CANADIAN NATIONAL RAILWAY CO
Form 6-K
February 06, 2006

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, 2006

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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Item 1

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 Committee, consisting solely of outside directors. The Audit Committee reviews the Company’s consolidated financial statements and management’s discussion and analysis and recommends their approval by the Board of Directors. Also, the Audit 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 24, 2006

(s) Serge Pharand
Vice-President and Corporate Comptroller

January 24, 2006

Item 2

Report of Independent Public Accounting Firm

To the Board of Directors and to the Shareholders of Canadian National Railway Company

We have audited the consolidated balance sheets of Canadian National Railway Company as at December 31, 2005 and 2004 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, 2005. 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, 2005 and 2004, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2005, in accordance with generally accepted accounting principles in the United States.

(s) KPMG LLP
Chartered Accountants

Montreal, Canada
January 24, 2006

Item 3

Consolidated Statement of Income

U.S. GAAP

In millions, except per share data	*Year ended December 31,*	**2005**	2004	2003
Revenues				
Petroleum and chemicals		**$ 1,096**	$ 1,059	$ 1,013
Metals and minerals		**837**	714	527
Forest products		**1,738**	1,505	1,320
Coal		**331**	284	261
Grain and fertilizers		**1,119**	1,063	947
Intermodal		**1,270**	1,117	1,101
Automotive		**514**	510	525
Other items		**335**	296	190
Total revenues		**7,240**	6,548	5,884
Operating expenses				
Labor and fringe benefits		**1,841**	1,819	1,698
Purchased services and material		**814**	746	703
Depreciation and amortization		**627**	598	554
Fuel		**725**	528	469
Equipment rents		**192**	244	293
Casualty and other		**417**	445	390
Total operating expenses		**4,616**	4,380	4,107
Operating income		**2,624**	2,168	1,777
Interest expense		**(299)**	(294)	(315)
Other income (loss) *(Note 14)*		**12**	(20)	21
Income before income taxes and cumulative effect of change in accounting policy		**2,337**	1,854	1,483
Income tax expense *(Note 15)*		**(781)**	(596)	(517)
Income before cumulative effect of change in accounting policy		**1,556**	1,258	966
Cumulative effect of change in accounting policy (net of applicable taxes) *(Note 2)*		**-**	-	48
Net income		**$ 1,556**	$ 1,258	$ 1,014

Basic earnings per share (Note 17)			
Income before cumulative effect of change in accounting policy	**$ 5.64**	$ 4.41	$ 3.38
Net income	**$ 5.64**	$ 4.41	$ 3.54
Diluted earnings per share (Note 17)			
Income before cumulative effect of change in accounting policy	**$ 5.54**	$ 4.34	$ 3.33
Net income	**$ 5.54**	$ 4.34	$ 3.49

See accompanying notes to consolidated financial statements.

Consolidated Statement of Comprehensive Income

U.S. GAAP

In millions	*Year ended December 31*
Net income	
Other comprehensive income (loss) *(Note 20)* **:**	
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	
Unrealized foreign exchange loss on translation of the net investment in foreign operations	
Increase (decrease) in unrealized holding gains on fuel derivative instruments *(Note 19)*	
Realized gain on settlement of interest rate swaps *(Note 19)*	
Minimum pension liability adjustment *(Note 13)*	
Other comprehensive loss before income taxes	
Income tax recovery on other comprehensive loss	
Other comprehensive loss	
Comprehensive income	

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet

U.S. GAAP

In millions	*December 31,*	**2005**	2004
Assets			
Current assets:			
Cash and cash equivalents		**$ 62**	$ 147
Accounts receivable *(Note 4)*		**623**	793
Material and supplies		**151**	127
Deferred income taxes *(Note 15)*		**65**	364
Other		**248**	279
		1,149	1,710
Properties *(Note 5)*		**20,078**	19,715
Intangible and other assets *(Note 6)*		**961**	940
Total assets		**$ 22,188**	$ 22,365
Liabilities and shareholders equity			
Current liabilities:			
Accounts payable and accrued charges *(Note 8)*		**$ 1,478**	$ 1,605
Current portion of long-term debt *(Note 10)*		**408**	578
Other		**72**	76
		1,958	2,259
Deferred income taxes *(Note 15)*		**4,817**	4,723
Other liabilities and deferred credits *(Note 9)*		**1,487**	1,513
Long-term debt *(Note 10)*		**4,677**	4,586
Shareholders equity:			
Common shares *(Note 11)*		**4,580**	4,706
Accumulated other comprehensive loss *(Note 20)*		**(222)**	(148)
Retained earnings		**4,891**	4,726
		9,249	9,284

Total liabilities and shareholders equity	**$ 22,188**	$ 22,365

On behalf of the Board:

David G.A. McLean
Director

E. Hunter Harrison
Director

See accompanying notes to consolidated financial statements.

