance VIA's state of preparedness, a Security Management System review was undertaken in late 2005. Potential improvements were identified and are currently being developed and implemented, including a new Corporate Security Policy.

VIA's security program as a whole will be defined by its Corporate Security Plan. This Plan encompasses the new Corporate Security Policy and identifies the actions, rules and procedures employees need to follow to protect the Corporation and its customers. The Corporate Security Plan is under development. In 2006, VIA will integrate its Security Plan into the Emergency Measures Organization, to ensure that appropriate systems and procedures are in place to respond quickly to security incidents. The Security Plan will then be integrated into the Safety Management System, giving the Corporation a single, consistent framework for maintaining passenger rail safety and security.

VIA also developed and tested a new Business Continuity Plan in 2005, which will ensure that a potential disruption to the rail network and passenger services can be minimized in the event of a security or other disruptive incident.

Ongoing review of all security measures at VIA is carried out by the Strategic Security Planning Committee. Co-chaired by the President and the Chief Operating Officer, with representatives from all departments and all parts of the passenger rail network, the Committee monitors security issues, identifies opportunities to improve security, and works with partners in the transportation industry, law enforcement and intelligence authorities, and government departments.

VIA's president participated in a number of panels, convened by the Minister of Transport and including industry experts, to discuss security measures implemented by each service operator and the need for integrated, industry-wide collaboration in maintaining the security of transportation. Collaboration is particularly important to VIA, since most of its infrastructure, and many station facilities, are shared with others. Following a risk assessment of VIA security by counter-terrorism experts, VIA is discussing shared security issues with CN, GO Transit, Toronto Terminal Railways, and others.

People

We will work together to create an environment that promotes a passionate commitment to realizing our vision and to VIA's business success.

The success of passenger rail is based on VIA's ability to provide customers with something more than transportation: a travel *experience* that sets rail apart. Every key goal for the Corporation – revenue growth, enhanced train services, improved cost-recovery, and continued progress towards financial self-sufficiency – depends on this ability. And that ability depends on creativity, innovation, and *caring* – the fundamental human talents that people bring to the job.

This is evident in VIA's success in 2005. Virtually every service improvement discussed in this annual report is the direct result of suggestions contributed by VIA employees.

In the future, efforts to engage, recognize, value and reward talent will become more critical than ever before. Throughout 2005, VIA took concrete steps to make these efforts a meaningful part of its business strategy, and an integral part of day-to-day business practices.

VALUING EMPLOYEE OPINIONS

A major step was the development of the *Moving Forward* plan itself. An unprecedented number of employees had the opportunity to influence the framework that will guide the Corporation into the future. When VIA's executives and senior management met with employees in 2005, the dedication of VIA's people was very clear. They are committed to excellence in passenger rail, to performing their jobs well, to improving rail services, and to the success of the Corporation. That commitment is reflected in the Strategic Plan.

The Corporation's effort to engage and listen to employees is also evident in the results of employee opinion surveys. For example, the 2005 survey showed that internal communications, especially between senior management and staff, had improved significantly. This reflects VIA's on-going efforts to discuss the Corporation's vision, mission and values, to keep employees informed about business challenges, and to provide better feedback on both individual and corporate performance.

Regular employee opinion surveys have proven to be a valuable tool to help create an environment where people feel empowered to influence the success of the Corporation. For example, the VIA uniform was fine-tuned in 2005 in direct response to employee feedback. New and modified garments and a more efficient allotment system are being implemented in 2006.

Departmental managers met with their staff to discuss the 2005 employee survey results, and each department developed action plans based on the feedback provided.

MANAGING VIA'S TALENT

VIA is transforming the role of people management within the organization to ensure a more strategic focus on developing the talent of VIA's people, and aligning that talent with the strategic goals of the Corporation.

The goal of this transformation is twofold. The first is to ensure that VIA has the people with the right knowledge, skills and experience to sustain the long-term success of the Corporation. VIA's involvement in an executive development program at McGill University attests to this commitment. Strategic talents are identified to participate in the Advanced Leadership Program, where as a group they make concentrated progress on a complex issue identified as essential for the organization. VIA's customer focus philosophy was developed and implemented out of the enriched international working environment offered by this program.

The second major goal is to further strengthen VIA's human resources. Its people are the foundation for VIA's competitive advantage in the marketplace. The processes of hiring, training, promoting and rewarding talent are all being more precisely managed to create an organization where every individual can succeed by directing their creativity and innovation towards the success of passenger rail.

This realignment of people management is a long-term undertaking, and VIA made substantial progress in 2005. A range of new e-Learning tools have been developed, giving employees convenient access to well-designed learning modules, focusing on skills that are linked to corporate objectives. VIA also began to identify and define corporate competencies that are essential to the Corporation's business strategy. These will provide the basis for future training and career development programs, hiring practices, and succession planning.

VIA has developed and reviewed a comprehensive succession plan which identifies key talent gaps the Corporation will face in the future, as more employees approach retirement. Development plans are being prepared for individuals within the company to fill these gaps, and priorities established for bringing new talent into the organization.

REWARDING PERFORMANCE

VIA has realigned total compensation programs for management personnel to ensure that it is both competitive with industry standards and effective in achieving corporate objectives. Cash compensation programs are closely linked to performance, and a flexible benefits plan will be introduced in 2006 in order to better meet the needs of VIA's new and current workforce.

The performance management system, used by managers to set annual objectives, to measure progress and to reward performance, has also been refocused to ensure that individual and departmental objectives are always clearly aligned with the strategic goals of the Corporation. The performance management system will include a process for self-assessment against corporate competencies in 2006, to support the strategic development of VIA's talent.

Service

We will consistently provide our customers with excellent travel experiences that exceed their expectations.

Customer service is at the very heart of passenger rail, and it is the heart of the *Moving Forward* plan. VIA's consistent success in the marketplace is the direct result of a commitment to continually refine passenger rail services to enhance the customer's experience, and to deliver that service efficiently, with care and attention to the needs of each customer.

Passenger services are developed and delivered by VIA's regional, cross-functional service teams in Western, Central and Eastern Canada. These teams work closely with the customers, businesses and communities they serve to ensure that VIA's operations reflect and respond to the unique needs of regions across the country.

As a federal institution, VIA plays an important role in promoting Canada's linguistic duality. VIA demonstrates daily its commitment to offer clients quality services, including in their preferred official language.

Regional service teams, and all VIA employees, have made service excellence a key focus of VIA's business strategy, and earned exceptionally high ratings from customers in 2005. In fact, 97 per cent of customers said that VIA met or exceeded their expectations during the year – 57 per cent said VIA met their expectations and, for the second consecutive year, 40 per cent said that VIA exceeded them.

IMPROVING SERVICE DELIVERY

A number of initiatives helped to strengthen VIA's focus on the customer and improve service delivery. Managers increased their on-board presence by riding the trains more frequently, and all employees were given the opportunity to experience VIA service themselves in order to gain a better understanding of the customer's perspective. A new monthly "Customer Focus" newsletter provides all employees with real life examples of service excellence and underscores the impact of good customer service on VIA's performance.

VIA has increased its emphasis on "soft skills" in serving customers. Deportment, communication, interpersonal skills, planning and organization are essential in shaping a positive travel experience for travellers. These are now more clearly identified and measured in employee performance reviews.

Self-service options for making travel arrangements and purchasing tickets continue to be very popular. In the last two years web sales have almost doubled, reaching $68 million in 2005 and amounting to 27 per cent of VIA's sales revenues. VIA has begun a comprehensive review of its web site and online reservation systems to make the process even easier for customers. VIA is also reviewing the placement of its self-service ticketing kiosks in key locations throughout the Quebec City-Windsor corridor, to ensure that customers have the best possible access to this service.

REFINING WESTERN SERVICES

VIA's Western transcontinental train, the *Canadian*, celebrated 50 years of service in 2005. In addition to providing basic, year-round transportation between Toronto and Vancouver, the *Canadian* supports Canada's tourism industry by attracting high-yield travellers with its world-renowned *Silver & Blue*™ class service.

