CANADIAN NATIONAL RAILWAY CO
Form 6-K
February 09, 2005

FORM 6-K
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Report of Foreign Issuer

Pursuant to Rule 13a-16 or 15d-16
of the Securities Exchange Act of 1934

For the month of February, 2005

Commission File Number: 001-02413

Canadian National Railway Company

(Translation of registrant s name into English)

935 de la Gauchetiere Street West
Montreal, Quebec
Canada H3B 2M9
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F ___ Form 40-F _X_

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes ___ No _X_

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes ___ No _X_

Indicate by check mark whether by furnishing the information contained in this Form, the Registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes ___ No _X_

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

Canadian National Railway Company

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Management Report

The accompanying consolidated financial statements of Canadian National Railway Company and all information in this annual report are the responsibility of management and have been approved by the Board of Directors.

The financial statements have been prepared by management in conformity with generally accepted accounting principles in the United States. These statements include some amounts that are based on best estimates and judgments. Financial information used elsewhere in the annual report is consistent with these financial statements.

Management of the Company, in furtherance of the integrity and objectivity of data in the financial statements, has developed and maintains a system of internal accounting controls and supports an extensive program of internal audits. Management believes that this system of internal accounting controls provides reasonable assurance that financial records are reliable and form a proper basis for preparation of financial statements, and that assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the financial statements in this report principally through its Audit, Finance and Risk Committee, consisting solely of outside directors. The Audit, Finance and Risk Committee reviews the Company□s consolidated financial statements and annual report and recommends their approval by the Board of Directors. Also, the Audit, Finance and Risk Committee meets regularly with the Chief, Internal Audit, and with the shareholders auditors.

These consolidated financial statements have been audited by KPMG *LLP*, who have been appointed as the sole auditors of the Company by the shareholders.

(s) Claude Mongeau
Executive Vice-President and Chief Financial Officer

January 25, 2005

(s) Serge Pharand
Vice-President and Corporate Comptroller

January 25, 2005

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AUDITORS' REPORT

To the Board of Directors of
Canadian National Railway Company

We have audited the consolidated balance sheets of Canadian National Railway Company as at December 31, 2004 and 2003 and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2004. These 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 audits in accordance with Canadian generally accepted auditing standards and with the standards of the Public Company Accounting Oversight Board (United States). 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, 2004 and 2003, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2004, in accordance with generally accepted accounting principles in the United States.

On January 25, 2005, we reported separately to the shareholders of the Company on consolidated financial statements for the same period, prepared in accordance with Canadian generally accepted accounting principles.

(s) KPMG LLP
Chartered Accountants

Montreal, Canada
January 25, 2005

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Consolidated Statement of Income

U.S. GAAP

In millions, except per share data *Year ended December 31,*	**2004**	2003	2002
Revenues			
Petroleum and chemicals	**$ 1,123**	$ 1,058	$ 1,102
Metals and minerals	**713**	527	521
Forest products	**1,452**	1,284	1,323
Coal	**284**	261	326
Grain and fertilizers	**1,053**	938	986
Intermodal	**1,117**	1,101	1,052
Automotive	**510**	525	591
Other items	**296**	190	209
Total revenues	**6,548**	5,884	6,110
Operating expenses			
Labor and fringe benefits	**1,819**	1,698	1,837
Purchased services and material	**746**	703	778
Depreciation and amortization	**598**	554	584
Fuel	**528**	469	459
Equipment rents	**244**	293	346
Casualty and other *(Note 2)*	**445**	390	637
Total operating expenses	**4,380**	4,107	4,641
Operating income	**2,168**	1,777	1,469
Interest expense *(Note 14)*	**(294)**	(315)	(361)
Other income (loss) *(Note 15)*	**(20)**	21	76

Income before income taxes and cumulative effect of change

in accounting policy		**1,854**		1,483		1,184
Income tax expense *(Note 16)*		**(596)**		(517)		(384)
Income before cumulative effect of change in accounting policy		**1,258**		966		800
Cumulative effect of change in accounting policy (net of applicable taxes) *(Note 2)*		**-**		48		-
Net income	**$**	**1,258**	$	1,014	$	800
Basic earnings per share (Note 18)						
Income before cumulative effect of change in accounting policy	**$**	**4.41**	$	3.38	$	2.71
Net income	**$**	**4.41**	$	3.54	$	2.71
Diluted earnings per share (Note 18)						
Income before cumulative effect of change in accounting policy	**$**	**4.34**	$	3.33	$	2.65
Net income	**$**	**4.34**	$	3.49	$	2.65