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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, 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 20)*	-	-	(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 20)*	-	-	(19)	-	(19)

Dividends ($0.78 per share)	-	-	-	(222)	(222)
Balances December 31, 2004	283.1	4,706	(148)	4,726	9,284
Net income	-	-	-	1,556	1,556
Stock options exercised and other *(Notes 11, 12)*	3.3	176	-	-	176
Share repurchase programs *(Note 11)*	(18.0)	(302)	-	(1,116)	(1,418)
Other comprehensive loss *(Note 20)*	-	-	(74)	-	(74)
Dividends ($1.00 per share)	-	-	-	(275)	(275)
Balances December 31, 2005	**268.4**	**$ 4,580**	**$ (222)**	**$ 4,891**	**$ 9,249**

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows

U.S. GAAP

In millions *Year ended December 31,*	**2005**	2004	2003
Operating activities			
Net income	**$ 1,556**	$ 1,258	$ 1,014
Adjustments to reconcile net income to net cash provided from operating activities:			
Depreciation and amortization	**630**	602	560
Deferred income taxes *(Note 15)*	**547**	366	411
Equity in earnings of English Welsh and Scottish Railway *(Note 14)*	**(4)**	4	(17)
Cumulative effect of change in accounting policy *(Note 2)*	**-**	-	(48)
Other changes in:			
Accounts receivable	**142**	(233)	153
Material and supplies	**(25)**	10	(3)
Accounts payable and accrued charges	**(156)**	5	(96)
Other net current assets and liabilities	**8**	21	(29)

Other	**7**	106	31
Cash provided from operating activities	**2,705**	2,139	1,976
Investing activities			
Net additions to properties	**(1,180)**	(1,072)	(1,043)
Acquisition of BC Rail *(Note 3)*	**-**	(984)	-
Acquisition of GLT *(Note 3)*	**-**	(547)	-
Other, net	**105**	192	(32)
Cash used by investing activities	**(1,075)**	(2,411)	(1,075)
Dividends paid	**(275)**	(222)	(191)
Financing activities			
Issuance of long-term debt	**2,728**	8,277	4,109
Reduction of long-term debt	**(2,865)**	(7,579)	(4,141)
Issuance of common shares *(Note 11)*	**115**	86	83
Repurchase of common shares *(Note 11)*	**(1,418)**	(273)	(656)
Cash provided from (used by) financing activities	**(1,440)**	511	(605)
Net increase (decrease) in cash and cash equivalents	**(85)**	17	105
Cash and cash equivalents, beginning of year	**147**	130	25
Cash and cash equivalents, end of year	**$ 62**	$ 147	$ 130
Supplemental cash flow information			
Net cash receipts from customers and other	**$ 7,375**	$ 6,501	$ 6,022
Net cash payments for:			
Employee services, suppliers and other expenses	**(3,872)**	(3,628)	(3,262)
Interest	**(306)**	(282)	(325)
Workforce reductions *(Note 9)*	**(87)**	(93)	(155)
Personal injury and other claims *(Note 18)*	**(92)**	(106)	(126)
Pensions *(Note 13)*	**(127)**	(161)	(92)
Income taxes *(Note 15)*	**(186)**	(92)	(86)
Cash provided from operating activities	**$ 2,705**	$ 2,139	$ 1,976

See accompanying notes to consolidated financial statements.

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. CNs 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 21 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 LLCs 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 Companys 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 Companys 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 Companys 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 20).

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. Major overhauls and large refurbishments are also capitalized when they result in an extension to the useful life or increase the functionality of the asset. Included in property additions are the costs of developing computer software for internal use. Maintenance costs are expensed as incurred.

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

1 Summary of significant accounting policies *(continued)*

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 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 significant line abandonments 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	6%

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 and occupational disease claims, based on actuarial estimates of their ultimate cost.

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 occur 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.

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1 Summary of significant accounting policies *(continued)*

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.

