



STATEMENT OF FINANCIAL INFORMATION
Fiscal Year Ended December 31, 2007

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Consolidated Financial Statements

BRITISH COLUMBIA RAILWAY COMPANY

December 31, 2007 and 2006



KPMG LLP
Chartered Accountants
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AUDITORS' REPORT

To the Lieutenant Governor in Council
Province of British Columbia

We have audited the consolidated balance sheet of British Columbia Railway Company as at December 31, 2007 and the consolidated statement of income and deficit and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. A horizontal line is drawn underneath the signature, extending from the left side of the 'K' towards the right.

Chartered Accountants

Vancouver, Canada

February 15, 2008

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

| December 31 | 2007 | 2006 <i>restated</i> <i>Note 2</i> |
|---|-------------------|--|
| ASSETS | | |
| Current | | |
| Cash and cash equivalents | \$ 267,464 | \$ 225,486 |
| Accounts receivable | 5,739 | 4,759 |
| Materials and other items | 259 | 635 |
| Discontinued operations - Note 3 | - | 8,434 |
| | 273,462 | 239,314 |
| Assets available for sale | 16,718 | 11,282 |
| Property and equipment - Note 5 | 282,278 | 293,006 |
| Other assets - Note 6 | 82,420 | 81,910 |
| Discontinued operations - Note 3 | - | 5,034 |
| | \$ 654,878 | \$ 630,546 |
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| Current | | |
| Accounts payable and accrued liabilities | \$ 10,932 | \$ 6,798 |
| Current portion of other liabilities - Note 7 | 2,375 | 11,338 |
| Discontinued operations - Note 3 | - | 5,957 |
| | 13,307 | 24,093 |
| Deferred lease revenue | 309,561 | 281,625 |
| Other liabilities - Note 7 | 121,395 | 133,772 |
| | 444,263 | 439,490 |
| Shareholder's equity | | |
| Share capital - Note 8 | 257,688 | 257,688 |
| Contributed surplus | 277,547 | 277,547 |
| Deficit | (324,620) | (344,179) |
| | 210,615 | 191,056 |
| | \$ 654,878 | \$ 630,546 |

Commitments - Note 9
Contingent liabilities - Note 10

See accompanying notes to the consolidated financial statements.

On behalf of the Board



Director



Director

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

| For the years ended December 31 | 2007 | 2006 |
|--|---------------------|----------------------------------|
| | | <i>restated</i> <i>Note 2</i> |
| Revenues | \$ 18,185 | \$ 17,554 |
| Expenses | | |
| Labour costs | 3,951 | 4,038 |
| Operations and maintenance | 7,280 | 3,768 |
| General and administration | 5,860 | 3,321 |
| Amortization | 4,113 | 7,356 |
| Environmental costs | 10,368 | 11,300 |
| Operating and other taxes | 2,006 | 1,647 |
| Accretion expense | 1,862 | 2,259 |
| | 35,440 | 33,689 |
| Operating loss | (17,255) | (16,135) |
| Other income | | |
| Gain on property sales | 19,801 | 63,667 |
| Interest income - Note 11 | 12,597 | 8,655 |
| Income from continuing operations | 15,143 | 56,187 |
| Income from discontinued operations - Note 3 | 4,416 | 12,676 |
| Net income and comprehensive income | 19,559 | 68,863 |
| Deficit, beginning of year, as previously reported | (373,160) | (441,333) |
| Adjustment to amortization expense - Note 2 | 28,981 | 28,291 |
| Deficit, beginning of year, restated | (344,179) | (413,042) |
| Deficit, end of year | \$ (324,620) | \$ (344,179) |

See accompanying notes to the consolidated financial statements.

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

| For the years ended December 31 | 2007 | 2006 |
|---|-------------------|-------------------|
| | | <i>restated</i> |
| | | <i>Note 2</i> |
| Operating activities | | |
| Income from continuing operations | \$ 15,143 | \$ 56,187 |
| Adjustment for items not involving cash | | |
| Gain on property sales | (19,801) | (63,667) |
| Amortization of property and equipment | 4,113 | 7,356 |
| Amortization of other assets and liabilities | (1,035) | (765) |
| Pension and post employment benefit income and contributions - Note 12 | 661 | 1,054 |
| Accretion of asset retirement obligation | 1,862 | 2,259 |
| Change in environmental liability accrual | 3,911 | 10,658 |
| Net change in non-cash working capital - Note 13(a) | 4,212 | (1,416) |
| Cash provided by operating activities | 9,066 | 11,666 |
| Investing activities | | |
| Purchase of property and equipment | (20,357) | (14,493) |
| Net proceeds on sale of property and equipment | 14,497 | 84,518 |
| Net proceeds from Kinder Morgan transaction - Note 3 | 34,239 | - |
| Changes in other assets | (1,810) | 517 |
| Cash provided by investing activities | 26,569 | 70,542 |
| Increase in cash and cash equivalents from continuing operations | 35,635 | 82,208 |
| Cash provided by discontinued operations | 6,343 | 6,211 |
| Cash and cash equivalents, beginning of year | 225,486 | 137,067 |
| Cash and cash equivalents, end of year | \$ 267,464 | \$ 225,486 |

See accompanying notes to the consolidated financial statements.