In 2005, the Western Services carried out a complete review of *Silver & Blue* to identify ways to update, refine and improve the experience of customers. They identified 25 specific ways to enhance service, and implemented eight of these during the year, including adjustments to staff training, telephone confirmations of bookings and signage enhancements. Additional improvements will be introduced at the start of the 2006 summer peak season.

IMPROVED SCHEDULES IN THE CORRIDOR

VIA's Corridor-East and Southwestern Ontario Service Teams carried out extensive consultations with customers, communities and major employers to find the best way to fine-tune train departure and arrival times in the Quebec City-Windsor corridor.

For example, in the Corridor-East, morning trains between Montreal and Quebec City now depart earlier to accommodate customers travelling to attend business meetings, and some Montreal-Ottawa trains have been extended to Ottawa's suburban Fallowfield station, eliminating the need for many customers to travel into the city centre.

In Southwestern Ontario, both the morning and evening trains from Sarnia to Toronto now leave slightly later, providing better connections with trains at both London and Toronto. The late evening Toronto-Kitchener train now provides through-service to London. Based on numerous requests from students, VIA also launched an additional train, on Friday nights, from London to Toronto via Brantford.

SERVING MARITIME TRANSPORTATION AND TOURISM

In response to regional transportation and tourism partners' demand for high-quality services in Eastern Canada, VIA launched an enhanced seasonal product on the *Ocean,* which runs between Montreal and Halifax. The new *Easterly* class service was developed in consultation with customers, staff, local governments and the tourism industry throughout the region.

This authentic, interactive rail tour offers a complete *Maritime learning experience*, with customers participating in a variety of on-board activities. Entertainment and educational content is tied to regional culture, history and geography, and the dining experience reinforces the cultural connection, with regionally-inspired cuisine and animated personal service. Inclusive meals and themed cars add further value to this enhanced first-class experience.

Response to the new *Easterly* class after the first year of operation was extremely positive. Customer satisfaction ratings on this route improved significantly, reaching 8.4 out of 10, with the dining experience and the learning component receiving even higher marks. Interest in this product remained high throughout its first season, and an increase in traffic is expected in the year ahead.

In 2005, the new *Easterly* operated from June through October; in 2006, it will be available from May through October, with further enhancements under development.

After an initial adjustment period, customer reaction to the Renaissance cars on the *Ocean* has been positive. In response to customer feedback, a number of modifications are underway to improve heating systems, to provide more flexible seating arrangements in the coach cars, and to add additional luggage racks for customer use.

VIA's Eastern Service Team has been meeting with local associations to enhance the value of rail passenger service to the region. One initiative, spearheaded by Halifax and Moncton front-line employees, was a Remembrance Day train in November. Launched by an honour guard and greeted en route by crowds of well-wishers, the service brought veterans and their families from Halifax to Ottawa to take part in *Year of the Veteran* Remembrance Day ceremonies in the nation's capital.

ON-TIME PERFORMANCE

On-time performance – VIA's ability to get customers to their destination at the scheduled time – is one of the most critical factors affecting customer satisfaction. In 2005, VIA raised on-time performance to 81 per cent, 11 percentage points higher than in 2004.

This follows a number of years in which performance was declining, due largely but not exclusively to the challenges of mixed passenger/freight operations on existing tracks. CN owns most of the track and infrastructure used by VIA's passenger trains. In recent years freight traffic has increased, and freight trains have grown longer. Both developments impact VIA's operations, limiting capacity for higher-speed passenger service and causing frequent delays for passenger trains.

VIA and CN executives maintain ongoing discussions to identify opportunities for improving on-time performance. The improvements achieved in 2005 are the result of joint efforts at various levels of both organizations. Train delays are tracked daily and reviewed every morning to identify the cause of delays. In some cases, VIA is able to solve the problem on its own. In other cases, delay issues are raised in weekly meetings with CN managers to identify causes and find solutions.

In 2005, VIA re-opened its Toronto Maintenance Centre service shop, which had been closed in 1997. This has improved equipment cycling efficiency for trains in the Corridor and will provide better support for on-time performance issues related to equipment maintenance.

While these efforts brought improvement, infrastructure challenges and limitations will need to be addressed to provide lasting solutions and to increase capacity and speed for passenger services in the future.


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122
121
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119
117
116
115
114
113
112

Growth

We will seize opportunities to offer innovative products and services in all markets that we serve.

VIA is recapturing the momentum for growth in passenger rail achieved in the decade before 2003. Record increases in both ridership and passenger revenues were achieved in 2005.

Much of this success is due to the customer focus framed by the *Moving Forward* plan. Improved on-time performance alone has helped recapture customers who were frustrated with delays in the past. Service improvements, such as more responsive frequencies and schedules, have made rail travel a more attractive option for new customers. As just one example, the reorganization of departures on Toronto-Sarnia trains has increased ridership by six per cent, while revenue on this service has grown by 13 per cent.

In addition, VIA has focused on capturing new markets and customers through effective marketing and pricing strategies, marketing partnerships, and innovative products that distinguish passenger rail in the marketplace.

MORE FLEXIBLE FARE STRUCTURE

VIA introduced Flexi Fares to provide customers with a more flexible fare structure, to increase choices for customers, and to eliminate complex restrictions on booking discount fares. This new pricing structure is simpler to understand, resembles that offered by other passenger services, and responds to the growing trend among customers to book seats closer to their desired departure date.

In order to make rail travel more accessible to seniors, VIA offers the Seniors' Companion Fare during the shoulder and off-peak season on Western and Eastern services, whereby seniors can take advantage of the standard seniors' discount and get a free companion ticket in *Comfort* class. The Kids Travel Free program provides an attractive option for family travel. And in September, VIA introduced gift cards in fixed denominations of $25, $50 and $100, as well as a flexible value gift card that is reloadable, encouraging reuse.

STRATEGIC PARTNERSHIPS

Strategic marketing and promotional partnerships with other service providers have been effective tools for increasing VIA's attractiveness and availability to new customers.

For example, the AIR MILES® Rewards Program now encourages its members to exchange their reward miles for VIA gift cards, which can be redeemed for rail travel. This program was launched in September 2005, and sales in the first four months exceeded expectations. Similar partnership opportunities are being explored with other programs and organizations. VIA's agreement with Expedia Canada, allowing customers to make hotel and rental car reservations directly from VIA's web site, continues to generate steadily increasing commission revenues for the Corporation.

Intermodal partnerships are another opportunity to attract new customers. VIA has partnered with WestJet to offer a seamless rail/air travel experience, and has integrated rail operations with bus services at its Halifax and Miramichi stations. The Corporation is currently exploring options with the City of Guelph to establish an inter-regional transportation centre at the Guelph passenger station.

NEW PRODUCTS AND SERVICES

In 2005, VIA completed a very encouraging pilot project offering Wi-Fi capabilities, or wireless Internet access, to *VIA 1* customers in the Quebec City-Windsor corridor. This kind of service enhancement attracts business customers who appreciate the opportunity to make productive use of their travel time, playing to the unique strengths of passenger rail in the marketplace. The project was a resounding success, and in 2006 Wi-Fi service will be expanded and offered on all trains and in select stations in the Corridor.

VIA offered customers the use of the *Glenfraser* lounge car on selected departures to Niagara Falls in 2005, and feedback on the experiment was enthusiastic. The Corporation is evaluating the potential revenue benefits of providing lounge car service on these trains, and between Montreal and Toronto, on a seasonal basis.

VIA is also exploring opportunities to increase ridership by re-deploying fleet capacity to key growth markets. For example, in 2005 VIA discontinued the seasonal *Bras d'Or*™ tour service in Nova Scotia, which had been unable to recover from declining tourism since 2003, and also discontinued its overnight service between Montreal and Toronto. At the same time, VIA introduced a 13-week additional frequency for the Niagara Falls-Toronto service, and the service will be available for a 20-week period in 2006. VIA is now considering options for adding weekly, seasonal or special theme trains in other markets.

Entrepreneurship

We will become increasingly self-sufficient by continually improving productivity and increasing the revenue/cost ratio on all train services.