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 Companys performance-based stock option awards and no compensation cost was recognized for the Companys 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 Companys pro forma net income and earnings per share would have been as follows:

Year ended December 31,	**2005**	2004	2003
Net income, as reported *(in millions)*	**$ 1,556**	$ 1,258	$ 1,014

Add (deduct) compensation cost, net of applicable taxes, determined under:			
Fair value method for all awards granted after Jan. 1, 2003 (SFAS No. 123)	**86**	38	10
Intrinsic value method for performance-based awards granted prior to 2003 (APB 25)	**-**	9	13
Fair value method for all awards (SFAS No. 123)	**(110)**	(78)	(53)
Pro forma net income *(in millions)*	**$ 1,532**	$ 1,227	$ 984
Basic earnings per share, as reported	**$ 5.64**	$ 4.41	$ 3.54
Basic earnings per share, pro forma	**$ 5.55**	$ 4.30	$ 3.43
Diluted earnings per share, as reported	**$ 5.54**	$ 4.34	$ 3.49
Diluted earnings per share, pro forma	**$ 5.45**	$ 4.23	$ 3.39

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,	**2005**	2004(1)	2003
Expected option life *(years)*	**5.2**	-	5.0
Risk-free interest rate	**3.5%**	-	4.12%
Expected stock price volatility	**25%**	-	30%
Average dividend per share	**$ 1.00**	-	$ 0.67

Year ended December 31,	**2005**	2004(1)	2003
Weighted average fair value of options granted	**$ 18.38**	$ -	$ 11.88

(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, 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. In April 2005, the U.S. Securities and Exchange Commission extended the effective application date of this standard from interim or annual reporting periods beginning after June 15, 2005 to annual reporting periods beginning after December 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. The Company does not expect this standard to have a significant impact on its results of operations.

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

2 Accounting changes

2005

Conditional asset retirement obligations

Effective December 31, 2005, the Company adopted the recommendations of FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143." The Interpretation clarifies that an obligation to perform an asset retirement activity exists, even if there may be uncertainty about the timing and/or method of settlement. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when incurred, generally upon acquisition, construction, or development and/or through the normal operation of the asset, if the fair value of the liability can be reasonably estimated. This standard had no impact on the Company's financial statements.

2003

Asset retirement obligations

Effective January 1, 2003, the Company adopted the recommendations of 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 substantially all of its asset classes that have 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 results in lower depreciation expense and higher labor and fringe benefits and 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).

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.

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, to acquire all the issued and outstanding shares of the former BC Rail Ltd. and all the partnership units of BC Rail Partnership (collectively BC Rail), and the right to operate over BC Rails roadbed under a long-term lease, for a purchase price of $1 billion.

On July 2, 2004, the Company reached a consent agreement with Canadas 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 Companys cost to acquire BC Rail of $991 million includes purchase price adjustments and transaction costs.

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

3 Acquisitions *(continued)*

The Company had estimated, on a preliminary basis, the fair value of BC Rails assets acquired, owned and leased, and liabilities assumed at acquisition based on then current available information. The Company has since finalized the allocation of the purchase price and has not made any significant adjustments. The following table reflects the fair values of BC Rails assets acquired, owned and leased, and liabilities assumed at acquisition:

In millions

Current assets	$ 200
Deferred income taxes	399
Properties	597
Other assets	3
Total assets acquired	1,199
Current liabilities	76
Other liabilities and deferred credits	119
Long-term debt	13
Total liabilities assumed	208
Net assets acquired	$ 991

Great Lakes Transportation LLCs 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 Company had estimated, on a preliminary basis, the fair value of GLT s assets acquired and liabilities assumed at acquisition based on then current available information. The Company has since finalized the allocation of the purchase price and has not made any significant adjustments. The following table reflects the fair values of GLT s assets acquired and liabilities assumed at acquisition:

In millions	
Current assets	$ 67
Properties	980
Intangible and other assets	87
Total assets acquired	1,134
Current liabilities	64
Deferred income taxes	286
Other liabilities and deferred credits	237
Total liabilities assumed	587
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 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 years 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,	**2005**	2004
Freight		
Trade	**$ 330**	$ 414
Accrued	**26**	93
Non-freight	**347**	356
	703	863
Provision for doubtful accounts	**(80)**	(70)
	$ 623	$ 793

The Company has an accounts receivable securitization program, expiring in June 2006, under which it may sell, on a revolving basis, a maximum of $500 million ($450 million prior to February 2005) 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 (loss) included $16 million in 2005 and $9 million in each of 2004 and 2003, for costs related to the agreement, which fluctuate with changes in prevailing interest rates.