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

British Columbia Railway Company ("BCRC") is owned by the Province of British Columbia (the "Province") and is incorporated under the *British Columbia Railway Act*. BCRC is principally a holding company with its commercial and business activities conducted through several operating subsidiaries, spanning the business areas of real estate, and railway and marine terminal management.

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., has retained ownership of certain port-related lands.

The Province has determined that the remaining assets and entities owned by the Company 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.

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, its subsidiaries and partnerships. 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 and third party valuations relate to the determination of net recoverable value of assets, useful lives for amortization and provisions for post employment benefits, contingencies, restructuring and environmental matters. Actual amounts may ultimately differ from these estimates.

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.

Inventories

Inventories of material and supplies are valued at the lower of average cost and net realizable value.

Property and equipment

Property and equipment are recorded at cost less accumulated depreciation. Acquisitions and installations are recorded at cost while repairs are charged to operations. Betterments are capitalized. On major projects 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 annually assesses the value of its property and equipment. When indicators of

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

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 over the following number of years:

| | Number of Years |
|-----------|-----------------|
| Buildings | 30 - 40 |
| Equipment | 3 - 20 |

Equipment and leasehold improvements under capital lease are amortized over their lease term.

Joint Capital Account

The Company has invested in railway assets for its BCR Port Subdivision operation. An agreement between the Company and the three user railways requires the Company to maintain a separate account of these 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 the balance accounted for as direct financing leases.

Discontinued operations

As described in Note 3, the Company completed a transaction in May 2007 to sell the operating assets and transfer the operations of their subsidiary, Vancouver Wharves, to a new operator. The operating results of Vancouver Wharves to the date of the transaction have been reported separately as discontinued operations on the balance sheet and statement of operations.

Assets available for sale

The Company is preparing non port-related real estate assets for sale and once ready, the assets are reclassified as held for sale.

Deferred lease revenue

The Company has two long-term lease arrangements currently in effect. One operating lease relates to a portion of 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. The second lease came into effect in 2007 as a result of a transaction with Kinder Morgan Canada Terminals ULC ("KM") and is for the land upon which the Vancouver Wharves terminal facility operates (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 collectibility is reasonably assured.

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

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 and capital taxes.

Environmental expenditures and liabilities

Environmental expenditures that relate to current operations are expensed as part of operating activities or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations and which are not expected to contribute to current or future operations are expensed. 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.

Asset retirement obligation

The Company recognizes asset retirement obligations in accordance with Canadian GAAP as set out in CICA Handbook Section 3110. Under this standard future costs to retire an asset, including dismantling, remediation, ongoing treatment and monitoring of the asset, are recognized and recorded as a liability at fair value, assuming a credit adjusted risk-free discount rate and an inflation factor. The liability is accreted over time through periodic charges to earnings. In addition, the asset's retirement cost is capitalized as part of the assets' carrying value and amortized over the assets' useful lives.

Financial Instruments

Effective with the commencement of its 2007 fiscal year, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1530, *Comprehensive Income*, CICA Handbook Section 3251, *Equity*, CICA Handbook Section 3855 *Financial Instruments – Recognition and Measurement*, CICA Handbook Section 3861, *Financial Instruments – Disclosure and Presentation*, and CICA Handbook Section 3865, *Hedges*. These new Handbook Sections provide comprehensive requirements for the recognition and measurement of financial instruments, as well as standards on when and how hedge accounting may be applied.

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

CICA Handbook Section 1530 establishes standards for reporting and displaying 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. This standard requires certain 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 into net earnings.

Under CICA Handbook Section 3855, 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 investments 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.

The standards also require derivative instruments to be recorded as either assets or liabilities measured at their fair value unless exempted from derivative treatment as a normal purchase and sale. 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.

As a result of the adoption of these standards, the Company has classified cash and equivalents as held-for-trading. Amounts 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 embedded derivatives and currently the Company does not have any financial instruments that would qualify for hedge accounting.

The adoption of these standards has no impact on the financial statements for the year ended December 31, 2007.

