

**Consolidated Financial Statements**

**BRITISH COLUMBIA RAILWAY COMPANY**

**March 31, 2011**

# INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of British Columbia Railway Company, and  
To the Minister of the Ministry of Transportation and Infrastructure, Province of British Columbia

## Report on the Consolidated Financial Statements

I have audited the accompanying consolidated financial statements of British Columbia Railway Company ("the Entity"), which comprise the consolidated balance sheet as at March 31, 2011, and the consolidated statements of income and comprehensive income and deficit, and cash flow for the period then ended, and a summary of significant accounting policies and other explanatory information.

## Management's Responsibility for the Consolidated Financial Statements

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

## Auditor's Responsibility

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

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

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

## **Opinion**

In my opinion, the consolidated financial statements present fairly, in all material respects, the financial position of British Columbia Railway Company as at March 31, 2011, and the results of its operations and its cash flows for the period then ended in accordance with Canadian generally accepted accounting principles.

Victoria, British Columbia  
May 20, 2011

John Doyle, MBA, CA  
Auditor General

**BRITISH COLUMBIA RAILWAY COMPANY**  
**CONSOLIDATED BALANCE SHEET**  
(in thousands of dollars)

	March 31 2011	December 31 2009
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 153,371	\$ 315,010
Accounts receivable	4,103	5,031
Materials and other items	626	282
	<b>158,100</b>	<b>320,323</b>
Assets available for sale	22,186	25,276
Property and equipment - Note 5	264,543	272,623
Other assets - Note 6	91,206	81,153
	<b>\$ 536,035</b>	<b>\$ 699,375</b>
<b>LIABILITIES AND SHAREHOLDER'S EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 1,930	\$ 2,923
Current portion of deferred revenue - Note 7	849	1,499
	<b>2,779</b>	<b>4,422</b>
Deferred lease revenue - Note 7	313,341	312,703
Other liabilities - Note 8	130,787	132,710
	<b>446,907</b>	<b>449,835</b>
<b>Shareholder's equity</b>		
Share capital - Note 10	257,688	257,688
Contributed surplus - Note 11	104,547	277,547
Deficit	<b>(273,107)</b>	<b>(285,695)</b>
	<b>89,128</b>	<b>249,540</b>
	<b>\$ 536,035</b>	<b>699,375</b>
Commitments - Note 12		
Contingent liabilities - Note 13		

See accompanying notes to the consolidated financial statements.

On behalf of the Board



Director

**BRITISH COLUMBIA RAILWAY COMPANY**  
**CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME AND DEFICIT**  
(in thousands of dollars)

	15 months ended March 31 2011	12 months ended December 31 2009
<b>Revenues</b>	\$ 20,168	\$ 20,209
<b>Expenses</b>		
Labour costs	4,251	4,369
Operations and maintenance	4,751	3,472
General and administration	4,211	5,106
Amortization of property and equipment	4,796	3,992
Environmental costs	2,634	17,182
Operating and other taxes	2,367	1,931
Accretion expense	2,264	1,604
	<b>25,274</b>	<b>37,656</b>
<b>Operating loss</b>	<b>(5,106)</b>	<b>(17,447)</b>
<b>Other income</b>		
Gain on property sales	14,369	15,710
Interest income - Note 14(b)	3,325	2,974
<b>Net income and comprehensive income</b>	<b>12,588</b>	<b>1,237</b>
Deficit, beginning of year	<b>(285,695)</b>	<b>(286,932)</b>
<b>Deficit, end of year</b>	<b>\$ (273,107)</b>	<b>\$ (285,695)</b>

*See accompanying notes to the consolidated financial statements.*

**BRITISH COLUMBIA RAILWAY COMPANY**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
(in thousands of dollars)

	15 months ended March 31 2011	12 months ended December 31 2009
<b>Operating activities</b>		
Net income and comprehensive income	\$ 12,588	\$ 1,237
Adjustment for items not involving cash		
Gain on property sales	(14,369)	(15,710)
Amortization of property and equipment	4,796	3,992
Amortization of deferred lease revenue	(1,760)	(1,145)
Accretion income on long-term notes receivable	(512)	(384)
Pension and post-employment benefit income and contributions - Note 9	1,062	10
Accretion of asset retirement obligation	2,264	1,604
Increase (decrease) in environmental provision	(2,242)	10,948
Increase in long-term receivable	(3,179)	(2,283)
Net change in non-cash working capital - Note 14(a)	(1,209)	172
<b>Cash used in operating activities</b>	<b>(2,561)</b>	<b>(1,559)</b>
<b>Investing activities</b>		
Purchase of property and equipment	(2,094)	(13,934)
Purchase of Joint Capital Account assets	(8,034)	(1,019)
Proceeds on sale of property and equipment	22,848	25,359
Proceeds received on mortgage receivable	1,200	-
Decrease in other assets	2	8
<b>Cash provided by investing activities</b>	<b>13,922</b>	<b>10,414</b>
<b>Financing activities</b>		
Payments from contributed surplus - Note 11	(173,000)	-
<b>Cash used in financing activities</b>	<b>(173,000)</b>	<b>-</b>
<b>Increase (decrease) in cash and cash equivalents from operations</b>	<b>(161,639)</b>	<b>8,855</b>
Cash and cash equivalents, beginning of year	315,010	306,155
<b>Cash and cash equivalents, end of year</b>	<b>\$ 153,371</b>	<b>\$ 315,010</b>
Non-cash transactions:		
Disposal of property in exchange for mortgage	\$ -	\$ 1,200
Environmental remediation performed by KM and revenue deferred over lease term	2,398	3,416