At December 31, 2005, pursuant to the agreement, $489 million had been sold compared to $445 million at December 31, 2004.

5 Properties

In millions	***December 31, 2005***			*December 31, 2004*		
	Cost	**Accumulated depreciation**	**Net**	Cost	Accumulated depreciation	Net

Track, roadway and land	**$ 21,792**	**$ 6,388**	**$ 15,404**	$ 21,524	$ 6,300	$ 15,224
Rolling stock	**4,581**	**1,642**	**2,939**	4,336	1,549	2,787
Buildings	**1,878**	**724**	**1,154**	2,009	877	1,132
Other	**1,174**	**593**	**581**	1,078	506	572
	$ 29,425	**$ 9,347**	**$ 20,078**	$ 28,947	$ 9,232	$ 19,715
Capital leases included in properties						
Track and roadway	**$ 451**	**$ 16**	**$ 435**	$ 395	$ 5	$ 390
Rolling stock	**1,348**	**279**	**1,069**	1,155	241	914
Buildings	**57**	**8**	**49**	113	7	106
Other	**144**	**24**	**120**	119	9	110
	$ 2,000	**$ 327**	**$ 1,673**	$ 1,782	$ 262	$ 1,520

6 Intangible and other assets

In millions	*December 31,* **2005**	2004
Prepaid benefit cost *(Note 13)*	**$ 621**	$ 515
Investments *(A)*	**132**	166
Deferred receivables	**102**	77
Intangible assets *(B)*	**66**	69
Note receivable from EWS	**-**	57
Unamortized debt issue costs	**31**	35
Other	**9**	21
	$ 961	$ 940

A. Investments

As at December 31, 2005, the Company had $124 million ($157 million at December 31, 2004) of investments accounted for under the equity method and $8 million ($9 million at December 31, 2004) of investments accounted for under the cost method.

Investment in English Welsh and Scottish Railway (EWS)

As at December 31, 2005, the Company owned approximately 32% of the outstanding shares of EWS, a company that provides most of the rail freight services in Great Britain and operates freight trains through the English Channel tunnel, and accounted for this investment using the equity method. At December 31, 2005, the excess of the Company's share of the book value of EWS' net assets over the carrying value of the investment was not significant.

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

6 Intangible and other assets *(continued)*

In January 2004, EWS shareholders had approved a plan to reduce the EWS share capital to enable cash to be returned to the shareholders by offering them the ability to cancel a portion of their EWS shares in exchange for a combination of cash and notes receivable. The Company elected to have the maximum allowable number of shares cancelled under the plan, thereby reducing its ownership interest in EWS to approximately 31% on a fully diluted basis (13.7 million shares) compared to approximately 37% on a fully diluted basis (43.7 million shares) prior to the capital reorganization. In the first quarter of 2004, the Company received £57.7 million (Cdn$141 million) in cash and an 8% note receivable due 2009 of £23.9 million (Cdn$58 million) from EWS. In April 2005, EWS fully redeemed the Companys note receivable. The Company received £26 million (Cdn$61 million), which included principal and accrued but unpaid interest to the date of redemption.

B. Intangible assets

Intangible assets relate to customer contracts and relationships assumed through the GLT acquisition.

7 Credit facility

In March 2005, the Company refinanced, by way of amendment, its U.S.$1,000 million revolving credit facility, which was scheduled to mature in December 2005, for a five-year period to March 2010. The credit facility is available for general corporate purposes, including backstopping the Companys commercial paper program, and provides for borrowings at various interest rates, including the Canadian prime rate, bankers acceptance rates, the U.S. federal funds effective rate and the London Interbank Offer Rate, plus applicable margins. The amended credit facility agreement retained one financial covenant, the customary limitation on debt as a percentage of total capitalization, with which the Company has been in compliance. The Companys borrowings under its previous revolving credit facility of U.S.$90 million (Cdn$108 million) outstanding at December 31, 2004 (average interest rate of 2.77%) were entirely repaid in the first quarter of 2005. At December 31, 2005, the Company had borrowings under its revolving credit facility of U.S.$15 million (Cdn$17 million) at an interest rate of 4.66% and letters of credit drawn of $316 million.