2. REVISION OF PRIOR YEAR ACCOUNTING TREATMENT

During 2007, a review of the BCR Port Subdivision railway assets determined that depreciation taken in previous years on the Port Subdivision's Joint Capital Account assets should not have been taken as the lease agreements with the user railways should have been recorded as direct-financing lease receivables rather than as capital assets. Accordingly the 2006 financial statements have been restated to reduce amortization expense by \$0.7 million and increase the carrying value of the assets by \$29.0 million, with a corresponding decrease to the opening deficit as at January 1, 2006 of \$28.3 million. The Joint Capital Account assets, excluding the land, have accordingly been reclassified from Capital Assets and are now being presented with other assets as Joint Capital Account receivables.

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

3. KINDER MORGAN TRANSACTION

On May 30, 2007, BCRC and its subsidiaries, Vancouver Wharves Limited Partnership (“VWLP”) and BCR Properties Ltd. (“BCRP”) completed a transaction with Kinder Morgan Canada Terminals ULC (“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. Cash proceeds of \$40 million were received on the transaction.

As part of the agreement, KM assumed responsibility to remediate the land at the end of the lease and to complete certain projects designed to prevent further off-site migration of contamination from the land during the lease. At May 29, 2007, VWLP had accrued \$44.6 million in an asset retirement obligation for remediation of the land and \$14.0 million in respect of the off-site migration projects. As BCR Properties retains ultimate responsibility for the asset retirement obligations and the remediation of the land, the obligations will continue to be reflected in the Company’s consolidated financial statements until such time as management is satisfied that KM has completed the remediation work.

Transaction costs of \$5.8 million were applied against the proceeds of \$40 million resulting in net proceeds on the transaction of \$34.2 million. The operating assets were sold at fair value which approximated their net book value of \$5.6 million and the remaining cash proceeds of \$28.6 million were allocated to the operating lease and are being recognized in income on a straight-line basis over the term of the lease. In addition, the fair value of the remediation services at the date of the agreement, presently estimated as \$27.1 million for the asset retirement obligation and \$14.0 million for off-site migration projects, will be accreted into income on a straight-line basis over the term of the lease. An annual assessment will be made concerning Kinder Morgan’s plans and progress towards completion of the remediation services.

Environmental obligations relating to the land adjacent to the main VWLP site which is leased from Canada Lands Company Limited (Note 10 (a) and (b)) will be retained by the Company. KM will however be responsible for the cost of moving certain operations from the adjacent land to the main site.

The Company’s share of the assets, liabilities and revenues and expenses have been reclassified to discontinued operations for the years ended December 31, 2007 and 2006 as follows:

| | VWLP | |
|---|-----------|-----------|
| | 2007 | 2006 |
| Balance sheet | | |
| Current assets | \$ - | \$ 8,434 |
| Capital assets | - | 5,034 |
| Current liabilities | - | (5,957) |
| Net assets of discontinued operations | \$ - | \$ 7,511 |
| Statement of income | | |
| Revenues | \$ 15,741 | \$ 46,742 |
| Expenses | (11,586) | (35,247) |
| Gain on disposal of assets | 191 | 600 |
| Net interest | 70 | 581 |
| Net income from discontinued operations | \$ 4,416 | \$ 12,676 |

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

4. CN TRANSACTION

The CN transaction was the main component of the Company's original plan to dispose of its residual assets and activities.

- (a) On July 14, 2004, BCRC and BCR Properties Ltd. completed a transaction with Canadian National Railway Company (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 Partnership entered into a Revitalization Agreement, under which BC Rail Partnership leased the railway right-of-way land, railbed assets, and related track infrastructure from BCRC under a long-term lease. BC Rail Partnership prepaid all lease payments under the Revitalization Agreement. The lease of certain items included in railbed assets is being accounted for as an operating lease. The lease of the remaining railbed assets and track infrastructure has been treated as a capital lease. As a result of the CN Transaction, the Revitalization Agreement was assumed by CN.
- (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 made by CN to a trust fund held by BCRC and dedicated to upgrades of the BC railway system to improve reliability and transit times for the railway users. As at December 31, 2007, the trust fund held \$1.1 million (2006 - \$0.3 million) in CN penalty payments, which are not recognized in these financial statements.

5. PROPERTY AND EQUIPMENT

| | 2007 | | | 2006 | | |
|--------------------------------------|-------------------|-----------------------------|-------------------|-------------------|-----------------------------|------------------------|
| | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| | | | | | | <i>restated Note 2</i> |
| Assets under operating lease | \$ 628,604 | \$ 403,224 | \$ 225,380 | \$ 628,918 | \$ 397,175 | \$ 231,743 |
| Land | 20,323 | - | 20,323 | 37,692 | - | 37,692 |
| Buildings | 10,700 | 2,842 | 7,858 | 10,738 | 2,299 | 8,439 |
| Equipment and leasehold improvements | 1,863 | 1,066 | 797 | 1,543 | 797 | 746 |
| Construction in progress | 27,920 | - | 27,920 | 14,386 | - | 14,386 |
| | \$ 689,410 | \$ 407,132 | \$ 282,278 | \$ 693,277 | \$ 400,271 | \$ 293,006 |