See accompanying notes to the consolidated financial statements.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
**(tabular amounts in thousands of dollars)**

British Columbia Railway Company ("BCRC" or the "Company") is incorporated under the *British Columbia Railway Act*. It is owned by the British Columbia Transportation Finance Authority ("BCTFA"), a subsidiary of the Province of British Columbia (the "Province"), operating under the management of the Ministry of Transportation and Infrastructure ("MoTI"). Ownership of BCRC was transferred to the BCTFA on April 1, 2010 from the Province. The Company changed its year end from December 31 to March 31 to match the year end of its parent company. BCRC has commercial and business activities conducted through several operating subsidiaries, spanning the business areas of real estate, railway and marine terminal management.

BCRC's primary mandate is to support and facilitate the British Columbia Ports Strategy and Pacific Gateway Strategy, by providing consulting advice, acquiring and holding railway corridor and strategic port lands, and making related infrastructure investments for the Province.

The Company owns the former BC Rail right-of-way and railway track infrastructure and leases those assets to Canadian National Railway Company ("CN") for the purposes of operating a freight railway. Consistent with the government's Ports Strategy and Pacific Gateway Strategy, BCRC has retained ownership of the Port Subdivision operation, which provides open, neutral rail access to the port terminals at Roberts Bank and, through its subsidiary BCR Properties Ltd. ("BCRP"), has retained ownership of certain port-related lands.

The Province has determined that the remaining assets and entities owned by the Company that are not required to meet the Pacific Gateway Strategy are not required to be publicly owned, and that BCRC is to wind down or dispose of these in a timely manner which maximizes a commercial return to the Province. Management has completed its assessment of the Company and has concluded that the Company has the ability to continue as a going concern.

## **1. SIGNIFICANT ACCOUNTING POLICIES**

These consolidated financial statements are expressed in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

### **Basis of consolidation**

These consolidated financial statements include the accounts of BCRC and all of its subsidiaries. In these notes, "Company" refers to BCRC, including its subsidiaries. All significant intercompany transactions have been eliminated.

### **Use of estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of net recoverable value of receivables, property and equipment, assets available for sale, useful lives for amortization and provisions for post employment benefits, contingencies and environmental matters. Actual amounts may ultimately differ from these estimates. The estimates are reviewed periodically and as adjustments become necessary, they are reported in earnings in the year in which they become known.

### **Cash and cash equivalents**

Cash and cash equivalents include cash and those short-term money market instruments with initial terms to maturity of three months or less.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**Materials**

Materials are valued at the lower of average cost and net realizable value. Cost includes purchase price, import duties, other net taxes, and transport, handling and other costs directly attributable to acquisition. Net realizable value is the estimated revenues generated through operations plus estimated salvage value on disposal, less the estimated costs of completion and costs to generate the revenues.

**Property and equipment**

Property and equipment are capitalized at cost less accumulated amortization. Acquisitions and installations are capitalized at cost while repairs are charged to operations. Betterments are capitalized. On major projects, any directly attributable interest costs are capitalized as a cost of the project.

Property and equipment are amortized on a straight-line basis over the estimated useful lives of the assets. Management assesses the value of its property and equipment for impairment when events and changes in circumstances indicate the carrying amount may not be recoverable. When such indicators of impairment exist, management performs a fair value assessment and reduces the asset's carrying value to its estimated fair value.

The original cost of assets less estimated salvage value is amortized on a straight line basis over the following number of years (see Note 5):

	Number of Years
Buildings	30 - 40
Equipment	3 - 20
Assets under operating lease: - Ballast & culverts	75
- Tracklaying & surfacing	35

Equipment and leasehold improvements under capital lease are amortized over the lower of the assets useful life and the lease term.

**Assets available for sale**

The Company is preparing non port related and non-rail real estate assets for sale and once ready, the assets are reclassified as held for sale and no longer depreciated. The assets are measured at the lower of cost and net realizable value, which is the estimated proceeds less costs to sell.