The Companys commercial paper program is backed by a portion of its revolving credit facility. As at December 31, 2005, the Company had U.S.$367 million (Cdn$427 million) of commercial paper outstanding at an average interest rate of 4.40%, and U.S.$211 million (Cdn$254 million) at an average rate of 2.37%, as at December 31, 2004.

8 Accounts payable and accrued charges

In millions *December 31,*	**2005**	2004
Trade payables	**$ 475**	$ 491
Income and other taxes	**261**	310
Accrued charges	**226**	179
Payroll-related accruals	**207**	259
Personal injury and other claims provision	**115**	118
Accrued interest	**101**	106
Workforce reduction provisions	**49**	90
Other	**44**	52
	$ 1,478	$ 1,605

9 Other liabilities and deferred credits

In millions *December 31,*	**2005**	2004
Personal injury and other claims provision, net of current portion	**$ 542**	$ 524
Accrual for post-retirement benefits other than pensions *(A)*	**289**	284
Accrued benefit cost for pensions *(Note 13)*	**150**	156
Environmental reserve, net of current portion	**99**	93
Workforce reduction provisions, net of current portion *(B)*	**93**	149
Additional minimum pension liability *(Note 13)*	**18**	22
Deferred credits and other	**296**	285
	$ 1,487	$ 1,513

A. Post-retirement benefits other than pensions

(i) Change in benefit obligation

In millions *Year ended December 31,*	**2005**	2004
Benefit obligation at beginning of year	**$ 319**	$ 309
Acquisition of GLT and BC Rail	**-**	151
Amendments	**(4)**	(12)
Transfer from other plan	**8**	-
Actuarial gain	**(20)**	(111)
Interest cost	**19**	17
Service cost	**5**	8
Foreign currency changes	**(8)**	(25)
Benefits paid	**(19)**	(18)
Benefit obligation at end of year	**$ 300**	$ 319

The Company uses a measurement date of September 30 for its U.S. plans and December 31 for its Canadian plans.

9 Other liabilities and deferred credits *(continued)*

(ii) Funded status

In millions *December 31,*	**2005**	2004
Unfunded benefit obligation at end of year	**$ 300**	$ 319
Unrecognized net actuarial gain	**24**	6
Unrecognized prior service cost	**(11)**	(16)
Accrued benefit cost for post-retirement benefits other than pensions (including current portion)	**$ 313**	$ 309

(iii) Components of net periodic benefit cost

In millions *Year ended December 31,*	**2005**	2004	2003
Interest cost	**$ 19**	$ 17	$ 18
Service cost	**5**	8	5
Amortization of prior service cost	**1**	3	3
Recognized net actuarial (gain) loss	**(1)**	1	7
Net periodic benefit cost	**$ 24**	$ 29	$ 33

(iv) Weighted-average assumptions

December 31,	**2005**	2004	2003
To determine benefit obligation			
Discount rate	**5.30%**	5.90%	6.00%
Rate of compensation increase	**3.75%**	3.75%	3.75%
To determine net periodic benefit cost			
Discount rate	**5.90%**	6.00%	6.69%
Rate of compensation increase	**3.75%**	3.75%	4.00%

(v) For measurement purposes, increases in the per capita cost of covered health care benefits were assumed to be 13% for 2006 and 14% for 2005. It is assumed that the rate will decrease gradually to 6% in 2013 and remain at that level thereafter.

A one-percentage-point change in the assumed health care cost trend rates would have the following effect:

In millions	One-percentage-point	
	Increase	Decrease
Effect on total service and interest costs	**$ 2**	**$ (2)**
Effect on benefit obligation	**25**	**(22)**

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act), signed into law in the United States in December 2003, provides for prescription drug benefits under Medicare, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide prescription drug benefits that have been

concluded to be actuarially equivalent to the Medicare benefit. Pursuant to FASB Staff Position 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, adopted on July 1, 2004, the Company evaluated and determined the prescription drug benefits provided by its health care plans to be actuarially equivalent to the Medicare benefit under the Act. The Company measured the effects of the Act on the accumulated post-retirement benefit obligation (APBO) as of January 1, 2004 and, as such, the APBO was reduced by $49 million. Net periodic benefit cost for the year ended December 31, 2004 was reduced by $7 million due to the effects of the Act.