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

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

6. OTHER ASSETS

| | 2007 | 2006 |
|--|------------------|----------------------------------|
| | | <i>restated</i> <i>Note 2</i> |
| Accrued pension benefit asset - Note 12(a) | \$ 11,900 | \$ 12,600 |
| Mortgage receivable - 6(a) | 7,676 | 8,156 |
| Joint Capital Account receivables - 6(b) | 46,214 | 46,214 |
| Deferred property transfer tax - 6(c) | 8,976 | 8,985 |
| Long-term notes receivable from CN - 6(d) | 6,211 | 5,877 |
| Long-term receivable for environmental services - Note 3 | 1,262 | - |
| Other | 181 | 78 |
| | \$ 82,420 | \$ 81,910 |

- (a) The mortgage receivable was provided to a purchaser in 2004 as part of a sale of property from the Company's real estate portfolio. The mortgage term is currently being renegotiated. The mortgage bears interest at prime plus 2%.
- (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.
- (c) Deferred property transfer tax arose as part of the CN Transaction described in Note 4. 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.

7. OTHER LIABILITIES

| | 2007 | 2006 |
|---|-------------------|-------------------|
| Environmental liability accrual - Note 10 | \$ 93,013 | \$ 89,102 |
| Asset retirement obligations - 7(a) | 27,316 | 43,565 |
| Deferred gain on sale of real estate - 7(b) | - | 9,168 |
| Accrued pension benefit liability - Note 12(a) | 205 | - |
| Accrued non-pension benefit obligation - Note 12(a) | 861 | 1,105 |
| Other | 2,375 | 2,170 |
| | 123,770 | 145,110 |
| Less current portion | (2,375) | (11,338) |
| | \$ 121,395 | \$ 133,772 |

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

7. OTHER LIABILITIES (cont'd)

(a) Asset retirement obligations

| | 2007 | 2006 |
|---|-------------|-------------|
| Opening asset retirement obligations | \$ 43,565 | \$ 41,192 |
| Adjustment for change in lease term | (17,431) | - |
| Increase (decrease) in estimate for site-wide remediation | (680) | 114 |
| Accretion expense on obligation | 1,862 | 2,259 |
| Ending asset retirement obligations | \$ 27,316 | \$ 43,565 |
| Discount rate | 4.5% - 5.5% | 4.5% - 5.5% |
| Inflation | 2.5% | 2.5% |

The asset retirement obligations have been assumed by KM as part of the transaction described in Note 3. As the Company retains ultimate responsibility for the asset retirement obligations however, they will continue to be reflected in the financial statements until such time as management is satisfied that KM has completed the remediation work. The estimate of the obligations was reduced by \$17.4 million to reflect the change in the expected timing of future cash flows to be incurred for remediation.

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% is estimated to be approximately \$85.9 million (2006 - \$84.4 million).

- (b) The deferred gain on sale of real estate relates to property sold in 2004 in exchange for a mortgage (note 6(a)). The deferred gain was recognized as income in 2007 once the Company received more than 15% of the total proceeds.

8. SHARE CAPITAL

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

Issued and outstanding: 2,576,885 common shares held by the Province.

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

9. COMMITMENTS

The following is a schedule of future minimum payments at December 31, 2007, required under non-cancelable operating leases:

| | Total |
|------|--------|
| 2008 | 296 |
| 2009 | 169 |
| | \$ 465 |

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

10. 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 will be adjusted in the period that additional information becomes available.

- (a) The Company leases a portion of the property used in the Vancouver Wharves terminal operations in North Vancouver from Canada Lands Company Limited ("CLCL"). The Vancouver Wharves operations were transferred to a new operator in 2007 as described in Note 3, however, the CLCL lease remains with the Company and the new operator has access rights to carry on terminal operations.

On February 6, 2003, the Company received a notice of default on its lease from CLCL. The current lease with CLCL expired April 11, 2004 and CLCL advised the Company that, based on the alleged defaults under the lease, it had no right to renew the lease. The Attorney General of Canada and CLCL filed a Petition on August 6, 2004 seeking a writ of possession of the leased lands. Vancouver Wharves Ltd. and BCRC carrying on business as VWLP and VWLP, and BC Rail Ltd. are named as respondents in the Petition. The Petition was scheduled to be heard by the court in a proceeding commencing November 19, 2007 however, in August 2007, the parties reached a settlement. The Settlement Agreement sets out the process for vacating the property and the agreed amount of rent owing to the date the site is vacated. The costs of vacating the property as well as any resulting site reconfiguration costs related to the Vancouver Wharves operation have been assumed by the new operator.