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Comprehensive Income ***U.S. GAAP***

In millions *Year ended December 31,*		**2004**		2003		2002
Net income	**$**	**1,258**	$	1,014	$	800
Other comprehensive income (loss) *(Note 21)* **:**						
Unrealized foreign exchange gain on translation of U.S. dollar denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries		**326**		754		51
Unrealized foreign exchange loss on translation of the net investment in foreign operations		**(428)**		(1,101)		(40)
Unrealized holding gain on fuel derivative instruments *(Note 20)*		**54**		8		68
Realized gain on settlement of interest rate swaps *(Note 20)*		**12**		-		-
Minimum pension liability adjustment *(Note 13)*		**8**		7		(20)
Other comprehensive income (loss) before income taxes		**(28)**		(332)		59
Income tax (expense) recovery on other comprehensive income (loss)		**9**		106		(20)

Other comprehensive income (loss)	**(19)**	(226)	39
Comprehensive income	**$ 1,239**	$ 788	$ 839

See accompanying notes to consolidated financial statements.

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Consolidated Balance Sheet

U.S. GAAP

In millions December 31,	**2004**	2003
Assets		
Current assets:		
Cash and cash equivalents	**$ 147**	$ 130
Accounts receivable *(Note 4)*	**793**	529
Material and supplies	**127**	120
Deferred income taxes *(Note 16)*	**364**	125
Other	**279**	223
	1,710	1,127
Properties *(Note 5)*	**19,715**	18,305
Intangible and other assets *(Note 6)*	**940**	905
Total assets	**$ 22,365**	$ 20,337
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable and accrued charges *(Note 8)*	**$ 1,605**	$ 1,421
Current portion of long-term debt *(Note 10)*	**578**	483
Other	**76**	73
	2,259	1,977
Deferred income taxes *(Note 16)*	**4,723**	4,550
Other liabilities and deferred credits *(Note 9)*	**1,513**	1,203
Long-term debt *(Note 10)*	**4,586**	4,175
Shareholders equity:		
Common shares *(Note 11)*	**4,706**	4,664
Accumulated other comprehensive loss *(Note 21)*	**(148)**	(129)
Retained earnings	**4,726**	3,897
	9,284	8,432
Total liabilities and shareholders equity	**$ 22,365**	$ 20,337

On behalf of the Board:

David G.A. McLean	*E. Hunter Harrison*
Director	Director

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Shareholders Equity

U.S. GAAP

In millions	Issued and outstanding common shares	Common shares	Accumulated other comprehensive income (loss)	Retained earnings	Total shareholders equity
Balances December 31, 2001	289.1	$ 4,442	$ 58	$ 2,988	$ 7,488
Net income	-	-	-	800	800
Stock options exercised *(Notes 11, 12)*	2.7	75	-	-	75
Conversion of convertible preferred securities *(Note 11)*	9.0	340	-	-	340
Share repurchase program *(Note 11)*	(4.5)	(72)	-	(131)	(203)
Other comprehensive income *(Note 21)*	-	-	39	-	39
Dividends ($0.57 per share)	-	-	-	(170)	(170)
Balances December 31, 2002	296.3	4,785	97	3,487	8,369
Net income	-	-	-	1,014	1,014
Stock options exercised and other *(Notes 11, 12)*	2.9	122	-	-	122
Share repurchase program *(Note 11)*	(15.0)	(243)	-	(413)	(656)
Other comprehensive loss *(Note 21)*	-	-	(226)	-	(226)
Dividends ($0.67 per share)	-	-	-	(191)	(191)
Balances December 31, 2003	284.2	4,664	(129)	3,897	8,432
Net income	-	-	-	1,258	1,258
Stock options exercised and other *(Notes 11, 12)*	2.9	108	-	-	108
Share repurchase program *(Note 11)*	(4.0)	(66)	-	(207)	(273)

Other comprehensive loss *(Note 21)*	-	-	(19)	-	(19)
Dividends ($0.78 per share)	-	-	-	(222)	(222)
Balances December 31, 2004	**283.1**	**$ 4,706**	**$ (148)**	**$ 4,726**	**$ 9,284**