**Joint Capital Account**

The Company has invested in railway assets for its BCR Port Subdivision operation. Agreements between the Company and the three user railways require the Company to maintain a separate account of the invested costs (the "Joint Capital Account") as the costs will be reimbursed by the user railways in proportion to their use of the track at the time that the assets are retired or when the operation ceases to exist. The portion of the Joint Capital Account relating to land has been accounted for as an operating lease and included in property and equipment and the balance, accounted for as direct financing leases, is included in other assets as the Joint Capital Account Receivables to be collected upon retirement or cessation of operations.



**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
**(tabular amounts in thousands of dollars)**

**1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**Deferred lease revenue**

The Company has two long-term prepaid lease arrangements currently in effect:

- a) An operating lease related to the Company's long-term lease of its railway right-of-way land and railbed assets including grade and ballast as a result of the CN transaction in 2004 which is being amortized over 990 years, representing the initial lease term and the sum of the renewal options (see Note 2).
- b) A lease with Kinder Morgan Canada Terminals ULC ("KM") for the land upon which the Vancouver Wharves terminal facility operates which is being amortized over the 40-year lease term (see Note 3).

Both operating leases were prepaid therefore the amounts have been included in deferred revenue and are being amortized to income over the related terms of each lease.

**Revenue recognition**

Revenues are recognized when services have been substantially completed. Rental income is recognized as earned. All revenues are recognized when the amounts are measurable and collectability is reasonably assured.

**Post-employment benefits**

The Company accrues its obligations under employee benefit plans and the related costs as benefits are earned, net of returns on plan assets. The Company's policies are as follows:

- i) The cost of retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.
- ii) The expected interest cost on any prior service obligation is calculated using management's estimate for the long-term rate of return.
- iii) The expected return on plan assets is calculated at a market-related value for the assets.
- iv) Past service costs from plan amendments are amortized on a straight-line basis over the expected average remaining service period of active employees. Experience gains and losses and any changes in assumptions in excess of 10% of the greater of the accrued benefit obligation and the market value of plan assets are amortized over the expected average remaining service period of active employees. The amortization of past service costs, experience gains and losses and any changes in assumptions are included in the pension expense for the year.
- v) Unamortized costs on benefit plans are amortized over the remaining life expectancy of plan members when all the members are inactive.

**Income taxes**

The Company is exempt from Canadian federal and British Columbia provincial income taxes.

**Environmental expenditures and liabilities**

Environmental expenditures that relate to current operations or an existing condition caused by past operations and which are not expected to contribute to current or future operations are expensed as part of operating activities. Environmental liabilities related to environmental assessment and/or remedial efforts are accrued when the expenditures are considered likely and the costs can be reasonably estimated.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
**(tabular amounts in thousands of dollars)**

**1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**Asset retirement obligation**

The Company recognizes the fair value of a future asset retirement obligation as a liability in the period in which it incurs a legal or constructive obligation associated with the retirement of tangible long-lived assets that results from the acquisition, construction, development, and/or normal use of the assets. The Company concurrently recognizes a corresponding increase in the carrying amount of the related long-lived asset that is depreciated over the life of the asset. The fair value of the asset retirement obligation is estimated using the expected cash flow approach that reflects a range of possible outcomes discounted at a credit-adjusted risk-free interest rate. Subsequent to the initial measurement, the asset retirement obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. Changes in the obligation due to the passage of time are recognized in income as accretion expense using the interest method. Changes in the obligation due to the changes in estimated cash flows are recognized as an adjustment of the carrying amount of the related long-lived asset, if considered to be recoverable.

**Financial Instruments**

**(a) Recognition and Measurement**

All financial instruments are classified into one of the following five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. All financial instruments, including derivatives, are included on the consolidated balance sheet and are measured at fair market value, with the exception of loans and receivables, investments held-to-maturity and other financial liabilities, which are measured at amortized cost. Subsequent measurement and recognition of changes in fair value of financial instruments depends on their initial classification. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the assets are removed from the balance sheet.

Derivative instruments are recorded as either assets or liabilities measured at their fair value except when considered a normal purchase and sale arrangement. Certain derivatives embedded in other contracts must also be measured at fair value. All changes in the fair value of derivatives are recognized in earnings unless specific hedge accounting criteria are met, which requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

The Company has classified cash and cash equivalents as held-for-trading. Amounts receivable, Joint Capital Account receivables, and long-term notes receivable are classified as loans and receivables. Accounts payable and accrued liabilities and other liabilities are classified as other payables. The Company has not identified any derivatives or embedded derivatives.

**(b) Disclosures**

Disclosures are provided in the financial statements to enable users to evaluate the significance of financial instruments for the Company's financial position and performance, the nature and extent of risks arising from financial instruments to which the Company is exposed during the year and at the balance sheet date, and how the Company manages those risks (see Note 4).