- (b) On June 14, 2002, the Attorney General of Canada commenced legal proceedings in the B.C. Supreme Court against Vancouver Wharves Ltd. (formerly BCR Marine Ltd.), BC Rail Ltd., BCR Properties Ltd., British Columbia Wharves Ltd., CSCL, BCRC carrying on business as VWLP and VWLP, 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 lease described in (a) above. Effective February 1, 2008, an Agreement in Principle was reached with Environment Canada. The AIP will form the basis of the negotiations of a final agreement that is to be negotiated over the next 12 months.
- (c) 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.

The Company accrues 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.

- (d) The Province and BCRC have provided commercial indemnities to CN with respect to the CN Transaction and indemnities related to income tax attributes of BC Rail at closing. As at December 31, 2007, the maximum present value (calculated at 9%) of amounts payable under the tax indemnities related to income tax attributes (excluding any reimbursement of professional fees, tax arrears, interest or taxes payable, if any, on indemnity payments) is approximately \$494 million. These indemnities remain in effect until 90 days after the last date on which a tax assessment or

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

10. CONTINGENT LIABILITIES (cont'd)

reassessment can be issued in respect of the income tax attributes. Management believes it is unlikely that the Province or BCRC will ultimately be held liable for any amounts under the commercial and tax indemnities.

11. INTEREST INCOME

| | 2007 | 2006 |
|--|------------------|-----------------|
| Interest earned on temporary investments | \$ 11,414 | \$ 7,476 |
| Other interest income | 1,183 | 1,179 |
| | \$ 12,597 | \$ 8,655 |

12. EMPLOYEE BENEFITS

(a) The Company has defined benefit and defined contribution pension plans and other retirement and post employment benefit plans which cover most of its employees. The amounts presented in this note are actuarially determined projections.

| | Pension Plans | | Other Plans | |
|---|------------------|------------------|-----------------|-------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Reconciliation of accrued benefit obligation | | | | |
| Opening balance | \$ (17,988) | \$ (17,587) | \$ (975) | \$ (1,002) |
| Current service cost | (53) | (78) | - | (7) |
| Employee contributions | (5) | (8) | - | - |
| Benefits paid | 401 | 588 | 78 | 70 |
| Interest cost | (932) | (911) | (44) | (51) |
| Settlement | - | - | 210 | - |
| Actuarial gains (losses) | 2,177 | 8 | (233) | 15 |
| Ending balance | (16,400) | (17,988) | (964) | (975) |
| Reconciliation of plan assets | | | | |
| Opening balance | 22,520 | 22,112 | - | - |
| Actual return on plan assets | 997 | 921 | - | - |
| Employer contributions | 43 | 67 | 78 | 70 |
| Employee contributions | 5 | 8 | - | - |
| Benefits | (401) | (588) | (78) | (70) |
| Ending balance | 23,164 | 22,520 | - | - |
| Fund status - surplus (deficit) | 6,764 | 4,532 | (964) | (975) |
| Unamortized past service costs | 1,614 | 1,816 | - | - |
| Unamortized net actuarial loss (gain) | 3,317 | 6,252 | 103 | (130) |
| Accrued benefit asset (liability) | \$ 11,695 | \$ 12,600 | \$ (861) | \$ (1,105) |

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

12. EMPLOYEE BENEFITS (cont'd)

During 2007 as a result of the KM transaction described in Note 3, the Company began the process to wind up the pension plan related to the Vancouver Wharves operation. The effective date of the wind-up was May 30, 2007 however the wind-up has not been formally approved by the Office of the Superintendent of Financial Institutions therefore it continues to be recorded in the Company's financial statements. Currently it is estimated that the Vancouver Wharves pension plan is in a net liability position of \$205,000. In addition, as part of the KM transaction the Vancouver Wharves non-pension obligation estimated at \$210,000 at December 31, 2006 was assumed by KM.

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

| | Pension Plans | | Other Plans | |
|-----------------------------------|----------------------|-------------|--------------------|-------|
| | 2007 | 2006 | 2007 | 2006 |
| Discount rate for liabilities | 5.25% | 5.25% | 5.25% | 5.25% |
| Expected long-term rate of return | | | | |
| on plan assets | 3.5% / 7.0% | 3.5% / 7.0% | - | - |
| Salary escalation rate | N/A / N/A | N/A / 2.5% | - | - |

The weighted average rate of increase in the per capita cost of future covered health care benefits was assumed to be 4.00% per year starting in 2010.

The plan asset portfolio currently comprises equity investments and debt. Equity investments are 30%-70% of the portfolio and include Canadian, International, and Real Estate investments. Debt is 20%-40% of the portfolio and comprises short-term debt, bonds and mortgages. Asset mix is reviewed periodically and may vary in the future.