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows

U.S. GAAP

In millions *Year ended December 31,*	**2004**	2003	2002
Operating activities			
Net income	**$ 1,258**	$ 1,014	$ 800
Adjustments to reconcile net income to net cash provided from operating activities:			
Depreciation and amortization	**602**	560	591
Deferred income taxes *(Note 16)*	**366**	411	272
Equity in earnings of English Welsh and Scottish Railway *(Note 15)*	**4**	(17)	(33)
Charge to increase U.S. personal injury and other claims liability *(Note 2)*	**-**	-	281
Workforce reduction charge *(Note 9)*	**-**	-	120
Cumulative effect of change in accounting policy *(Note 2)*	**-**	(48)	-
Other changes in:			
Accounts receivable	**(233)**	153	(80)
Material and supplies	**10**	(3)	-
Accounts payable and accrued charges	**5**	(96)	(154)
Other net current assets and liabilities	**21**	(29)	(18)
Other	**106**	31	(167)
Cash provided from operating activities	**2,139**	1,976	1,612
Investing activities			
Net additions to properties	**(1,072)**	(1,043)	(938)
Acquisition of BC Rail *(Note 3)*	**(984)**	-	-
Acquisition of GLT *(Note 3)*	**(547)**	-	-
Other, net	**192**	(32)	14
Cash used by investing activities	**(2,411)**	(1,075)	(924)

Dividends paid		**(222)**		(191)		(170)
Financing activities						
Issuance of long-term debt		**8,277**		4,109		3,146
Reduction of long-term debt		**(7,579)**		(4,141)		(3,558)
Issuance of common shares *(Note 11)*		**86**		83		69
Repurchase of common shares *(Note 11)*		**(273)**		(656)		(203)
Cash provided from (used by) financing activities		**511**		(605)		(546)
Net increase (decrease) in cash and cash equivalents		**17**		105		(28)
Cash and cash equivalents, beginning of year		**130**		25		53
Cash and cash equivalents, end of year	**$**	**147**	$	130	$	25
Supplemental cash flow information						
Net cash receipts from customers and other	**$**	**6,501**	$	6,022	$	6,285
Net cash payments for:						
Employee services, suppliers and other expenses		**(3,628)**		(3,262)		(3,784)
Interest *(Note 14)*		**(282)**		(325)		(398)
Workforce reductions *(Note 9)*		**(93)**		(155)		(177)
Personal injury and other claims *(Note 19)*		**(106)**		(126)		(156)
Pensions *(Note 13)*		**(161)**		(92)		(93)
Income taxes *(Note 16)*		**(92)**		(86)		(65)
Cash provided from operating activities	**$**	**2,139**	$	1,976	$	1,612

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

U.S. GAAP

Canadian National Railway Company (CN or the Company), directly and through its subsidiaries, is engaged in the rail and related transportation business. CN spans Canada and mid-America, from the Atlantic and Pacific oceans to the Gulf of Mexico, serving the ports of Vancouver, Prince Rupert, B.C., Montreal, Halifax, New Orleans and Mobile, Alabama, and the key cities of Toronto, Buffalo, Chicago, Detroit, Duluth, Minnesota/Superior, Wisconsin, Green Bay, Wisconsin, Minneapolis/St. Paul, Memphis, St. Louis and Jackson, Mississippi, with connections to all points in North America. CN s revenues are derived from the movement of a diversified and balanced portfolio of goods, including petroleum and chemicals, grain and fertilizers, coal, metals and minerals, forest products, intermodal and automotive.

1 Summary of significant accounting policies

These consolidated financial statements are expressed in Canadian dollars, except where otherwise indicated, and have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). Significant differences between the accounting principles applied in the accompanying financial statements and those under Canadian generally accepted accounting principles (Canadian GAAP) are quantified and explained in Note 22 to the financial statements. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the period, the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, management reviews its estimates, including those related to personal injury and other claims, environmental claims, depreciation, pensions and other post-retirement benefits, and income taxes, based upon currently available information. Actual results could differ from these estimates.

A. Principles of consolidation

These consolidated financial statements include the accounts of all subsidiaries, including Great Lakes Transportation LLC s railroads and related holdings (GLT) and BC Rail for which the Company acquired control and consolidated effective May 10, 2004 and July 14, 2004, respectively. The Company s investments in which it has significant influence are accounted for using the equity method and all other investments are accounted for using the cost method.

B. Revenues

Freight revenues are recognized on services performed by the Company, based on the percentage of completed service method. Costs associated with movements are recognized as the service is performed.