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
**(tabular amounts in thousands of dollars)**

**1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

(c) Comprehensive Income

Comprehensive income is defined as the change in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources. Gains and losses that would otherwise be recorded as part of net earnings to be presented in other "comprehensive income" until it is considered appropriate to recognize such into net earnings.

**Future Accounting Framework**

The Public Sector Accounting Board (PSAB) has confirmed that government business enterprises shall adhere to the standards for publicly accountable enterprises. The standards for publicly accountable enterprises are transitioning from Canadian GAAP to International Financial Reporting Standards (IFRS) effective January 1, 2011, as confirmed by Canadian Accounting Standards Board.

BCRC has been directed by the Province's Treasury Board to consult with the Office of the Comptroller General for guidance prior to adopting accounting policy choices and elections related to the transition to the new accounting standards. Treasury Board has directed BCRC to adopt IFRS.

BCRC is a government business enterprise and is adopting IFRS effective April 1, 2011. The required accounting policy changes under IFRS have been determined and the financial statements for the year ended March 31, 2012 and thereafter will be prepared in accordance with IFRS.

**2. CN TRANSACTION**

- (a) On July 14, 2004, BCRC and BCRP completed a transaction with CN pursuant to an agreement signed between the parties on November 25, 2003 (the "CN Transaction"). Under the terms of the agreement, CN assumed the Company's industrial freight railway business by purchasing the shares of BC Rail Ltd., the partnership interests of BC Rail Partnership and railcars from a related entity (collectively "BC Rail").
- (b) BCRC and BC Rail entered into a Revitalization Agreement which has been assumed by CN. Under the agreement, BC Rail leased the railway right-of-way land, railbed assets, and related track infrastructure from BCRC under a long-term lease, which contains provision for prospective adjustments. BC Rail prepaid all lease payments under the Revitalization Agreement. The lease of the right of way land and railbed assets is being accounted for as an operating lease. The net proceeds from the operating lease are being recognized as deferred revenue (see Note 7) and amortized to income on a straight-line basis over the term of the lease including renewal options. The lease of the track infrastructure and equipment is being treated as a sales type lease and the related assets have been removed from the financial statements.
- (c) As part of the CN Transaction, CN committed to certain average transit times for rail traffic on the BC Railway system. Breach of the transit time commitments results in penalty payments required to be made by CN dedicated to upgrades of the BC railway system to improve reliability and transit times for the railway users. As at March 31, 2011, the trust fund held \$2.6 million (2009 - \$2.6 million) in CN penalty payments, which are not recognized in these financial statements.
- (d) Under the Revitalization Agreement, effective July 14, 2009 CN has the right to return certain segments of track to BCRC's control, for no proceeds; subject to specific legal and regulatory approvals. If segments are returned to BCRC, BCRC can retain, sell, or otherwise use the segment at its own discretion, or put the segment back to CN for \$1. At this time, CN has not commenced any action for the return of any segments.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
**(tabular amounts in thousands of dollars)**

**3. KINDER MORGAN (“KM”) TRANSACTION**

- (a) On May 30, 2007, BCRC and its subsidiaries, Vancouver Wharves Limited Partnership (“VWLP”) and BCRP completed a transaction with KM pursuant to an agreement signed on April 3, 2007. Under the terms of the agreement, KM assumed the operations of VWLP’s port terminal facility by acquiring certain operating assets from VWLP and signing a 40-year non-renewable operating lease with BCRP for the land upon which VWLP operates. The net proceeds from the lease are being recognized as deferred revenue (see Note 7) and amortized to income on a straight-line basis over the term of the lease.
- (b) As part of the agreement, KM assumed responsibility to complete certain projects designed to prevent further off-site migration of contamination on the land during the lease and to remediate the contamination at the end of the lease. The fair value of the remediation services at the date of the agreement were estimated at \$14.0 million for off-site migration contamination projects and \$27.1 million for the remediation at the end of the lease. As BCRC retains ultimate responsibility for the remediation of the land, the asset retirement and environmental obligations will continue to be reflected in the Company’s consolidated financial statements (see Note 8) until such time as management is satisfied that KM has completed the remediation work. As the value of the obligations is considered to be part of the lease proceeds, an equivalent amount of lease revenue will be recognized on a straight-line basis over the lease term. An annual assessment will be made concerning Kinder Morgan’s plans and progress towards completion of the remediation services. Any remediation performed in excess of revenue recognized will be reclassified to deferred revenue to ensure straight-line recognition over the lease term.

**4. FINANCIAL INSTRUMENTS**

**Risk management**

In the normal course of business, the Company is exposed to various risks such as credit risk, commodity price risk, interest rate risk, and liquidity risk. To manage these risks, the Company follows a financial risk management framework, which is monitored and approved by the Company’s Board of Directors, with a goal of maintaining a strong balance sheet, optimizing earnings and free cash flow, financing its operations at an optimal cost of capital and preserving its liquidity. The Company does not currently use derivative financial instruments in the management of its risks and does not use them for trading purposes. At March 31, 2011, the Company did not have any derivative financial instruments outstanding (December 31, 2009 – nil).