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

| | Pension Plans | | Other Plans | |
|---|----------------------|----------|--------------------|-------|
| | 2007 | 2006 | 2007 | 2006 |
| Current service cost | \$ 53 | \$ 78 | \$ - | \$ 7 |
| Interest cost | 932 | 911 | 48 | 51 |
| Actual return on plan assets | (828) | (804) | - | - |
| Amortization of transitional asset | - | 497 | - | - |
| Plan amendments | 202 | 202 | - | - |
| Plan curtailment / settlement loss (gain) | (174) | - | - | - |
| Net actuarial loss (gain) | 762 | 255 | 1 | (6) |
| | \$ 947 | \$ 1,139 | \$ 49 | \$ 52 |

BRITISH COLUMBIA RAILWAY COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007
(tabular amounts in thousands of dollars)

13. STATEMENT OF CASH FLOWS – SUPPLEMENTAL INFORMATION

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

| | 2007 | 2006 |
|--|-----------------|-------------------|
| Accounts receivable | \$ (503) | \$ (349) |
| Materials and other items | 376 | (36) |
| Accounts payable and accrued liabilities | 4,339 | (1,031) |
| | \$ 4,212 | \$ (1,416) |

(b) The following interest was received in the current year:

| | 2007 | 2006 |
|--------------------------------------|------------------|-----------------|
| Interest received from third parties | \$ 12,597 | \$ 8,330 |
| | \$ 12,597 | \$ 8,330 |

14. COMPARATIVE FIGURES

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

Schedule of Debts
January 1, 2007 to December 31, 2007

This organization had no third-party long-term debt outstanding during the period.

**Schedule of Guarantee and Indemnity Agreements
January 1, 2007 to December 31, 2007**

This organization has not given any guarantees under the Guarantees and Indemnities Regulation.

Information on all indemnities for this organization is included in Note 10 to the Financial Statements.

British Columbia Railway Company
Employee Remuneration (including Taxable Benefits) and Expenses
For Individuals Whose Remuneration and Expenses Exceeds \$75,000
January 1, 2007 to December 31, 2007

| Last Name | First Name | Remuneration | Expenses |
|----------------------|-------------------|---------------------|-------------------|
| Adair | Russell | 91,204.98 | 97.00 |
| Angelozzi | Cam | 75,423.48 | 601.21 |
| Becker | Gerry | 133,565.39 | 5,202.12 |
| Bevilacqua | Chris | 92,617.38 | 97.00 |
| Bryce | John | 88,633.15 | 89.00 |
| Carter | Greg | 92,560.67 | 110.24 |
| Cote | Claire | 87,689.10 | 6,946.22 |
| Dawson | Christopher | 81,468.70 | 46,650.66 |
| Derouin | Richard | 98,068.63 | 97.00 |
| Goold | Alex | 99,192.09 | 691.42 |
| Hodges | Ross | 93,373.70 | 203.41 |
| Kaye | Michael | 235,154.63 | 10,656.62 |
| Klitch | Dave | 93,271.11 | 1,255.16 |
| Lusney | John | 329,404.49 | 36,179.25 |
| MacMillan | Rodney | 133,580.09 | 2,418.03 |
| Mahoney | Kevin | 676,644.42 | 48,579.78 |
| Miller | Roy | 89,482.05 | 97.00 |
| Myhill-Jones | Richard | 159,819.81 | 76,063.74 |
| Patrick | Gregory | 91,734.55 | 8.00 |
| Raynard | Grant | 82,619.48 | - |
| Roy | Denis | 92,861.87 | 169.76 |
| Salmon | Rodney | 73,744.18 | 22,808.29 |
| Solley | Jennifer | 74,863.62 | 2,558.45 |
| Van Hatten | Arnie | 114,694.67 | 22,632.94 |
| Webb | Richard | 89,259.83 | 215.56 |
| Westerhout Hardman | Shelley | 102,664.91 | 614.43 |
| Westlake | Gordon | 207,574.29 | 10,545.85 |
| Weymark | Bill | 220,439.34 | 18,323.52 |
| Winter | Alan | 96,743.34 | 4,773.16 |
| Winters | Tom | 134,488.42 | 5,008.20 |
| Total over \$75,000 | | 4,132,842.37 | 323,693.02 |
| Total under \$75,000 | | 1,517,416.07 | 19,507.14 |
| | | 5,650,258.44 | 343,200.16 |

**British Columbia Railway Company
Statement of Severance Agreements
January 1, 2007 to December 31, 2007**

There was 1 severance agreement made between British Columbia Railway Company and its non-unionized employees during 2007. The agreement represented 7 months compensation.