Cost-recovery for passenger rail operations has improved dramatically – by more than 120 per cent – over the past 15 years. While results in 2003 and 2004 were less than satisfactory, cost-recovery rose back to 2002 levels in 2005. Revenue growth was a key component in this success, and efforts to increase productivity and develop new, cost-effective business partnerships have also played an essential role.

PRODUCTIVITY INITIATIVES

Employees at VIA have demonstrated their commitment to controlling costs, and recognize the importance of increasing the financial self-sufficiency of passenger rail operations. This goal has been newly incorporated into VIA's performance management and incentive programs, which are designed to encourage and reward good revenue performance and effective cost controls.

Technology has been an important tool for increasing productivity. Automated and online services have proven to be the most cost-effective way to manage reservations, and to provide customers with travel information. Self-service ticketing kiosks in the Quebec City-Windsor corridor, and customer self-service through VIA's web site, contributed significantly to reduced costs in 2005.

VIA is undertaking a comprehensive review and redesign process for its web site, to make it more convenient and efficient for customers to locate information and make travel reservations. And online booking tools are being developed to enable major corporate customers to administer their travel programs directly with VIA.

VIA also introduced automated billing and settlement for IATA-affiliated travel agencies, which has encouraged large numbers of agents to move their bookings online. More and more travel agencies are using the VIA Agency Web Portal to book train trips for their clients – sales through this portal increased from $2.8 million in 2004 to $9 million in 2005.

Technology is also helping to increase productivity at VIA's Telephone Sales Offices. An automated call monitoring and reporting system allows managers to measure agent performance against clearly defined objectives, analyze performance statistics, and devote more time for personal coaching and training of staff. A workforce management system has improved demand forecasting and performance management, and allowed for optimal, cost-effective staff scheduling.

Following improved telephone sales systems and online services, VIA closed its Toronto Telephone Sales Office in 2005. This has resulted in cost-savings, while consolidated operations in the Montreal and Moncton facilities will ensure continued, high-quality service.

PRODUCTIVE PARTNERSHIPS

Partnerships are an effective way to develop new or enhanced service for customers, while minimizing VIA's direct costs and associated business risks.

On-board wireless Internet access is a prime example. Wi-Fi service in *VIA 1* class is provided by Parsons Transportation Group, one of the world's largest engineering firms with transportation and communications expertise. Parsons recognized the potential for growth in this area and made a long-term commitment, assuming the risks and costs of providing the network and equipping VIA's trains with the technology. In return, the firm benefits through fees-for-use paid by the passenger. At the same time, VIA attracts and retains more customers, particularly business travellers, by offering them a popular service that adds considerable value to their travel time.

On selected train departures from Toronto to Niagara Falls, on-board activities, wine sampling and cheese tasting were offered to customers free of charge and at no cost to VIA. These activities were organized by partners to promote their own products and services, while enhancing the travel experience for VIA's customers.

Partnerships with tour operators, tourism agencies and associations remain an important means for VIA to help develop Canada's tourism industry, while sharing the development and marketing costs of reaching tourists overseas. For example, the Canadian tour operator Brewster provides VIA with marketing services in China, one of the biggest emerging markets for travel to Canada. VIA benefits from Brewster's international expertise, while gaining access to a key market at a reasonable cost.

Environment

We will actively structure our operations to meet the needs of our customers in an environmentally sustainable and responsible manner, while contributing to Canada's commitment to the Kyoto accord.

VIA is a transportation leader in environmental performance, and environmental goals have been integrated into VIA's business for a number of years. These goals continue to be a priority in the Corporation's *Moving Forward* plan. VIA's Environmental Policy, supported by the Environmental Management System, is ingrained in the company's day-to-day business practices.

Passenger rail is already recognized as one of the most environmentally sustainable modes of public transportation available today. VIA believes that there is enormous potential for enhancing rail's contribution to environmental protection in Canada, by continually improving current operations and by expanding rail services as an environmentally responsible travel choice for Canadians.

REDUCING GREENHOUSE GAS EMISSIONS

Greenhouse gas (GHG) emissions are a primary cause of global warming, and transportation is one of the major sources of these emissions. Since 1990, VIA has succeeded in reducing fuel consumption by 25 per cent per passenger-kilometre, thereby reducing GHG emissions by 13 per cent. This reduction is more than double Canada's commitment to the Kyoto target of six per cent by 2008-2012, using 1990 as a base year.

Significant reductions were achieved by modernizing VIA's transcontinental equipment in the 1990s, and through the purchase of 21 new cleaner-running locomotives in 2001. At the same time, VIA has continually worked to manage the entire fleet more efficiently, and increase its productivity. For example, while fuel consumption is down significantly, VIA has increased passenger-miles per train – quite literally, doing more with less.

Current emission reduction strategies focus on improving both the equipment and technology VIA uses, and VIA's efficiency in operating that equipment.

In 2005, VIA began work on a prototype for rebuilding the engines of its older F-40 General Motors locomotives in order to meet the highest North American environmental standards for rebuilt engines. Separate generators for on-board amenities will be installed to allow the main engine to operate more efficiently, and an electric engine heating system will be installed to allow engines to be shut down even in the coldest winter temperatures, where ground-based electric power is available. An automatic start-stop system will allow engines to shut down year-round where no trackside power is available, by automatically restarting when the engine temperature gets too low.

These new systems will reduce the time engines spend idling at stations, and allow for more energy efficient heating during layovers. VIA is also working with General Electric to equip the newer General Electric P-42 locomotives with the layover heating and start-stop systems.

VIA is planning to overhaul the electrical systems in our older LRC cars by converting to more efficient and longer-lasting LED lighting where possible, using new high-efficiency motors to operate doors and other systems, and installing new microprocessor controls for heating and cooling systems. Curtains will also be installed in all cars to reduce the need for air-conditioning in the summer.

GREEN BUSINESS PRACTICES

While train emissions are a major focus of VIA's environmental efforts, the Corporation is committed to operating all aspects of its business in an environmentally responsible manner, introducing reduce, reuse and recycling strategies throughout its operation. An on-board recycling program has been fully implemented on all trains in Western Canada and the Corridor, and will soon be implemented on Eastern services. In December 2005, VIA received the Environmental Protection Award from the Railway Association of Canada for a new component of this recycling program, VIA's textile recovery and recycling initiative. Under this initiative, VIA recovers old uniforms and damaged linen from its operations and donates these for reuse to charitable organizations.

The Corporation is also increasing its emphasis on purchasing environmentally friendly products and services when dealing with suppliers, and is currently working with suppliers to reduce waste generation from materials such as packaging. As an example, VIA's Annual Report and national timetables are printed on paper produced in an environmentally responsible manner.

VIA employees formed three new Green Teams in 2005, bringing the total to 10. Through voluntary participation in these Teams, employees develop environmental initiatives in their own workplaces and communities, while helping to educate Canadians about the environmental consequences of transportation and the advantages of rail. They are making a difference in the most direct way possible – through individual action.

VIA's Green Teams organized a wide range of activities in 2005, including Earth Day celebrations across the country, and VIA's participation in Car Free Day in Montreal. Employees were also invited to take part in Transport Canada's "One Tonne Challenge," which encouraged Canadians to reduce emissions generated by their personal activities by one tonne in 2005.

INCREASING AWARENESS AND CHOICE

VIA's most important contribution to environmental protection in Canada is to provide Canadians with an efficient and environmentally responsible choice in transportation.

A full 50 per cent of personal greenhouse gas emissions in Canada come from the use of private cars, and passenger rail is a mode of transportation with the capacity to divert significant travel away from cars. The potential to reduce total transportation emissions by increasing the use of passenger rail further in the future is significant. This depends on VIA's ability to provide faster, more frequent rail service, to make rail travel more convenient for people to use. And to a large extent, this requires new investment in equipment and infrastructure – equipment that can run faster, and infrastructure that can handle both higher speeds and more trains safely.

VIA is exploring investment options which would allow modest but significant improvements. The Corporation has prepared a medium-term investment plan for the Government's consideration, which could allow VIA to divert scores of car trips to passenger rail – considerably reducing annual overall transportation GHG emissions.