(vi) The estimated future benefit payments for each of the next five years and the subsequent five-year period are as follows:

In millions	
2006	$ 16
2007	17
2008	18
2009	19
2010	19
Years 2011 to 2015	110

B. Workforce reduction provisions

The workforce reduction provisions, which cover employees in both Canada and the United States, are mainly comprised of payments related to severance, early retirement incentives and bridging to early retirement, the majority of which will be disbursed within the next five years. In 2005, net charges and adjustments decreased the provisions by $10 million. In 2004, liabilities assumed through acquisitions and other charges and adjustments had increased the provisions by $107 million. Payments have reduced the provisions by $87 million for the year ended December 31, 2005 ($93 million for the year ended December 31, 2004). As at December 31, 2005, the aggregate provisions, including the current portion, amounted to $142 million ($239 million as at December 31, 2004).

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

10 Long-term debt

In millions		Maturity	Currency in which payable	*December 31,* **2005**	2004
Debentures and notes: (A)					
Canadian National series:					
6.45%	Puttable Reset Securities (PURS) *(B)*	July 15, 2006	U.S.$	**$ 291**	$ 301
4.25%	5-year notes *(C)*	Aug. 1, 2009	U.S.$	**349**	361
6.38%	10-year notes *(C)*	Oct. 15, 2011	U.S.$	**465**	482
4.40%	10-year notes *(C)*	Mar. 15, 2013	U.S.$	**465**	482
6.80%	20-year notes *(C)*	July 15, 2018	U.S.$	**233**	241
7.63%	30-year debentures	May 15, 2023	U.S.$	**174**	181
6.90%	30-year notes *(C)*	July 15, 2028	U.S.$	**552**	572

7.38%	30-year debentures *(C)*	Oct. 15, 2031	U.S.$	**233**	241
6.25%	30-year notes *(C)*	Aug. 1, 2034	U.S.$	**582**	602
Illinois Central series:					
7.75%	10-year notes	May 1, 2005	U.S.$	**-**	120
6.98%	12-year notes	July 12, 2007	U.S.$	**58**	60
6.63%	10-year notes	June 9, 2008	U.S.$	**23**	24
5.00%	99-year income debentures	Dec. 1, 2056	U.S.$	**9**	9
7.70%	100-year debentures	Sept. 15, 2096	U.S.$	**145**	151
Wisconsin Central series:					
6.63%	10-year notes	April 15, 2008	U.S.$	**174**	181
				3,753	4,008
BC Rail series:					
Non-interest bearing 90-year subordinated notes *(D)*		July 14, 2094	CDN$	**842**	843
Total debentures and notes				**4,595**	4,851
Other:					
Revolving credit facility *(A) (Note 7)*			U.S.$	**17**	108
Commercial paper *(E) (Note 7)*			U.S.$	**427**	254
Capital lease obligations and other *(F)*			Various	**897**	805
Total other				**1,341**	1,167
				5,936	6,018
Less:					
Current portion of long-term debt				**408**	578
Net unamortized discount				**851**	854
				1,259	1,432
				$ 4,677	$ 4,586

A. The Company's debentures, notes and revolving credit facility are unsecured.

B. The PURS contain imbedded simultaneous put and call options at par. At the time of issuance, the Company sold the option to call the securities on July 15, 2006 (the reset date). If the call option is exercised, the imbedded put option is automatically triggered, resulting in the redemption of the original PURS. The call option holder will then have the right to remarket the securities at a new coupon rate for an additional 30-year term ending July 15, 2036. The new coupon rate will be determined according to a pre-set mechanism based on market conditions then prevailing. If the call option is not exercised, the put option is deemed to have been exercised, resulting in the redemption of the PURS on July 15, 2006.

C. These debt securities are redeemable, in whole or in part, at the option of the Company, at any time, at the greater of par and a formula price based on interest rates prevailing at the time of redemption.

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

10 Long-term debt *(continued)*

D. The Company records these notes as a discounted debt of $6 million, using an imputed interest rate of 5.75% . The discount of $836 million is included in the net unamortized discount.

E. The Company has a commercial paper program, which is backed by a portion of its revolving credit facility, enabling it to issue commercial paper up to a maximum aggregate principal amount of $800 million, or the U.S. dollar equivalent. Commercial paper debt is due within one year but is classified as long-term debt, reflecting the Company's intent and contractual ability to refinance the short-term borrowing through subsequent issuances of commercial paper or drawing down on the revolving credit facility. At December 31, 2004, the amounts outstanding under both the revolving credit facility and the commercial paper program were presented as short-term debt given the anticipated maturity in December 2005 of the revolving credit facility. In March 2005, the Company refinanced by way of amendment, its revolving credit facility, for a five-year period to March 2010.