(a) Credit risk

In the normal course of business, the Company monitors the financial condition and credit limits of its customers and reviews the credit history of each new customer. The Company believes there are no significant concentrations of credit risk, except as discussed specifically below.

To manage its credit risk, the Company’s focus includes the active management of relationships with customers to ensure timely payments, and requiring increased financial security through guarantees or letters of credit.

Included in Other Assets (Note 6(b)) is \$55 million of long-term receivables due from CN Rail, CP Rail, and Burlington Northern Railway which will be recovered based on the relative usage by the railroads at the time the assets are retired. In addition, there is a further \$8 million (Note 6(d)) in long-term notes receivable from CN Rail, which remain as part of the Transaction and are repayable in July 2094.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
**(tabular amounts in thousands of dollars)**

**4. FINANCIAL INSTRUMENTS (contd)**

(b) Interest rate

The Company is exposed to interest rate risk, which is the risk that the fair value or future cash flows of a financial instrument will vary as a result of changes in market interest rates. Such risk exists in relation to the funded status of the Company's pension and post-retirement plans and to its money market instruments. A 25 bps change to interest rates on the money market instruments would have an impact of \$188,000 on the Company's income statement.

The Company does not currently hold any derivative financial instruments to manage its interest rate risk.

(c) Liquidity risk

The Company monitors and manages its cash requirements to ensure access to sufficient funds to meet operational and investing requirements. The Company pursues a solid financial policy framework with the goal of maintaining a strong balance sheet, by monitoring its current ratio, and free cash flow forecasts.

The Company's principal source of liquidity is cash generated from the disposal of non-core assets. The Company's primary uses of funds are for working capital requirements, as they come due, pension and post-retirement benefit contributions, contractual obligations, capital expenditures to prepare properties for sale, funding future environmental obligations, and other potential acquisitions. As such, the Company sets priorities on its uses of available funds based on short-term operational requirements, while keeping in mind its long-term contractual obligations and returning value to its shareholders.

**Fair value of financial instruments**

GAAP defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. The Company uses the following methods and assumptions to estimate the fair value of each class of financial instruments for which the carrying amounts are included in the Consolidated Balance Sheet under the following captions:

(a) Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities:

The carrying amounts approximate fair value because of the short maturity of these instruments.

(b) Other assets:

i) Joint Capital Account Receivables – these receivables generate interest at current market terms for instruments with similar terms and conditions, therefore the fair value approximates the carrying value.

ii) Long-Term Note Receivable from CN – the notes are generating an implicit interest rate of 5.75% per annum, which is consistent with instruments with similar terms and conditions, therefore the fair value approximates the carrying value.

The financial instruments measured at fair value held within each investment are classified according to a hierarchy which includes three levels, reflecting the reliability of the inputs involved in the fair value determination. The Company's instruments are all considered to be level II financial instruments for which the fair value is determined using pricing models based on market observable inputs. Changes in fair valuation methods or in the availability of market observable inputs may result in a transfer between levels. During the year there were no significant transfers of securities between the different levels.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**4. FINANCIAL INSTRUMENTS (contd)**

**Capital Management**

As a result of its ownership by the Province of British Columbia, BCRC is not able to obtain financing through the issuance of new equity. All capital resources, both sustaining and growth or investment capital, must be generated out of operating cashflows, or, where there is a shortfall, through debt.

BCRC currently has no debt outstanding and is retaining surplus equity to fund operating costs and disposition costs for non-port related and non-rail real estate properties, capital requirements for additional rail capacity and related infrastructure for port terminal expansions at Roberts Bank.

BCRC made payments to the Province during the year of \$173 million from its contributed surplus.

**5. PROPERTY AND EQUIPMENT**

	March 31, 2011			December 31, 2009		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Assets under operating lease	\$ 628,252	\$ 414,240	\$ 214,012	\$ 628,069	\$ 410,003	\$ 218,066
Land	39,735	-	39,735	39,810	-	39,810
Buildings	5,731	2,560	3,171	5,731	2,123	3,608
Equipment and leasehold improvements	1,889	1,703	186	1,905	1,595	310
Construction in progress	7,439	-	7,439	10,829	-	10,829
	<b>\$ 683,046</b>	<b>\$ 418,503</b>	<b>\$ 264,543</b>	<b>\$ 686,344</b>	<b>\$ 413,721</b>	<b>\$ 272,623</b>

Assets under operating lease include railway right-of-way land and railbed assets.