Corporate Governance

Following a year of transition in VIA's leadership, the Government of Canada appointed Mr. Paul Côté as President and Chief Executive Officer of the Corporation on February 1, 2005. The Government also filled many of the existing vacancies on VIA's Board of Directors, appointing nine new members to the Board in 2005. The Government has not yet named a new Chairman of the Board.

The Corporation and its Board of Directors are committed to principles of good governance within the framework of the governance program introduced in 2003 and fully implemented in 2004. Training and orientation for the new Board members began in 2005, focusing on their roles and responsibilities in directing a Crown Corporation. Additional orientation sessions will take place in 2006.

CODE OF CONDUCT

VIA implemented a clear Code of Conduct for all of its employees in 2005, in anticipation of federal legislation.

This Code of Conduct supports the Corporation's core values and confirms VIA's dedication to maintaining a work environment that fosters respect and integrity. It is a formal statement of VIA's values and business practices, and a promise to serve Canadians with the highest standards in ethical behaviour and customer service. All management and unionized employees are required to complete a training course related to the new Code.

VIA has also retained the services of an independent, third-party Compliance Officer, ensuring that VIA employees are free to raise concerns about VIA operations with the assurance that those concerns will be recognized and resolved fairly.

Management Discussion and Analysis

This discussion and analysis presents data and comments on the Corporation's financial position and results of operations for the year 2005. It should be read in conjunction with the Financial Statements, which follow.

OVERVIEW OF FINANCIAL RESULTS

VIA delivered exceptional financial results in 2005, continuing and surpassing its strong financial performance in 2004. Despite the pressures of turbulent travel markets and rising operating costs, the Corporation considerably reduced its net operating deficit, both as compared to budget and to 2004.

This exceptional performance reflects a significant increase in passenger revenues, and revenue from a one-time recognition of capital gains in VIA's Asset Renewal Fund investment portfolio. Total revenues in 2005 hit an all-time high of $289.8 million. This is $26.3 million (or 10 per cent) higher than budget and $31 million (or 12 per cent) higher than 2004.

Higher revenues more than offset higher than expected operating expenses, enabling the Corporation to end its financial year with an operating deficit of $175.9 million. This represents a substantial reduction of $14.9 million (or eight per cent) compared to budget and $9.2 million (or five per cent) compared to 2004.

Annual operating funding for passenger rail from the federal government has been frozen at $169 million since 1999. The Corporation must use its internal resources (the Asset Renewal Fund) to make up the difference between government funding available and the actual funding required. Due to the excellent financial results, VIA was able to reduce its 2005 funding shortfall, and therefore the amount of funding required from the Asset Renewal Fund, to $6.9 million. This is $14.9 million (or 68 per cent) better than anticipated.

REVENUE AND RIDERSHIP

Both revenue and ridership exceeded budget targets in 2005. This growth is particularly significant given the uneven performance of the Canadian travel market as a whole, with some key international markets experiencing no growth during the year.

Following the JetsGo bankruptcy in March, VIA benefited from a surge in domestic market demand, including a high percentage of new rail users. Flexi Fares, introduced earlier in January, helped VIA to retain these new customers by offering simplified, more flexible purchase options. Flexi Fares also produced higher yields compared to 2004 and improved usage of capacity.

A fare adjustment introduced at mid-year, largely to offset higher energy costs, had no negative effect on demand, as airlines had already increased fares.

Overall, revenue per passenger-mile increased to 28.6 cents, over two per cent higher than 2004. Passenger revenues increased $15 million over 2004, exceeding budget targets by over six per cent. Passenger-miles, at 888 million, grew over four per cent as a result of strong Corridor ridership and recovery of long-distance travel markets in Eastern and Western Canada. Ridership reached 4.1 million passenger trips in 2005, a record for the current passenger rail network.

While facing revenue challenges in the first part of the year, VIA met and exceeded targets as of mid-year. Beginning in September, passenger revenue growth accelerated significantly. Between September and December, passenger revenues increased by over nine per cent and passenger ridership grew by approximately six per cent as compared to 2004. *Comfort* class experienced both strong revenue and ridership growth in 2005. *VIA 1* and sleeper classes recorded revenue growth, but only minimal ridership increases.

OPERATING COSTS

Total operating costs in 2005 were influenced by a number of one-time and recurring factors, which caused expenses to exceed budget by $11.5 million, or three per cent. Compared to 2004, total operating expenses increased by five per cent.

Rising fuel prices were a major source of increased costs. However, the negative effects on VIA's financial results were attenuated somewhat in 2005 by the use of fare adjustments and hedging techniques, which sheltered the Corporation from the full impact of increases in the price of oil.

Changing financial conditions affecting the pension plan for VIA's unionized employees also influenced operating costs, and will continue to do so in the years to come. As required by the *Income Tax Act*, the Corporation did not contribute to the unionized plan for a number of years. VIA resumed contributions in 2005 as a result of the deteriorating financial position of the plan. These unplanned contributions started during the second half of the year and totalled $5 million.

In addition, accident costs and provisions for third party claims jumped in 2005, exceeding budget by $4 million.

The overall increase in operating costs masks the impact of the Corporation's stringent control of costs. Despite rising fuel prices and cost increases associated with poor on-time performance on the Western and Eastern long-haul services, costs for train operations – including fuel, maintenance material, and station and property expenses – were below budget for 2005, but nearly $10 million more than last year. Marketing and sales expenses, as well as on-train product costs, were up versus last year and higher than budget, but this is due to higher passenger volumes and revenues.

CAPITAL EXPENDITURES

At the present time, the government has approved no new capital funding for passenger rail. VIA is thus obliged to use the internal Asset Renewal Fund not only to satisfy its capital requirements but to cover operating funding shortfalls as well.

VIA originally planned to spend $32.4 million on capital expenditures in 2005, funded almost entirely through the Asset Renewal Fund. Actual spending for 2005, however, totalled only $21.2 million, which is $11.2 million less than planned.

This under-spending is in part a reflection of VIA's prudent management of its scarce capital resources. The continued absence of an expected government decision to approve new capital funding for 2006 left VIA at risk of having no capital funding in that year. Therefore, VIA decided to revise its 2005 capital spending plans so as to reallocate some of its remaining Asset Renewal Funds to 2006 to provide for a minimal level of capital investment in that year. This involved the cancellation of planned projects to permit the transfer of $5 million dollars of capital funding from 2005 to 2006.

ON-TIME PERFORMANCE

VIA achieved a substantial improvement in on-time performance for the first time in the last four years. Overall on-time performance reached 81 per cent for 2005, an 11 percentage point improvement over 2004. This is one of the best gains in VIA's history. Most notable were improvements achieved over the Christmas period and during the difficult winter months.

VIA tracks delay minutes and distinguishes between those caused by its own operations and those attributable to infrastructure owners or other third parties. As such, VIA addressed critical problems in areas under the Corporation's direct control, such as equipment maintenance and passenger handling. Equipment maintenance delays for the Quebec City-Windsor corridor decreased 18 per cent compared to 2004, and passengers experienced fewer service disruptions related to mechanical failures. Another factor contributing to improved performance was the efforts of the Customer Service department, which achieved a 31 per cent reduction of non-mechanical delay minutes compared to 2004.

The Western transcontinental service suffered a significant rise in CN-related delays for a second consecutive year. Delay minutes increased by 38 per cent over 2004, resulting from a combination of increased freight congestion and derailments. Some delays resulting from track congestion are due to a major undertaking by CN to increase the capacity of its sidings, which will continue into 2006. VIA is working closely with CN to minimize delays resulting from such work projects, which will ultimately improve on-time performance.

The Eastern transcontinental service faced challenges of its own. On-time performance fell eight percentage points from 2004. Shortline railway delays more than doubled during 2005 as result of a need for reduced speed.

OUTLOOK FOR 2006

VIA is confident that it will sustain and further improve a high level of performance for passenger rail in 2006. The Conference Board of Canada predicts that travel in Canada will grow by 2.6 per cent, roughly in line with industry growth during 2005. VIA expects to match or exceed this rate of growth, by continuing to focus on customer service and the key goals set out in the *Moving Forward* plan.