C. Foreign exchange

All of the Company s United States (U.S.) operations are self-sustaining foreign entities with the U.S. dollar as their functional currency. The Company also has an equity investment in an international affiliate based in the United Kingdom with the British pound as its functional currency. Accordingly, the U.S. operations assets and liabilities and the Company s foreign equity investment are translated into Canadian dollars at the rate in effect at the balance sheet date and the revenues and expenses are translated at average exchange rates during the year. All adjustments resulting from the translation of the foreign operations are recorded in Other comprehensive income (loss) (Note 21).

The Company designates the U.S. dollar denominated long-term debt of the parent company as a foreign exchange hedge of its net investment in U.S. subsidiaries. Accordingly, unrealized foreign exchange gains and losses, from the dates of designation, on the translation of the U.S. dollar denominated long-term debt are also included in Other comprehensive income (loss).

D. Cash and cash equivalents

Cash and cash equivalents include highly liquid investments purchased three months or less from maturity and are stated at cost, which approximates market value.

E. Accounts receivable

Accounts receivable are recorded at cost net of the provision for doubtful accounts that is based on expected collectibility. Any gains or losses on the sale of accounts receivable are calculated by comparing the carrying amount of the accounts receivable sold to the total of the cash proceeds on sale and the fair value of the retained interest in such receivables on the date of transfer. Fair values are determined on a discounted cash flow basis. Costs related to the sale of accounts receivable are recognized in earnings in the period incurred.

F. Material and supplies

Inventory is valued at weighted-average cost for ties, rails, fuel and new materials in stores, and at estimated utility or sales value for usable secondhand, obsolete and scrap materials.

G. Properties

Railroad properties are carried at cost less accumulated depreciation including asset impairment write-downs. Labor, materials and other costs associated with the installation of rail, ties, ballast and other track improvements are capitalized to the extent they meet the Company s minimum threshold for capitalization. Included in property additions are the costs of developing computer software for internal use. Maintenance costs are expensed as incurred.

The cost of railroad properties, less net salvage value, retired or disposed of in the normal course of business is charged to accumulated depreciation, in accordance with the group method of depreciation. The Company reviews the carrying amounts of properties held and used

1 Summary of significant accounting policies *(continued)*

whenever events or changes in circumstances indicate that such carrying amounts may not be recoverable based on future undiscounted cash flows. Assets that are deemed impaired as a result of such review are recorded at the lower of carrying amount or fair value.

Assets held for sale are measured at the lower of their carrying amount or fair value, less cost to sell. Losses resulting from significant line sales are recognized in income when the asset meets the criteria for classification as held for sale whereas losses resulting from abandonment are recognized in income when the asset ceases to be used. Gains are recognized in income when they are realized.

H. Depreciation

The cost of properties, including those under capital leases, net of asset impairment write-downs, is depreciated on a straight-line basis over their estimated useful lives as follows:

Asset class	Annual rate
Track and roadway	2%
Rolling stock	3%
Buildings	6%
Other	4%

The Company follows the group method of depreciation for railroad properties and, as such, conducts comprehensive depreciation studies on a periodic basis to assess the reasonableness of the lives of properties based upon current information and historical activities. Changes in estimated useful lives are accounted for prospectively.

I. Intangible assets

Intangible assets relate to customer contracts and relationships assumed through recent acquisitions and are being amortized on a straight-line basis over 40 to 50 years.

J. Pensions

Pension costs are determined using actuarial methods. Net periodic benefit cost is charged to income and includes:

(i) the cost of pension benefits provided in exchange for employees services rendered during the year,

(ii) the interest cost of pension obligations,

(iii) the amortization of the initial net transition obligation on a straight-line basis over the expected average remaining service life of the employee group covered by the plans,

(iv) the amortization of prior service costs and amendments over the expected average remaining service life of the employee group covered by the plans,

(v) the expected long-term return on pension fund assets, and

(vi) the amortization of cumulative unrecognized net actuarial gains and losses in excess of 10% of, the greater of the beginning of year balances of the projected benefit obligation or market-related value of plan assets, over the expected average remaining service life of the employee group covered by the plans.

The pension plans are funded through contributions determined in accordance with the projected unit credit actuarial cost method.

K. Post-retirement benefits other than pensions

The Company accrues the cost of post-retirement benefits other than pensions using actuarial methods. These benefits, which are funded by the Company as they become due, include life insurance programs, medical benefits and free rail travel benefits.