As required in the Financial Information Act Guidance Package, payments made under these severance agreements are excluded from the Schedule of Employee Remuneration.

British Columbia Railway Company
Schedule Showing Total Remuneration and Expenses
In Respect of Each Board Member
January 1, 2007 to December 31, 2007

**Elected Officials, Employees appointed by
Cabinet, and Members of the Board of Directors:**

| Name | Position | Remuneration | Expenses |
|------------------|-----------------|---------------------|-----------------|
| McLernon, John | Chair | 54,850.00 | 5,574.09 |
| Briscoe, Beverly | Member, Board | 35,300.00 | - |
| Kenning, Brian | Member, Board | 39,850.00 | - |
| Marchand, Len | Member, Board | 26,750.00 | 2,454.06 |
| Offet, Gerald | Member, Board | 27,450.00 | 3,549.29 |
| Phillips, Bob | Member, Board | 28,960.00 | - |
| Yeates, Jim | Member, Board | 25,550.00 | - |

British Columbia Railway Company
Schedule of Payments Made for the Provision of Goods and Services
Amounts Exceeding \$25,000
January 1, 2007 to December 31, 2007

| | | | |
|--|---------------|---|---------------|
| 0695980 BC Ltd. | \$ 62,150.00 | Lori Jean Perry | \$ 33,203.30 |
| A & B Rail Services Ltd. | 4,394,694.78 | Luna Systems Corporation | 48,018.00 |
| Acklands-Grainger Inc. | 135,991.97 | Marsh Canada Limited | 188,610.00 |
| Ajilon Staffing of Canada Ltd. | 27,030.00 | Marshik & Associates | 39,877.40 |
| Allied Blower & Sheet Metal Ltd. | 289,350.37 | Mason Lift Ltd. | 28,279.19 |
| Allied Sweeping Ltd. | 50,039.53 | McElhanney Associates | 139,693.22 |
| Allnorth Consultants Limited | 69,255.46 | McRaes Sewer & Drain Cleaning | 169,252.71 |
| AlSCO Uniform & Linen Service Ltd. | 28,454.48 | Minister of Finance | 1,914,899.44 |
| Aon Insurance Managers | 43,908.22 | Morrow Environmental Consultants Inc. | 216,270.69 |
| Ashcroft Treating (a Division of Tolko Industries Ltd) | 56,680.81 | Murrays Water Hauling | 28,582.19 |
| Barry N. Wilson, BCOM, CA | 52,488.00 | Mutual Construction (2000) Ltd. | 84,365.40 |
| BC Hydro | 468,228.02 | Navigata Communications Limited | 93,985.86 |
| BC Maritime Employers Association | 207,497.40 | Nicolson Tamaki Architects Inc. | 39,561.19 |
| Belterra | 120,121.36 | North Country Appraisals (1985) Ltd. | 1,471,270.38 |
| Blake, Cassels & Graydon LLP | 31,645.18 | Nucurve Consulting Ltd. | 29,234.80 |
| Borden Ladner Gervais | 3,505,263.85 | Nuline Design | 33,852.69 |
| Britco Leasing Ltd. | 47,300.88 | On the Coast Business Services Ltd. | 100,276.00 |
| British Columbia Safety Authority | 27,478.00 | Orang-Utan Innovations Inc. | 29,216.25 |
| British Columbia Transmission Corporation | 187,620.00 | Pacific Blue Cross | 47,066.18 |
| Bull Housser & Tupper | 218,732.10 | Pacific Northern Rail Contractors Inc. | 1,097,894.49 |
| Bunbury & Associates | 46,263.70 | Pacific Weed Services | 57,752.30 |
| Burchell Hayman | 361,438.02 | Pagliari Construction Ltd. | 226,671.46 |
| Canada Life | 26,800.67 | Petro Canada | 201,364.15 |
| Canadian National Railway | 326,715.69 | Pipe And Piling Supplies BC Ltd. | 77,274.00 |
| Canadian Pacific Railway Company | 304,331.04 | Piteau & Associates | 831,029.92 |
| Challenge Mechanical Ltd. | 79,521.84 | Pitman Asphalt | 27,585.95 |
| CIBC World Markets Inc. | 642,130.69 | Predator Pest Bird Clearance | 28,047.60 |
| City of Prince George | 163,431.87 | PricewaterhouseCoopers Inc. | 146,949.67 |
| City of Surrey | 99,169.38 | PVA Eco Services | 95,974.17 |
| City of Williams Lake | 31,881.02 | Q.C.A. Systems Ltd. | 258,877.50 |
| Coastland Engineering & Surveying Ltd. | 100,053.11 | Quantum Murray LP. | 3,968,738.95 |