With the prospect of continued increases in basic operating expenses, VIA will maintain rigorous cost controls, explore new opportunities to improve productivity, and capitalize on new market opportunities. Efforts to enhance web-based marketing and sales options and other technologies will respond to growing demand from customers, while further reducing distribution costs. Efforts to increase ridership will focus on fine tuning existing services, managing capacity in off-peak periods, and exploring opportunities to re-deploy fleet capacity in markets that show long-term growth potential.

While VIA enters 2006 with confidence, the Corporation remains very concerned about the financial stability of Canada's passenger rail service, and prospects for maintaining a quality service in the longer-term. While operating costs are rising substantially, operating funding for the service remains frozen at 1999 levels, creating a significant funding shortfall. VIA has managed to cover this shortfall by using funds intended for capital investment, but those funds will be exhausted by the end of 2006.

Capital investment, in turn, has been postponed, pending decisions from the federal government with respect to the future role of passenger rail in national transportation. Indefinite delays in critical investment will affect the performance of passenger rail, and ultimately its viability as a service to Canadians.

VIA will make every effort to continue improving the on-time performance of passenger rail, which depends largely on the infrastructure owned by freight railways. Cooperation between VIA and CN to address capacity issues has achieved excellent results, and will continue. However, it is clear that long-term solutions with respect to infrastructure will require investment to increase capacity, and to improve infrastructure owned by shortline operators.

VIA will continue to work closely with the Government of Canada to explore a long-term vision for the future of passenger rail, and options for investing in that future. The Corporation is confident that, with a clear vision in place, passenger rail will continue to be a relevant and cost-effective transportation service for Canadians.

Financial Statements

Management's Responsibility Statement

YEAR ENDED DECEMBER 31, 2005

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 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 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 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 Ernst & Young LLP, have audited the Corporation's financial statements for the year ended December 31, 2005, and their report indicates the scope of their audit and their opinion on the financial statements.

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

Paul Côté
President and Chief Executive Officer

J. R. Paquette
Chief Financial Officer

Montreal, Canada
February 8, 2006

Auditors' Report

TO THE MINISTER OF TRANSPORT, INFRASTRUCTURE AND COMMUNITIES

We have audited the balance sheet of VIA Rail Canada Inc. as at December 31, 2005, and the statements of operations and retained earnings 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 Canadian 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, 2005, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the *Financial Administration Act,* 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 regulations, the *Canada Business Corporations Act* and articles and the by-laws of the Corporation.

Ernst & Young LLP

Ernst & Young LLP
Chartered Accountants

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Montreal, Canada
February 8, 2006

Balance Sheet

AS AT DECEMBER 31

(IN THOUSANDS)	2005	2004
Current assets		
Cash and cash equivalents	$ 2,621	$ 9,814
Accounts receivable, trade	6,723	5,323
Accounts receivable, other	1,514	2,029
Derivative financial instruments (NOTE 11)	5,678	3,976
Materials	16,105	15,943
Asset renewal fund (NOTE 4)	37,700	-
	70,341	37,085
Long-term assets		
Property, plant and equipment (NOTE 3)	571,012	610,012
Asset renewal fund (NOTE 4)	68,489	110,706
Accrued benefit asset (NOTE 6)	177,245	145,928
Derivative financial instruments (NOTE 11)	6,587	2,921
Other	986	4,752
	824,319	874,319
	$ 894,660	$ 911,404
Current liabilities		
Accounts payable and accrued liabilities (NOTES 5 AND 11)	$ 99,692	$ 86,682
Deferred revenues	8,988	7,403
Other	-	558
	108,680	94,643
Long-term liabilities		
Accrued benefit liability (NOTE 6)	21,805	19,345
Future corporate taxes (NOTE 7)	35,408	33,832
Deferred investment tax credits	2,639	2,986
Other	568	364
	60,420	56,527
Deferred capital funding (NOTE 8)	578,733	635,666
Shareholder's equity		
Share capital (NOTE 9)	9,300	9,300
Contributed surplus	4,963	4,963
Retained earnings	132,564	110,305
	146,827	124,568
	$ 894,660	$ 911,404

COMMITMENTS AND CONTINGENCIES (NOTES 10 AND 15 RESPECTIVELY)

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS

On behalf of the Board,

James J. Smith, FCA
Director and Chairman of the Audit and Risk Committee

Donald Pettit
Director and Acting Chairman of the Board

Statement of Operations and Retained Earnings

YEAR ENDED DECEMBER 31

(IN THOUSANDS)	2005	2004
Revenues		
Passenger	**$ 255,593**	$ 240,620
Investment income	**22,017**	5,735
Other	**12,150**	12,358
	289,760	258,713
Expenses		
Compensation and benefits	**210,825**	195,726
Train operations and fuel (NOTE 11)	**97,091**	87,560
Stations and property	**27,818**	27,706
Marketing and sales	**27,120**	25,254
Maintenance material	**23,964**	24,382
On-train product costs	**17,359**	16,618
Operating taxes	**11,394**	1,557
Employee future benefits (NOTE 6)	**(14,043)**	(19,263)
Amortization and losses on write-down and disposal of property, plant and equipment	**59,599**	60,672
Other	**31,025**	47,014
	492,152	467,226
Operating loss before funding from the Government of Canada and corporate taxes	**202,392**	208,513
Operating funding from the Government of Canada	**169,001**	177,444
Amortization of deferred capital funding (NOTE 8)	**57,633**	59,354
Income before corporate taxes	**24,242**	28,285
Corporate tax expense (NOTE 7)	**1,983**	6,621
Net income for the year	**22,259**	21,664
Retained earnings, beginning of year	**110,305**	88,641
Retained earnings, end of year	**$ 132,564**	$ 110,305

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS

Statement of Cash Flows

YEAR ENDED DECEMBER 31

(IN THOUSANDS)	2005	2004
Operating activities		
Net income for the year	$ 22,259	$ 21,664
Non-cash items relating to operations:		
Amortization of property, plant and equipment	59,336	59,362
Losses on write-down and disposal of property, plant and equipment	610	1,657
Gain on disposal of asset renewal fund investments	(7,073)	(766)
Amortization of premium and discount on purchase of bonds in the asset renewal fund	187	181
Amortization of investment tax credits	(347)	(347)
Amortization of deferred capital funding	(57,633)	(59,354)
Future corporate taxes	1,576	8,511
Unrealized net gain on derivative financial instruments	(5,827)	(4,919)
Change in non-cash working capital related to operations	13,720	8,434
Change in other long-term assets	3,766	766
Change in accrued benefit asset	(31,317)	(28,646)
Change in accrued benefit liability	2,460	1,643
Change in other long-term liabilities	(67)	(91)
	1,650	8,095
Financing activities		
Capital funding from the Government of Canada	700	20,156
Change in capital funding receivable from the Government of Canada	-	3,710
	700	23,866
Investing activities		
Acquisition of investments in the asset renewal fund	(64,787)	(10,659)
Proceeds from sale and maturity of investments in the asset renewal fund	76,190	5,217
Acquisition of property, plant and equipment	(21,198)	(20,156)
Proceeds from disposal of property, plant and equipment	252	899
	(9,543)	(24,699)
Cash and cash equivalents		
Increase (decrease) during the year	(7,193)	7,262
Balance, beginning of year	9,814	2,552
Balance, end of year	$ 2,621	$ 9,814
Represented by:		
Cash and outstanding cheques	$ 126	$ (1,544)
Short-term investments, 3.28%, maturing in January 2006 (2004: 2.51%)	2,495	11,358
	$ 2,621	$ 9,814

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS

Notes to the Financial Statements

AS AT DECEMBER 31, 2005

1 | AUTHORITY AND OBJECTIVES

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

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

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

2 | ACCOUNTING POLICIES

These 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 | FUNDING FROM THE GOVERNMENT OF CANADA

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

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

B | CASH EQUIVALENTS

Cash equivalents include highly liquid investments purchased three months or less from maturity and are carried at lower of cost or market value.