F. Interest rates for capital leases range from approximately 3.00% to 13.13% with maturity dates in the years 2006 through 2025. The imputed interest on these leases amounted to $360 million as at December 31, 2005 and $342 million as at December 31, 2004.

The capital lease obligations are secured by properties with a net carrying amount of $1,243 million as at December 31, 2005 and $1,080 million as at December 31, 2004.

During 2005, the Company recorded $222 million in assets it acquired through equipment leases ($160 million in 2004), for which an equivalent amount was recorded in debt.

G. Long-term debt maturities, including repurchase arrangements and capital lease repayments on debt outstanding as at December 31, 2005, for the next five years and thereafter, are as follows:

In millions		
2006	$	408
2007		169
2008		238
2009		429
2010		467
2011 and thereafter		3,374

H. The aggregate amount of debt payable in U.S. currency as at December 31, 2005 was U.S.$4,169 million (Cdn$4,849 million) and U.S.$4,022 million (Cdn$4,845 million) as at December 31, 2004.

11 Capital stock

A. Authorized capital stock

The authorized capital stock of the Company is as follows:

- Unlimited number of Common Shares, without par value
- Unlimited number of Class A Preferred Shares, without par value issuable in series
- Unlimited number of Class B Preferred Shares, without par value issuable in series

B. Issued and outstanding common shares

During 2005, the Company issued 3.3 million shares (2.9 million shares in both 2004 and 2003) related to stock options exercised. The total number of common shares issued and outstanding was 268.4 million as at December 31, 2005.

C. Share repurchase programs

In July 2005, the Board of Directors of the Company approved a share repurchase program which allows for the repurchase of up to 16.0 million common shares between July 25, 2005 and July 24, 2006 pursuant to a normal course issuer bid, at prevailing market prices. As at December 31, 2005, 8.0 million common shares had been repurchased for $670 million, at an average price of $83.81 per share.

The Company's previous share repurchase program, initiated in 2004, allowed for the repurchase of up to 14.0 million common shares between November 1, 2004 and October 31, 2005 pursuant to a normal course issuer bid, at prevailing market prices. By the second quarter of 2005, the Company had completed this share repurchase program, repurchasing 14.0 million common shares for $1,021 million, at an average price of $72.94 per share (10.0 million and 4.0 million in 2005 and 2004, respectively).

In October 2003, the Company completed its 19.5 million share repurchase program at a total cost of $859 million, and an average price of $44.04 per share (15.0 million and 4.5 million shares in 2003 and 2002, respectively).

12 Stock plans

The Company has various stock-based incentive plans for eligible employees. A description of the Company's major plans is provided below:

Employee share investment plan

The Company has an Employee Share Investment Plan (ESIP) giving eligible employees the opportunity to subscribe for up to 10% (6% prior to 2003) of their gross salaries to purchase shares of the Company's common stock on the open market and to have the Company invest, on the employees' behalf, a further 35% of the amount invested by the employees, up to 6% of their gross salaries.

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12 Stock plans *(continued)*

Participation at December 31, 2005 was 11,010 employees (10,073 at December 31, 2004 and 8,894 at December 31, 2003). The total number of ESIP shares purchased on behalf of employees, including the Company's contributions, was 0.8 million in 2005, 0.7 million in 2004 and 0.9 million in 2003, resulting in a pre-tax charge to income of $12 million, $11 million and $8 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Stock-based plans

Compensation cost for awards under all stock-based plans was $120 million, $65 million and $23 million for the years ended December 31, 2005, 2004 and 2003, respectively.

A. Restricted share units

The Company has granted restricted share units (RSUs), 0.4 million in 2005 and 1.2 million in 2004, to designated management employees entitling them to receive payout in cash based on the Company□s share price. The RSUs granted are generally scheduled for payout after three years and vest upon the attainment of targets relating to return on invested capital over the three-year period and to the Company□s share price during the three-month period ending December 31, 2007 for the 2005 grant and December 31, 2006 for the 2004 grant. The 2004 grant was subject to accelerated payout if specified targets related to the Company□s 20-day average share price were attained during the period ending December 31, 2005. Given that these targets were met, vesting of the 2004 grant was accelerated and increased to its maximum allowable amount under the plan, resulting in a payout of $105 million. Of this amount, $41 million was converted into deferred share units (see section C) at December 31, 2005, and the remaining payout of $64 million will be paid in cash in January 2006. For the years ended December 31, 2005 and 2004, the Company recorded compensation cost of $89 million and $36 million, respectively, for RSUs. As at December 31, 2005, the Company had approximately 0.6 million RSUs outstanding.