| Corporation of Delta | 468,036.77 | R.E. Gook & Associates | 61,075.20 |
| David K. Arnott | 126,714.56 | Rail Sciences | 30,367.92 |
| District of Mackenzie | 30,487.04 | Raines Janitorial Ltd. | 35,790.90 |
| District of North Vancouver | 284,983.01 | Ray & Berndtson/Tanton Mitchel | 60,934.46 |
| District of Squamish | 294,343.28 | Receiver General for Canada - CDN Grain Commission | 70,294.67 |
| Eagle View Security Ltd. | 51,492.75 | Receiver General for Canada - GST | 564,676.24 |
| EBA Engineering Consultants Ltd. | 28,191.51 | Receiver General for Canada - Leases, Licenses & Fees | 2,901,827.00 |
| Eleanore Laureles | 32,016.00 | Receiver General for Canada - Source Deductions | 2,139,326.96 |
| Environmental Dynamics Inc. | 105,672.20 | Regal West Holdings Ltd. | 52,594.94 |
| Equitable Life Of Canada | 46,214.56 | Relumen Engineering Inc. | 43,030.70 |
| Finning Ltd. | 639,645.79 | Revenue Services of British Columbia | 91,950.00 |
| Flynn Canada Ltd. | 65,776.18 | Richmond Chrysler Dodge Jeep | 45,640.47 |
| Fraser River Pile & Dredging Ltd. | 431,127.92 | Rob Thurrott | 80,012.45 |
| Frontline Software Corp. | 53,330.00 | Ross Morrison Electrical Ltd. | 458,637.03 |
| GensCorp IT Inc. | 628,356.32 | Ruskin Construction Ltd. | 194,196.88 |
| Golder Associates Ltd. | 46,909.71 | RW Patton Limited | 100,759.14 |
| Gordon Helgeson | 154,975.95 | Simplex Grinnell | 37,034.41 |
| Harder Associates Engineering Consulting | 268,126.67 | Squamish Nation | 178,320.76 |
| Hatch Mott MacDonald Ltd. | 173,659.80 | Squamish-Lillooet Regional District | 39,215.19 |
| Hobbs Giroday | 68,804.73 | Standard Life | 116,331.04 |
| Howells Contracting Ltd. | 26,021.72 | Sunlife Group Insurance | 163,927.66 |
| Humphrey Construction Ltd. | 150,363.12 | Syscom Consulting Inc. | 182,725.19 |
| IDL Projects Inc. | 15,068,614.87 | Target Land Surveying | 30,989.59 |
| Industrial Equipment Manufacturing | 42,601.00 | Telus Communications (BC) Inc. | 64,388.19 |
| Inform Solutions Inc. | 34,238.00 | Telus Mobility | 47,441.86 |
| Iron Mountain Canada Corp. | 26,135.77 | Teranis Consulting Ltd. | 28,686.39 |
| ISS-Wonderware Canada C3160 | 40,578.86 | Terasen Gas Inc. | 318,612.75 |
| J. B. Brodie | 164,732.55 | The B.C. Corps Of Commissionaires | 77,030.99 |
| John Leighton | 40,415.69 | The Great Canadian Landscaping | 45,802.60 |
| Karen MacWilliam | 134,832.80 | The Office Resource | 48,983.51 |
| Keystone Environmental Ltd. | 400,467.75 | Towers Perrin | 48,687.00 |
| KPMG LLP | 404,187.27 | Toyo Pumps North America Corp. | 46,496.73 |
| KWH Constructors Ltd. | 164,561.38 | VAE Nortrak Ltd. | 113,542.40 |
| L & M Engineering Limited | 1,586,651.36 | Vancouver Port Authority | 154,983.82 |
| Lake Mechanical Ltd. | 101,909.46 | Village of Pemberton | 38,886.19 |
| Lawson Lundell LLP | 62,152.17 | W. S. Leasing Ltd. | 84,226.95 |
| Leavitt Machinery | 254,687.72 | Waterfront Employers of BC | 5,421,287.34 |
| Leong & Associates Actuaries and Consultants Inc. | 43,485.19 | Westburne Electric Supply BC | 36,364.83 |
| Les Pongracz | 107,298.28 | Western Belting And Hose | 29,665.77 |
| Levelton Consultants Ltd. | 40,706.37 | Westmar Consultants Inc. | 324,359.19 |
| Loram Maintenance of Way, Inc. | 60,183.80 | Workers' Compensation Board of BC | 273,729.20 |
| | | Total payments exceeding \$25,000 | 61,804,866.38 |

British Columbia Railway Company
Schedule of Payments Made for the Provision of Goods and Services
Amounts Exceeding \$25,000
January 1, 2007 to December 31, 2007

| | |
|------------------------------------|------------------------|
| Total payments of \$25,000 or less | 2,593,728.81 |
| Grand Total | \$64,398,595.19 |