C | ASSET RENEWAL FUND

Short-term investments are carried at the lower of cost or market value, determined on an aggregate basis.

The other investments in the asset renewal fund are carried at cost. The carrying value of each of these investments is assessed periodically to determine if there has been an other than temporary decline in value. A charge to income is recorded during the period in which such a decline in value is determined.

D | REVENUE RECOGNITION

Revenues earned from passenger transportation are recorded as services are rendered. Amounts received for train travel not yet rendered are included in current liabilities as deferred revenues. Investment income and other revenues which includes third party revenues are recorded as they are earned.

E | FOREIGN CURRENCY TRANSLATION

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

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

F | MATERIALS

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

G | 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, including those acquired under capital leases, are recorded at cost.

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

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

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

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

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

H | CORPORATE TAXES

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

I | INVESTMENT TAX CREDITS

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

J | EMPLOYEE FUTURE BENEFITS

The Corporation accrues obligations under its employee future benefit plans.

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

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

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

Past service costs are amortized on a straight-line basis over the expected average remaining service lives of the active employee groups which is, in most cases, estimated to be 12 years.

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.

K | DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments such as Swaps, call options and forward foreign exchange contracts, are utilized by the Corporation in the management of its exposure to changes in fuel prices. 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.

Derivative financial instruments are recognized on the Balance Sheet at inception and removed when they expire or are terminated. On the inception, each derivative is recognized at fair value as either an asset or a liability on the Balance Sheet and changes in fair value are recognized in the train operations and fuel expenses. Derivative financial instruments with a positive fair value are reported as derivative financial instrument assets and derivatives with a negative fair value are reported as part of accounts payable and accrued liabilities or other long-term liabilities.

L | MEASUREMENT UNCERTAINTY

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

M | *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 included in accounts payable and accrued liabilities.

N | NON-MONETARY TRANSACTIONS

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

3 | PROPERTY, PLANT AND EQUIPMENT

(IN MILLIONS OF DOLLARS)	2005			2004		
	COST	ACCUMULATED AMORTIZATION	NET	COST	ACCUMULATED AMORTIZATION	NET
Land	**5.0**	**-**	**5.0**	5.0	-	5.0
Rolling stock	**746.9**	**413.4**	**333.5**	738.2	378.1	360.1
Maintenance buildings	**181.8**	**124.6**	**57.2**	179.9	116.3	63.6
Stations and Facilities	**44.2**	**26.6**	**17.6**	44.1	24.4	19.7
Infrastructure improvements	**141.4**	**50.1**	**91.3**	137.0	46.5	90.5
Leasehold improvements	**113.0**	**87.4**	**25.6**	112.8	82.3	30.5
Machinery and Equipment	**34.2**	**28.5**	**5.7**	33.7	27.5	6.2
Information systems	**44.1**	**39.9**	**4.2**	42.6	36.5	6.1
Other property, plant and equipment	**20.2**	**19.3**	**0.9**	20.0	19.1	0.9
	1,330.8	**789.8**	**541.0**	1,313.3	730.7	582.6
Projects in progress			**28.7**			25.3
Retired property, plant and equipment (at net realizable value)			**1.3**			2.1
			571.0			610.0

Projects in progress as at December 31, 2005, primarily consist of rolling stock for \$23.4 million (2004: \$21.1 million) and improvements to infrastructure and information systems for \$3.1 million (2004: \$3.4 million).

4 | 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 up to $5 million of annual funding approved but not expended during the fiscal year to 2006.

The asset renewal fund includes the following investment instruments:

(IN MILLIONS OF DOLLARS)	2005		2004	
	COST	**MARKET VALUE**	COST	MARKET VALUE
Government of Canada bonds	**18.2**	**25.0**	19.8	26.2
Other Canadian bonds and debentures	**16.1**	**17.6**	20.8	22.8
Pooled equity unit trust	**58.4**	**61.7**	57.7	67.6
Cash and short-term investments	**13.5**	**13.5**	12.4	12.4
	106.2	**117.8**	110.7	129.0
Expected cash drawdown	**37.7**		-	
Long-term portion	**68.5**		110.7	

The Treasury Board has approved an amount of $66.9 million (2004: $39.5 million) to fund 2005 and prior years operating deficits as well as certain property, plant and equipment while the balance of the asset renewal fund of $39.4 million (2004: $71.2 million) represents the funds that are retained for future investments in property, plant and equipment.

During the year, the Treasury Board approved the use of the Asset Renewal Fund to fund the operating deficit of $6.9 million and capital expenditures of $20.5 million.

The Short-term portion of the Asset Renewal Fund presented as Current Assets represents the amount of cash that the Corporation expects to draw from the fund in 2006 for operating expenses and capital expenditures.

The weighted average effective rate of return on bonds and debentures as well as short-term investments as at December 31, 2005 was 5.10 per cent (2004: 5.01 per cent) and the weighted average term to maturity as at December 31, 2005 is seven years (2004: eight years).

The market value of bonds and debentures, pooled equity unit trust and short-term investments is based on the current bid price at the Balance Sheet date.

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

5 | ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The Accounts payable and accrued liabilities include the following:

(IN MILLIONS OF DOLLARS)	2005	2004
Accrued liabilities	**31.9**	31.5
Wages payable and accrued	**31.7**	25.6
Trade payables	**25.5**	22.6
Capital tax and sales taxes payable	**7.6**	4.0
Derivative financial instruments	**1.2**	1.4
Current portion of Network Restructuring and reorganization accrual	**1.7**	0.8
Account payable to the Government of Canada	**-**	0.7
Other	**0.1**	0.1
	99.7	86.7

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

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

The latest actuarial valuation for the post-retirement unfunded plan was carried out as at July 31, 2004. The next actuarial valuation will be carried out as at July 31, 2007.

The latest actuarial valuation for the post-employment unfunded plan was carried out as at August 31, 2004. The next actuarial valuation will be carried out as at August 31, 2007.

The latest actuarial valuation for the self-insured workers' compensation benefits was carried out as at January 1, 2004. The next actuarial valuation will be carried out as at January 1, 2007.

The latest actuarial valuations of the pension plans were carried out as at December 31, 2004 by external actuaries who are members of the Canadian Institute of Actuaries. The next actuarial valuation will be carried out as at December 31, 2007 and will be available in June 2008.

The actuarial valuation of the Supplemental Executive Retirement Plan is carried out annually. The last actuarial valuation was carried out as at December 31, 2004.

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	
	2005	2004	**2005**	2004
ACCRUED BENEFIT OBLIGATION:				
Balance at beginning of year	**1,351.6**	1,260.6	**27.5**	29.5
Current service cost	**20.0**	14.7	**4.5**	4.0
Employee contributions	**9.8**	10.2	**-**	-
Interest cost	**76.3**	74.4	**1.6**	1.7
Benefits paid	**(79.8)**	(78.8)	**(5.8)**	(6.1)
Plan amendments	**-**	-	**-**	0.2
Special termination benefits	**1.8**	-	**0.1**	-
Actuarial (gain) loss	**131.7**	70.5	**1.9**	(1.8)
Accrued benefit obligation at end of year	**1,511.4**	1,351.6	**29.8**	27.5
FAIR VALUE OF PLAN ASSETS:				
Balance at beginning of year	**1,465.2**	1,370.1	**-**	-
Actual return on plan assets	**256.3**	162.5	**-**	-
Employer contributions	**7.5**	1.2	**5.8**	6.1
Employee contributions	**9.8**	10.2	**-**	-
Benefits paid	**(79.8)**	(78.8)	**(5.8)**	(6.1)
Balance at end of year	**1,659.0**	1,465.2	**-**	-

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

	2005	2004
ASSET CATEGORIES:		
Equity securities (public market)	**57.2%**	58.3%
Fixed income securities (public market)	**34.1%**	34.7%
Private equity, hedge funds and other	**7.5%**	5.7%
Real estate	**1.2%**	1.3%
	100.0%	100.0%