Construction in progress includes improvements being made to prepare properties for sale, once completed the assets will be transferred to assets available for sale. During the year, no interest was capitalized on construction in progress (2009 - \$ nil).

**6. OTHER ASSETS**

	March 31 2011	December 31 2009
Accrued pension benefit asset - Note 9(a)	\$ 10,564	\$ 11,173
Mortgage receivable - (a)	-	1,050
Joint Capital Account receivables - (b)	55,267	47,233
Deferred property transfer tax - (c)	8,946	8,957
Long-term notes receivable from CN - (d)	7,506	6,994
Long-term receivable for environmental services, KM - (e)	8,923	5,744
Other	-	2
	<b>\$ 91,206</b>	<b>\$ 81,153</b>

(a) The mortgage receivable was provided to a purchaser in 2009 as part of a sale of property from the Company's real estate portfolio. The mortgage bears interest at prime plus 2%. It was repaid in full in February 2011.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**6. OTHER ASSETS (contd)**

- (b) The Joint Capital Account receivables relate to direct-financing leases which will be repaid to the Company by the users of the railway in proportion to their use of the track when the assets are either retired or the operation ceases. The receivables bear interest at prime plus 1%.
- (c) Deferred property transfer tax arose as part of the CN Transaction described in Note 2. The cost is being amortized over the lease term of 990 years.
- (d) The long-term notes receivable from CN are non-interest bearing and due on July 12, 2094. The notes were discounted using an implied interest rate of 5.75% and are accreted each year to their ultimate face value of \$842 million.
- (e) The long-term receivable for environmental services from KM will be settled through KM's remediation performance at the end of the lease agreement (see Note 3). The value of the receivable is recognized at the discounted rate, equivalent to the discounted asset retirement obligation. Annually, the Company recognizes the accretion on the asset retirement obligation and an equivalent return on the receivable at approximately 5.5%.

**7. DEFERRED REVENUE**

	March 31 2011	December 31 2009
CN operating lease	\$ 280,414	\$ 280,770
KM operating lease	32,927	31,933
Deferred rental revenue	849	1,499
	<b>\$ 314,190</b>	<b>\$ 314,202</b>
Less: current portion	(849)	(1,499)
	<b>\$ 313,341</b>	<b>\$ 312,703</b>

During the year, KM performed remediation activities on the site, which reduced BCRC's environmental liability accrual. The estimated value of the remediation is \$2.4 million (2009 - \$3.4 million) recognized as a reduction in the environmental liability and increase in deferred revenue as the revenue will be amortized over the term of the lease.

**8. OTHER LIABILITIES**

	March 31 2011	December 31 2009
Environmental liability accrual	\$ 93,538	\$ 98,178
Asset retirement obligations - (a)	35,756	33,492
Accrued non-pension benefit obligation - Note 9(a)	1,493	1,040
	<b>\$ 130,787</b>	<b>\$ 132,710</b>

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**8. OTHER LIABILITIES (contd)**

(a) Asset retirement obligations

	<b>March 31 2011</b>	December 31 2009
Opening asset retirement obligations	\$ 33,492	\$ 29,292
Increase in estimate for site-wide remediation	-	2,596
Accretion expense on obligation	<b>2,264</b>	1,604
Ending asset retirement obligations	<b>\$ 35,756</b>	\$ 33,492
Discount rate	<b>4.25% - 5.5%</b>	4.25% - 5.5%
Inflation	<b>2.5%</b>	2.5%

The asset retirement obligations have been assumed by KM as part of the transaction described in Note 3(b). However, as the Company retains ultimate responsibility for the asset retirement obligations, they will continue to be reflected in the financial statements until such time as management is satisfied that KM has completed the remediation work.

In 2009, the Company received a revised estimate of the ultimate remediation costs, which exceeded the previous estimate. This resulted in an increase to the obligation of \$2.6 million and a corresponding increase to the value of the land. There has been no change to the estimate as at March 31, 2011.

Although the ultimate amount to be incurred is uncertain, the liability for retirement and remediation, on an undiscounted basis, before applying an inflation factor of 2.5% and discounting is estimated to be approximately \$98.1 million (2009- \$95.1 million).

**9. EMPLOYEE BENEFITS**

- (a) The Company makes contributions to a registered retirement savings plan on behalf of its employees which are expensed as contributions are made.

The Company also provides post-retirement benefits to its employees and a defined benefit supplementary pension plan for current and retired executives. The amounts presented in this note are actuarially determined projections based on management's assumptions provided to the actuary.

As a result of the KM transaction described in Note 3, the Company wound up the pension plan related to the Vancouver Wharves operation. The plan was formally wound up with all liabilities being distributed in 2009.