The Company amortizes the cumulative unrecognized net actuarial gains and losses in excess of 10% of the projected benefit obligation at the beginning of the year, over the expected average remaining service life of the employee group covered by the plans.

L. Personal injury claims

In Canada, the Company accounts for costs related to employee work-related injuries based on actuarially developed estimates of the ultimate cost associated with such injuries, including compensation, health care and administration costs.

In the U.S., the Company accrues the expected cost for personal injury claims and asserted occupational disease claims, based on actuarial estimates of their ultimate cost. A liability for the minimum amount of unasserted occupational disease claims is also accrued to the extent they can be reasonably estimated.

M. Environmental expenditures

Environmental expenditures that relate to current operations are expensed unless they relate to an improvement to the property. 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. Liabilities are recorded when environmental assessments and/or remedial efforts are likely, and when the costs, based on a specific plan of action in terms of the technology to be used and the extent of the corrective action required, can be reasonably estimated.

N. Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under the asset and liability method, the change in the net deferred tax asset or liability is included in the computation of net income. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

1 Summary of significant accounting policies *(continued)*

O. Derivative financial instruments

The Company uses derivative financial instruments in the management of its fuel exposure, and may use them from time to time, in the management of its interest rate and foreign currency exposures. Derivative instruments are recorded on the balance sheet at fair value and the changes in fair value are recorded in earnings or other comprehensive income (loss) depending on the nature and effectiveness of the hedge transaction. Income and expense related to hedged derivative financial instruments are recorded in the same category as that generated by the underlying asset or liability.

P. Stock-based compensation

The Company follows the fair value based approach for stock option awards and had prospectively applied this method of accounting to all awards granted, modified or settled on or after January 1, 2003, as explained in Note 2 Accounting changes. The Company follows the intrinsic value method for cash settled awards.

Prior to 2003, compensation cost was recorded for the intrinsic value of the Company's performance-based stock option awards and no compensation cost was recognized for the Company's conventional awards, in accordance with Accounting Principles Board Opinion (APB) 25, Accounting for Stock Issued to Employees, and related interpretations. If compensation cost had been determined based upon fair values at the date of grant for awards under all plans, the Company s pro forma net income and earnings per share would have been as follows:

Year ended December 31,		**2004**		2003		2002
Net income, as reported *(in millions)*	**$**	**1,258**	$	1,014	$	800
Add (deduct) compensation cost, net of applicable taxes, determined under:						
Fair value method for all awards granted after Jan. 1, 2003 (SFAS No. 123)		**38**		10		-
Intrinsic value method for performance-based awards granted prior to 2003 (APB 25)		**9**		13		9
Fair value method for all awards (SFAS No. 123)		**(78)**		(53)		(45)
Pro forma net income *(in millions)*	**$**	**1,227**	$	984	$	764
Basic earnings per share, as reported	**$**	**4.41**	$	3.54	$	2.71
Basic earnings per share, pro forma	**$**	**4.30**	$	3.43	$	2.59
Diluted earnings per share, as reported	**$**	**4.34**	$	3.49	$	2.65
Diluted earnings per share, pro forma	**$**	**4.23**	$	3.39	$	2.53

Compensation cost related to stock option awards under the fair value based approach was calculated using the Black-Scholes option-pricing model with the following assumptions:

Year ended December 31,	**2004(1)**		2003		2002
Expected option life *(years)*	**-**		5.0		7.0
Risk-free interest rate	**-**		4.12%		5.79%
Expected stock price volatility	**-**		30%		30%
Average dividend per share	**-**	$	0.67	$	0.57

Year ended December 31,		**2004(1)**		2003		2002
Weighted average fair value of options granted	**$**	**-**	$	11.88	$	20.65

(1) The Company did not grant any stock option awards in 2004.

Q. Recent accounting pronouncement

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, which requires expensing of all options issued, modified or settled based on the grant-date fair value and recognizing the expense over the period during which an employee is required to provide service (vesting period). The standard also requires that cash settled awards be measured at fair value at each reporting date until ultimate settlement. This standard is effective as of the beginning of the first interim reporting period after June 15, 2005. The Company has elected to apply the modified prospective approach, which requires compensation cost to be recognized for unvested awards based on their grant-date fair value. Pursuant to the application of this standard, stock-based compensation expense for the second half of 2005 will increase by approximately $10 million for awards outstanding at December 31, 2004.