(IN MILLIONS OF DOLLARS)	PENSION PLANS		OTHER BENEFIT PLANS	
	2005	2004	**2005**	2004
RECONCILIATION OF THE FUNDED STATUS:				
Fair value of plan assets	**1,659.0**	1,465.2	**-**	-
Accrued benefit obligation	**1,511.4**	1,351.6	**29.8**	27.5
Funded status of plans – surplus (deficit)	**147.6**	113.6	**(29.8)**	(27.5)
Unamortized net actuarial losses (gain)	**276.8**	311.7	**1.6**	(0.3)
Unamortized past service costs	**3.1**	3.5	**0.5**	0.6
Unamortized transitional (asset) obligation	**(250.3)**	(282.9)	**6.8**	9.3
	177.2	145.9	**(20.9)**	(17.9)
Network restructuring long-term liability	**-**	-	**(0.9)**	(1.4)
Accrued benefit asset (liability)	**177.2**	145.9	**(21.8)**	(19.3)

ELEMENTS OF DEFINED BENEFIT COSTS RECOGNIZED IN THE YEAR:				
Current service cost	**20.0**	14.7	**4.5**	4.0
Interest cost	**76.3**	74.4	**1.6**	1.7
Actual return on plan assets	**(256.3)**	(162.5)	**-**	-
Actuarial losses (gains)	**131.7**	70.5	**1.9**	(1.8)
Special termination benefits	**1.8**	-	**0.1**	-
Plan amendments	**-**	-	**-**	0.2
Elements of employee future benefits (income) costs before adjustment to recognize the long-term nature of these costs	**(26.5)**	(2.9)	**8.1**	4.1
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	**153.1**	62.8	**-**	-
Actuarial (loss) gain recognized for the year and the actual actuarial loss on accrued benefit obligation for the year	**(118.2)**	(55.2)	**(1.9)**	1.7
Amortization of past service costs for the year and the actual plan amendments for the year	**0.4**	0.4	**0.1**	(0.1)
Amortization of transitional (asset) obligation	**(32.5)**	(32.5)	**2.4**	2.5
Defined benefit (income) costs recognized	**(23.7)**	(27.4)	**8.7**	8.2

The employee future benefits expense in the Statement of Operations and Retained Earnings includes the pension plans net income, the other benefit plans net costs as well as the adjustment of Network restructuring and reorganization accrual of $1.0 million (2004: $(0.1) million).

	PENSION PLANS		OTHER BENEFIT PLANS	
	2005	2004	**2005**	2004
WEIGHTED-AVERAGE OF SIGNIFICANT ASSUMPTIONS:				
Accrued benefit obligation as at December 31:				
Discount rate	**5.00%**	5.75%	**5.00%**	5.75%
Rate of compensation increase	**3.25%**	3.25%	**3.25%**	3.25%
Benefit costs for the year ended December 31:				
Discount rate	**5.75%**	6.00%	**5.75%**	6.00%
Expected long-term rate of return on plan assets	**7.25%**	7.50%	**-**	-
Rate of compensation increase	**3.25%**	3.00%	**3.25%**	3.00%
Assumed health care cost trend rates as at December 31:				
Initial health care cost trend rate	**-**	-	**6.50%**	7.12%
Cost trend rate declines to	**-**	-	**3.37%**	3.37%
Year ultimate rate is reached	**-**	-	**2011**	2011

SENSITIVITY ANALYSIS

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2005:

(IN THOUSANDS OF DOLLARS)	INCREASE	DECREASE
Total service and interest cost	19	(17)
Accrued benefit obligation	228	(203)

7 | CORPORATE TAXES

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

(IN MILLIONS OF DOLLARS)	**2005**	2004
Corporate tax expense (recovery)	**0.4**	(1.9)
Future corporate tax expense	**1.6**	8.5
Corporate tax expense	**2.0**	6.6

Corporate tax expense on Net income for the year differs from the amount that would be computed by applying the combined Federal and provincial statutory income tax rate of 32.3 per cent (2004: 32.3 per cent) to income before corporate taxes. The reasons for the differences are as follows:

(IN MILLIONS OF DOLLARS)	**2005**	2004
Computed tax expense - statutory rates	**7.8**	9.1
Permanent differences:		
Large corporation tax expense (recovery)	**0.4**	(1.9)
Non-taxable portion of capital and accounting gains	**(3.5)**	(0.7)
Non-taxable portion of dividends received	**(0.2)**	(0.2)
Recognition of tax benefits previously not recognized on property, plant and equipment	**(2.7)**	-
Other	**0.2**	0.3
	2.0	6.6

Future corporate income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the future corporate tax assets and liabilities of the Corporation are as follows:

(IN MILLIONS OF DOLLARS)	**2005**	2004
Future corporate tax assets:		
Property, plant and equipment	**(18.2)**	(8.1)
Contingencies, other liabilities and net amounts	**(5.0)**	(4.0)
Accrued benefit liability	**(7.1)**	(6.3)
Loss carry-forward	**(6.9)**	(2.5)
	(37.2)	(20.9)
Less the valuation allowance	**12.2**	5.9
	(25.0)	(15.0)
Future corporate tax liabilities:		
Accrued benefit asset	**58.5**	47.2
Unrealized gain on derivative financial instruments	**1.9**	1.6
	60.4	48.8
Net future corporate tax liabilities	**35.4**	33.8

The Corporation has $22.2 million of unused Federal non-capital tax losses carried forward and their related year of expiry are as follows:

(IN MILLIONS OF DOLLARS)	
2007	**2.2**
2008	**4.0**
2010	**0.7**
2014	**3.3**
2015	**12.0**
	22.2

8 | DEFERRED CAPITAL FUNDING

(IN MILLIONS OF DOLLARS)	**2005**	2004
Balance, beginning of year	**635.7**	674.9
Government funding for depreciable property, plant and equipment	**0.7**	20.2
Amortization of deferred capital funding	**(57.6)**	(59.4)
Balance, end of year	**578.8**	635.7

9 | SHARE CAPITAL

The authorized share capital of the Corporation is comprised of an unlimited number of common shares with no par value. As at December 31, 2005 and 2004, 93,000 shares at $100 per share are issued and fully paid.

10 | COMMITMENTS

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

(IN MILLIONS OF DOLLARS)	
2006	**16.5**
2007	**16.8**
2008	**15.9**
2009	**8.8**
2010	**5.7**
Subsequent years proportionately to 2049	**163.6**
	227.3

B | As at December 31, 2005, the Corporation has outstanding purchase commitments amounting to $5.7 million consisting mainly of advertising as well as the maintenance and completion of rolling stock projects.

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

D | The Corporation has issued letters of credit totalling approximately $19.9 million (2004: $21.8 million) to various provincial government workers' compensation boards as security for future payment streams.

11 | DERIVATIVE FINANCIAL INSTRUMENTS

The derivative financial instruments used by the Corporation include Swaps which are typically a commodity or price Swap where parties exchange payments in cash based on changes in the price of the commodity (heating oil) or a market index while fixing the price they effectively pay for fuel. The Corporation has also used call options that give the Corporation the right but not the obligation to buy a futures contract for a specified price within a specified period of time in exchange for premium payment. It obligates the seller of an option to sell the underlying futures contract at the designated price should the option be exercised at that price. These call options can no longer be exercised should the price of the commodity exceed a trigger level for more than a specified amount of time. The foreign exchange forwards and futures are contractual agreements to either buy or sell US dollars at a specified price and date in the future.