**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**9. EMPLOYEE BENEFITS (contd)**

	<b>Pension Plans</b>		<b>Other Plans</b>	
	<b>March 31 2011</b>	<b>December 31 2009</b>	<b>March 31 2011</b>	<b>December 31 2009</b>
<b>Reconciliation of accrued benefit obligation</b>				
Opening balance	\$ (14,184)	\$ (15,538)	\$ (1,040)	\$ (790)
Benefits paid	1,210	819	148	93
Interest cost	(1,103)	(923)	(72)	(48)
Settlement	-	1,673	-	-
Actuarial gains (losses)	(1,737)	(215)	(529)	(295)
Ending balance	<b>(15,814)</b>	<b>(14,184)</b>	<b>(1,493)</b>	<b>(1,040)</b>
<b>Reconciliation of plan assets</b>				
Opening balance	20,017	22,332	-	-
Actual return on plan assets	1,025	(515)	-	-
Employer contributions	-	754	148	93
Benefits paid	(1,210)	(819)	(148)	(93)
Settlement	-	(1,735)	-	-
Ending balance	<b>19,832</b>	<b>20,017</b>	<b>-</b>	<b>-</b>
Fund status - surplus (deficit)	4,018	5,833	(1,493)	(1,040)
Unamortized past service costs	958	1,210	-	-
Unamortized net actuarial loss (gain)	5,588	4,130	-	-
Net accrued benefit asset (liability)	<b>\$ 10,564</b>	<b>\$ 11,173</b>	<b>\$ (1,493)</b>	<b>\$ (1,040)</b>
Accrued benefit asset	10,564	11,173	-	-
Accrued benefit liability	-	-	(1,493)	(1,040)
Net Accrued benefit asset (liability)	<b>\$ 10,564</b>	<b>\$ 11,173</b>	<b>\$ (1,493)</b>	<b>\$ (1,040)</b>

- (b) Significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows as of March 31, 2011 and December 31, 2009:

	<b>Pension Plans</b>		<b>Other Plans</b>	
	<b>March 31 2011</b>	<b>December 31 2009</b>	<b>March 31 2011</b>	<b>December 31 2009</b>
Discount rate for liabilities	5.60%	6.45%	5.00%	6.00%
Expected long-term rate of return on plan assets	3.50%	3.50%	N/A	N/A
Salary escalation rate	N/A	N/A	N/A	N/A

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**9. EMPLOYEE BENEFITS (cont'd)**

The weighted average rate of increase in the per capita cost of future covered health care benefits was assumed to be 5.00% per year starting in 2015.

The plan asset portfolio currently comprises equity investments, debt instruments, and deposits in the CRA's refundable tax account ("RTA"). Investments outside of the RTA consist of equity investments of 30%-60% including Canadian, International, and Real Estate investments and debt of 20%-40% comprising of short-term debt, bonds and mortgages. The RTA consists of 52%-55% of the assets. Asset mix is reviewed periodically and may vary in the future.

(c) The Company's net benefit plan expense is as follows:

	<b>Pension Plans</b>		<b>Other Plans</b>	
	<b>March 31 2011</b>	December 31 2009	<b>March 31 2011</b>	December 31 2009
Interest cost	\$ 1,103	\$ 923	\$ 72	\$ 48
Actual return on plan assets	(854)	(515)	-	-
Plan amendments	253	-	-	-
Plan curtailment / settlement loss (gain)	-	62	-	-
Amortize actuarial loss (gain)	107	80	529	-
	<b>\$ 609</b>	\$ 550	<b>\$ 601</b>	\$ 48

Every three years, an actuarial valuation is performed to assess the financial position of the Plan and the adequacy of plan funding. The latest full actuarial valuation was carried out at September 30, 2009. For accounting purposes a second actuarial valuation of the benefit obligations was performed at March 31, 2011 using plan asset data at March 31, 2011 to satisfy disclosure requirements under CICA 3461.

(d) During the period the Company made contributions, on behalf of its employees, to a registered retirement savings' plan of \$276,000 (2009 - \$240,000).

**10. SHARE CAPITAL**

Authorized: 10,000,000 common shares with a par value of \$100 each.

Issued and outstanding March 31, 2011: 2,576,885 common shares held by the BCTFA (subsidiary of the Province).

Issued and outstanding December 31, 2009: 2,576,885 common shares held directly by the Province.

As all of the issued and outstanding common shares of the Company are held by the Province or its subsidiary, earnings per share data has not been provided.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**11. CONTRIBUTED SURPLUS**

During the period ended March 31, 2011, based on a directive from the Province, BCRC made payments of \$173 million from its contributed surplus to the Province.