2 Accounting changes

2003

Asset retirement obligations

Effective January 1, 2003, the Company adopted the recommendations of the FASB s SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires that the fair value of an asset retirement obligation be recorded as a liability only when there is a legal obligation associated with a removal activity. The Company has concluded that no legal obligation exists for its various removal programs. In accordance with SFAS No. 143, the Company changed its accounting policy for certain track structure assets to exclude removal costs as a component of depreciation expense where the inclusion of such costs would result in accumulated depreciation balances exceeding the historical cost basis of the assets. As a result, a cumulative benefit of $75 million, or $48 million after tax, was recorded for the amount of removal costs accrued in accumulated depreciation on certain track structure assets at January 1, 2003. This change in policy will result in lower depreciation expense and higher labor and fringe benefits and

2 Accounting changes *(continued)*

other expenses in the period in which removal costs are incurred. For the year ended December 31, 2003, this change in policy resulted in an increase to net income of $2 million ($0.01 per basic and diluted share).

Had the Company applied this accounting policy retroactively to 2002, pro forma net income and earnings per share would have been as follows:

Year ended December 31,		2002
Net income, as reported *(in millions)*	$	800
Effect of SFAS No. 143		6
Pro forma net income *(in millions)*	$	806
Basic earnings per share, as reported	$	2.71
Basic earnings per share, pro forma	$	2.73

Diluted earnings per share, as reported	$	2.65
Diluted earnings per share, pro forma	$	2.67

Stock-based compensation

Effective January 1, 2003, the Company voluntarily adopted the fair value based approach of SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. The Company elected to prospectively apply this method of accounting to all stock option awards granted, modified or settled on or after January 1, 2003, as permitted by SFAS No. 148. Prior to 2003, the Company accounted for stock-based compensation in accordance with APB 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation cost was recorded for the intrinsic value of the Company s performance-based stock option awards and no compensation cost was recognized for the Company s conventional awards.

In 2003, the Company granted 3.0 million stock options, which will be expensed over their vesting period based on their estimated fair value on the date of grant, determined using the Black-Scholes option-pricing model. For the year ended December 31, 2003, the Company recorded compensation cost of $23 million, of which $10 million ($0.03 per basic and diluted share) was related to the change in policy. For the year ended December 31, 2002, the Company recorded compensation cost of $9 million.

2002

U.S. personal injury and other claims

In the fourth quarter of 2002, the Company changed its methodology for estimating its liability for U.S. personal injury and other claims, including occupational disease claims and claims for property damage, from a case-by-case approach to an actuarial-based approach. Consequently, for the year ended December 31, 2002, the Company recorded a charge of $281 million ($173 million after tax) to increase its provision for these claims.

Under the actuarial-based approach, the Company accrues the expected cost for personal injury and property damage claims and asserted occupational disease claims, based on actuarial estimates of their ultimate cost. The Company is unable to estimate the total cost for unasserted occupational disease claims. However, a liability for unasserted occupational disease claims was accrued to the extent they were reasonably estimable.

Under the case-by-case approach, a liability was recorded only when the expected loss was both probable and reasonably estimable based on currently available information. In addition, the Company did not record a liability for unasserted claims, as such amounts could not be reasonably estimated under the case-by-case approach.

In 2002, the Company s U.S. personal injury and other claims expense, including the above-mentioned charge, was $362 million. Had the Company continued to apply the case-by-case approach to its U.S. personal injury and other claims liability, recognizing the effects of the actual claims experience for existing and new claims in the fourth quarter, these expenses would have been approximately $135 million in 2002.

3 Acquisitions

BC Rail

In November 2003, the Company entered into an agreement with British Columbia Railway Company, a corporation owned by the Government of the Province of British Columbia (Province), to acquire all the issued and outstanding shares of BC Rail Ltd. and all the partnership units of BC Rail Partnership (collectively BC Rail), and the right to operate over BC Rail s roadbed under a long-term lease, for a purchase price of $1 billion.

On July 2, 2004, the Company reached a consent agreement with Canada s Competition Bureau, allowing for the closing of the transaction, whereby the Company reaffirmed its commitment to share merger efficiencies with BC Rail shippers and assure them competitive transportation options through its Open Gateway Rate and Service Commitment. The consent agreement also maintains competitive rates and service for grain shippers in the Peace River region.