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

DESCRIPTION	MATURITY DATE	FIXED PRICE PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
				2005	2004
Crude Swap	December 31, 2005	0.650	4,536	-	2,747
Crude Swap	December 31, 2005	0.867	3,024	-	1,056
Crude Swap	December 31, 2006	1.560	2,016	572	-
Crude Swap	December 31, 2006	0.818	4,536	5,098	1,516
Crude Swap	December 31, 2007	0.800	4,536	5,085	1,250
Crude Swap	December 31, 2007	1.498	2,016	743	-
Crude Swap	December 31, 2007	1.780	1,008	64	-
Crude Swap	December 31, 2008	1.457	2,016	690	-
				12,252	6,569

DESCRIPTION	MATURITY DATE	CAP PRICE PER U.S. GALLON (USD)	TRIGGER LEVEL PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
					2005	2004
Crude Call Option	Dec. 31, 2005	1.140	1.450	3,696	-	173
Crude Call Option	Dec. 31, 2006	1.065	1.450	2,520	**	155
					-	328

** This Financial instrument has a negative fair value in 2005.

DESCRIPTION	MATURITY DATE	FORWARD RATE CAD / USD	NOTIONAL AMOUNT (USD) (000'S)	FAIR VALUE CAD (000'S)	
				2005	2004
Foreign Exchange	Monthly in 2006	1.148	824	8	-
Foreign Exchange	Monthly in 2007	1.147	1,859	5	-
				13	-
				12,265	6,897

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

DESCRIPTION	MATURITY DATE	FORWARD RATE CAD / USD	NOTIONAL AMOUNT (USD) (000'S)	FAIR VALUE CAD (000'S)	
				2005	2004
Foreign Exchange	Monthly in 2005	1.314	5,570	-	(619)
Foreign Exchange	Monthly in 2005	1.290	2,177	-	(191)
Foreign Exchange	Monthly in 2005	1.268	1,565	-	(102)
Foreign Exchange	Monthly in 2006	1.290	2,117	(273)	(188)
Foreign Exchange	Monthly in 2006	1.277	357	(42)	(27)
Foreign Exchange	Monthly in 2006	1.189	5,999	(182)	-
Foreign Exchange	Monthly in 2006	1.170	3,730	(46)	-
Foreign Exchange	Monthly in 2006	1.181	4,098	(94)	-
Foreign Exchange	Monthly in 2007	1.179	9,369	(254)	-
				(891)	(1,127)

DESCRIPTION	MATURITY DATE	FIXED PRICE PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
				2005	2004
Crude Swap	April 30, 2005	1.240	1,848	-	(86)
Crude Swap	April 30, 2005	1.543	672	-	(207)
Crude Swap	December 31, 2006	2.033	2,016	(507)	-
Crude Swap	December 31, 2006	1.850	2,016	(91)	-
Crude Swap	December 31, 2007	1.844	1,008	(6)	-
Crude Swap	December 31, 2008	1.799	1,008	(10)	-
				(614)	(293)

DESCRIPTION	MATURITY DATE	CAP PRICE PER U.S. GALLON (USD)	TRIGGER LEVEL PER U.S. GALLON (USD)	NOTIONAL QUANTITY (000'S OF U.S. GALLONS)	FAIR VALUE CAD (000'S)	
					2005	2004
Crude Call Option	Dec. 31, 2006	1.065	1.450	2,520	(13)	-
					(1,518)	(1,420)

The fair value of the positive balance of the above derivative financial instruments at December 31, 2005 is $12.3 million (2004: $6.9 million) of which $5.7 million is recorded as Current Assets (2004: $4.0 million) and $6.6 million as Long-term assets (2004: $2.9 million). The negative balance is $1.5 million (2004: $1.4 million) of which $1.2 million (2004: $1.4 million) is included in "Account payable and Accrued liabilities" as a short-term derivative financial instrument liability and $0.3 million is included in "Other" as a long-term derivative financial instrument liability.

Included in the "Train operations and fuel" expense is a realized and unrealized net gain of $13.5 million (2004: $10.3 million) on these derivative financial instruments.

The Corporation is exposed to credit risk in the event of non-performance by the counterparty to its derivative financial instruments but does not expect such non-performance as the counterparty is of high credit quality.

12 | FAIR VALUE OF FINANCIAL INSTRUMENTS

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

13 | RELATED PARTY TRANSACTIONS

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

14 | NON-MONETARY TRANSACTIONS

The Corporation recorded a revenue from non-monetary transactions of approximately $1.0 million (2004: $1.6 million) as "Passenger revenue" in the accompanying statements of operations and retained earnings for the year ended December 31, 2005. The Corporation also recorded non-monetary expenses of $1.0 million (2004: $2.7 million) in the accompanying statements of operations and retained earnings, mainly as "Marketing and Sales" and other expenses resulting from non-monetary transactions.

15 | CONTINGENCIES

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

On March 2, 2005, the Corporation was successful in overturning the earlier CTA decision by a judgement of the Federal Court of Appeal. That appeal decision has been further appealed to the Supreme Court of Canada by the CCD. The oral hearing is scheduled for May 2006.

If the CTA decision is finally upheld, the cost of modifying the Renaissance cars would be significant. Management is of the opinion that this could cost between $50 million and $100 million, an amount that would exceed funding approved by the Government of Canada for the Renaissance project. No provision has been made in the financial statements for a major modification of the cars.

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

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

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

The Corporation has made a provision in its financial statements.

C | The Corporation has performed an assessment of all of its operations and of all of its sites and facilities in order to determine the environmental risks. The sites and facilities that are suspected to represent an environmental risk will be further investigated in the coming years. Action plans will be developed for facilities and sites that require decontamination measures or mitigation.

The Corporation is unable to estimate any amount related to these risks and therefore no provision has been made in the financial statements.

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

16 | RECLASSIFICATION

The comparative financial statements have been reclassified from the statements previously presented to conform to the presentation of the 2005 financial statements.

Corporate Directory

AS AT DECEMBER 31, 2005

BOARD OF DIRECTORS

Paul Côté
President and Chief Executive Officer
Montreal, Quebec

***Michel Crête**
Montreal, Quebec

***Steven Cummings**
Montreal, Quebec

***Angela Ferrante**
Toronto, Ontario

***Paul Fraser**
Surrey, British Columbia

Jean-Louis Hamel
Montreal, Quebec

Wendy Kelly
Regina, Saskatchewan

***Margaret MacInnis**
Halifax, Nova Scotia

***Lore Mirwaldt**
Winnipeg, Manitoba

Donald Pettit
Acting Chairman of the Board
Vancouver, British Columbia

Timothy Reid
Toronto, Ontario

***Charles Ross**
London Ontario

***Kenneth Savage**, CA, CFP
Fredericton, New Brunswick

James J. Smith, FCA
Winnipeg, Manitoba

***Louis Tremblay**
Cornwall, Ontario

OFFICERS

Paul Côté
President and Chief Executive Officer

Christena Keon Sirsly
Chief Strategy Officer

J. Roger Paquette
Chief Financial Officer

Steve Del Bosco
Vice-President, Marketing

Mike Greenberg
Vice-President, Environment,
Procurement and Real Estate

Carole Mackaay
General Counsel and
Corporate Secretary

John Marginson
Chief Operating Officer

Denis Pinsonneault
Vice-President, Human Resources

* Indicates new members appointed in 2005.
The Board wishes to thank outgoing members for their important contribution:

Greg Black
Jacqueline L. Boutet
Alan Chapple
Anthony Friend, QC
Barbara Kane
Yvon LeBlanc, QC
Marlene McGraw, CA

Donald Pettit, Acting Chairman of the Board, and Paul Côté, President and Chief Executive Officer, are ex-officio members of each Committee of the Board.

COMMITTEES OF THE BOARD

Audit and Risk Committee

James J. Smith, FCA, Chairman
Steven Cummings
Jean-Louis Hamel
Kenneth Savage, CA, CFP
Louis Tremblay

Human Resources Committee

Donald Pettit, Chairman
Michel Crête
Angela Ferrante
Margaret MacInnis
Timothy Reid
James J. Smith, FCA

Investment Committee

Vacant, Chairman
Steven Cummings
Jean-Louis Hamel
Kenneth Savage, CA, CFP
Louis Tremblay

Corporate Governance Committee

Jean-Louis Hamel, Chairman
Angela Ferrante
Wendy Kelly
Margaret MacInnis
Charles Ross

Planning and Finance Committee

James J. Smith, FCA, Chairman
Michel Crête
Wendy Kelly
Timothy Reid
Charles Ross
Kenneth Savage, CA, CFP

Executive Committee

Donald Pettit, Chairman
Paul Côté
Jean-Louis Hamel
James J. Smith, FCA

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(416) 956-7600

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146-123 Main Street
Winnipeg, Manitoba
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