	<b>March 31</b>	December 31
	<b>2011</b>	2009
Opening balance	<b>\$ 277,547</b>	\$ 277,547
Payments to the Province	<b>(173,000)</b>	-
Closing balance	<b>\$ 104,547</b>	\$ 277,547

**12. COMMITMENTS**

The following is a schedule of future minimum payments at March 31, 2011, required under non-cancelable operating leases of office equipment and office space:

2011	<b>\$</b>	<b>248</b>
2012		<b>256</b>
2013		<b>262</b>
2014		<b>153</b>
	<b>\$</b>	<b>919</b>

**13. CONTINGENT LIABILITIES**

The Company is contingently liable with respect to environmental obligations and pending litigation and claims arising in the normal course of business. Provisions have been made based on the best estimates of management with the information available. Estimates are periodically reviewed and will be adjusted in the period that additional information becomes available.

- (a) The Company previously leased a portion of the property used in the Vancouver Wharves terminal operations in North Vancouver from Canada Lands Company Limited ("CLCL"). On June 14, 2002, the Attorney General of Canada commenced legal proceedings in the B.C. Supreme Court against the Company and its subsidiaries alleging that those entities are responsible for soil and groundwater contamination on a site adjacent to the VWLP operation and in Burrard Inlet adjacent to that property as included in the CLCL lease. On February 1, 2008, an Agreement in Principle ("AIP") was reached with Environment Canada which describes the remediation process, the responsibilities of the parties, and the estimated costs of remediation. The AIP which expires June 30, 2011 forms the basis of the negotiations of a final agreement. Based on the agreement principles, management has estimated and accrued a liability in the financial statements.
- (b) The risk of environmental liability is inherent in the operation of the Company's business with respect to both current and past operations. As a result, the Company incurs costs, on an ongoing basis, associated with environmental regulatory compliance and clean-up requirements.

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**13. CONTINGENT LIABILITIES (contd)**

The Company has made accruals for both anticipated expenditures on existing environmental remediation programs and contingent liabilities in relation to specific sites where the expected costs can be reasonably estimated.

The Company believes it has identified the costs likely to be incurred over the next several years, based on known information. However, ongoing efforts to identify potential environmental concerns associated with the Company's properties may lead to future environmental investigations, which may result in the identification of additional environmental costs and liabilities, the magnitude of which cannot be reasonably estimated.

- (c) The Province and BCRC have provided commercial indemnities to CN with respect to the CN Transaction and certain income tax attributes of BC Rail that existed prior to and immediately after the closing of the transaction. Following the CN Transaction, the Canada Revenue Agency ("CRA") proceeded with an audit of the said transaction, which management understands has been completed. Management has received legal advice that the CRA tax reassessments following from the audit did not change the income tax attributes of BC Rail in a manner that would require any indemnification payment from the Province or from BCRC. Nevertheless, the indemnities remain in effect until 90 days after the last date on which a relevant tax assessment or reassessment can be issued. It is expected that the normal reassessment period for the taxation years that have been audited will expire by the end of 2011. In the absence of information with respect to income tax filings of CN following the CN Transaction, it is not possible for management to determine the value of any remaining amounts potentially payable under the indemnities related to the income tax attributes. However, in light of all of the circumstances including the fact that CRA has completed an audit of the CN Transaction that has not resulted in any indemnification payment, management believes the likelihood that the Province or BCRC would ultimately be held liable for any amounts under the aforementioned indemnities to be remote.

**14. STATEMENT OF CASH FLOWS – SUPPLEMENTAL INFORMATION**

- (a) The components of changes in non-cash working capital balances relating to operations are as follows:

	<b>March 31</b>	<b>December 31</b>
	<b>2011</b>	<b>2009</b>
Accounts receivable	\$ 778	\$ 1,606
Materials and other items	(344)	158
Accounts payable and accrued liabilities	(993)	(1,037)
Current portion of deferred revenue	(650)	(555)
	\$ (1,209)	\$ 172

- (b) The following interest was received during the period:

	<b>15 months ended</b>	<b>12 months ended</b>
	<b>March 31</b>	<b>December 31</b>
	<b>2011</b>	<b>2009</b>
Interest received from third parties	\$ 3,325	\$ 2,974
	\$ 3,325	\$ 2,974

**BRITISH COLUMBIA RAILWAY COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2011**  
(tabular amounts in thousands of dollars)

**15. RELATED PARTY TRANSACTIONS**

The related party transactions during the period are as follows:

	<b>15 months ended March 31 2011</b>	12 months ended December 31 2009
Employee costs paid to the MoTI	\$ 259	\$ -
Consulting costs paid to the MoTI during the transition period	275	-
Legal fees paid to the Office of the Attorney General	75	-
	<b>\$ 609</b>	<b>\$ -</b>

As at the end of the year, the amounts due to related parties are as follows:

	<b>March 31 2011</b>	December 31 2009
Amounts due to the MoTI	\$ 401	\$ -
Amounts due to the Office of the Attorney General	75	-
	<b>\$ 476</b>	<b>\$ -</b>

**16. COMPARATIVE FIGURES**

Certain of the comparative figures have been reclassified to conform with the current year's financial statement presentation.