On July 14, 2004, the Company completed its acquisition of BC Rail and began a phased integration of the companies operations. The acquisition was financed by debt and cash on hand.

The Company accounted for the acquisition using the purchase method of accounting as required by SFAS No.141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets. As such, the accompanying consolidated financial statements include the assets, liabilities and results of operations of BC Rail as of July 14, 2004, the date of acquisition. The Company s cost to acquire BC Rail of $991 million includes purchase price adjustments and

3 Acquisitions *(continued)*

transaction costs. The following table reflects the preliminary purchase price allocation, based on the fair value of BC Rail s assets acquired, owned and leased, and liabilities assumed at acquisition, which is subject to a final valuation, the impact of which, is not expected to have a material effect on the results of operations.

In millions		July 14, 2004
Current assets	$	202
Deferred income taxes		397
Properties		620
Other assets		3
Total assets acquired		1,222
Current liabilities		76
Other liabilities and deferred credits		142
Long-term debt		13
Total liabilities assumed		231
Net assets acquired	$	991

Great Lakes Transportation LLC s Railroads and Related Holdings

In October 2003, the Company, through an indirect wholly owned subsidiary, entered into an agreement for the acquisition of GLT for a purchase price of U.S.$380 million.

As of April 2004, the Company received all necessary regulatory approvals, including the U.S. Surface Transportation Board (STB) ruling rendered on April 9, 2004.

On May 10, 2004, the Company completed its acquisition of GLT and began a phased integration of the companies operations. The acquisition was financed by debt and cash on hand.

The Company accounted for the acquisition using the purchase method of accounting. As such, the accompanying consolidated financial statements include the assets, liabilities and results of operations of GLT as of May 10, 2004, the date of acquisition. The Company s cost to acquire GLT of U.S.$395 million (Cdn$547 million) includes purchase price adjustments and transaction costs. The following table reflects the preliminary purchase price allocation, based on the fair value of GLT s assets acquired and liabilities assumed at acquisition, which is subject to a final valuation, the impact of which, is not expected to have a material effect on the results of operations.

In millions		May 10, 2004
Current assets	$	67
Properties		977
Intangible and other assets		87
Total assets acquired		1,131
Current liabilities		64
Deferred income taxes		290
Other liabilities and deferred credits		230
Total liabilities assumed		584
Net assets acquired	$	547

If the Company had acquired BC Rail and GLT on January 1, 2003, based on their respective historical amounts, net of the amortization of the difference between the Company s cost to acquire BC Rail and GLT and their respective net assets (based on preliminary estimates of the fair values of BC Rail s and GLT s assets and liabilities), revenues, income before cumulative effect of change in accounting policy, net income, basic and diluted earnings per share for the year ended December 31, 2004 and 2003 would have been as follows:

	Year ended December 31,			
In millions, except per share data		2004		2003
Revenues	$	6,773	$	6,428
Income before cumulative effect of change in accounting policy	$	1,272	$	1,026
Net income	$	1,272	$	1,077
Basic earnings per share				
Income before cumulative effect of change in accounting policy	$	4.46	$	3.58
Net income	$	4.46	$	3.76
Diluted earnings per share				
Income before cumulative effect of change in accounting policy	$	4.39	$	3.53
Net income	$	4.39	$	3.70

The pro forma figures for both BC Rail and GLT do not reflect synergies, and accordingly, do not account for any potential increases in operating income, any estimated cost savings or facilities consolidation.

Notes to Consolidated Financial Statements ***U.S. GAAP***

4 Accounts receivable

In millions *December 31*,	**2004**	2003
Freight		
Trade	**$ 414**	$ 252
Accrued	**93**	55
Non-freight	**356**	277
	863	584
Provision for doubtful accounts	**(70)**	(55)
	$ 793	$ 529

The Company has an accounts receivable securitization program, expiring in June 2006, under which it may sell, on a revolving basis, a maximum of $450 million of eligible freight trade and other receivables outstanding at any point in time, to an unrelated trust. The Company has a contingent residual interest of approximately 10% of receivables sold, which is recorded in Other current assets. The Company has retained the responsibility for servicing, administering and collecting freight receivables sold. Other income included $9 million in each of 2004, 2003 and 2002, for costs related to the agreement, which fluctuate with changes in prevailing interest rates.

At December 31, 2004, pursuant to the agreement, $445 million had been sold compared to $448 million at December 31, 2003.

5 Properties

In millions ***December 31, 2004***