B. Mid-term incentive share unit plan

The 2001 mid-term incentive share unit plan entitled designated senior management employees to receive payout on June 30, 2004. The share units vested conditionally upon the attainment of targets relating to the Company□s share price during the six-month period ending June 30, 2004. On June 30, 2004, upon the partial attainment of these targets, the Company recorded additional compensation cost of $13 million based on the number of share units vested multiplied by the Company□s share price on such date. For the year ended December 31, 2003, the Company recorded compensation cost of $7 million related to the plan.

C. Voluntary incentive deferral plan

The Company has a voluntary incentive deferral plan (VIDP), providing eligible senior management employees the opportunity to elect to receive their annual incentive bonus payment and other eligible incentive payments in deferred share units (DSUs). A DSU is equivalent to a common share of the Company and also earns dividends when normal cash dividends are paid on common shares. The number of DSUs received by each participant is established using the average closing price for the 20 trading days prior to and including the date of the incentive payment. For each participant, the Company will grant a further 25% of the amount elected in DSUs, which will vest over a period of 4 years. The election to receive eligible incentive payments in DSUs is no longer available to a participant when the value of the participant's vested DSUs is sufficient to meet the Company's stock ownership guidelines. The value of each participant□s DSUs is payable in cash at the time of cessation of employment.

At December 31, 2005, the total liability under the VIDP was $83 million ($22 million at December 31, 2004), representing 1.0 million units outstanding (0.4 million units in 2004) under the plan, which includes the deferred share units related to the 2004 RSU grant as discussed herein. For the years ended December 31, 2005 and 2004, the Company recognized an expense of $13 million and $7 million, respectively, related to the plan.

D. Stock options

The Company has stock option plans for eligible employees to acquire common shares of the Company upon vesting at a price equal to the market value of the common shares at the date of granting. The options are exercisable during a period not exceeding 10 years. The right to exercise options generally accrues over a period of four years of continuous employment. Options are not generally exercisable during the first 12 months after the date of grant. At December 31, 2005, 8.1 million common shares remained authorized for future issuances under these plans.

Options issued by the Company include conventional options, which vest over a period of time, performance options, which vest upon the attainment of Company targets relating to the operating ratio and unlevered return on investment, and performance-accelerated options, which vest on the sixth anniversary of the grant or prior if certain Company targets relating to return on investment and revenues are attained. The total conventional, performance, and performance-accelerated options outstanding at December 31, 2005 were 7.4 million, 0.5 million and 2.6 million, respectively.

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

12 Stock plans *(continued)*

Changes in the Company's stock options are as follows:

	Number of options	Weighted-average exercise price
	In millions	
Outstanding at December 31, 2002 [1]	16.7	$35.67
Granted	3.0	$40.95
Canceled and expired	(0.6)	$45.11
Exercised	(2.9)	$26.60
Outstanding at December 31, 2003 [1]	16.2	$37.16
Granted	-	-
Canceled and expired	(0.2)	$42.58
Exercised	(2.9)	$28.70
Outstanding at December 31, 2004 [1]	13.1	$38.85
Granted	0.7	$69.84
Canceled and expired	-	-
Exercised	(3.3)	$35.14
Outstanding at December 31, 2005 [1]	**10.5**	**$41.91**

[1] Stock options with a U.S. dollar exercise price have been translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

Stock options outstanding and exercisable as at December 31, 2005 were as follows:

	Options outstanding			Options exercisable	
Range of exercise prices	Number of options	Weighted-average years to expiration	Weighted-average exercise price	Number of options	Weighted-average exercise price
	In millions			*In millions*	
$12.35-$23.34	1.0	3	$21.43	1.0	$21.43
$23.69-$29.51	0.7	3	$26.05	0.7	$26.05
$30.23-$39.67	1.9	5	$33.17	1.9	$33.17
$40.54-$49.21	2.7	7	$41.00	1.8	$41.03
$51.05-$56.41	3.5	6	$51.19	2.4	$51.20
$67.88-$94.25	0.7	9	$69.83	-	-

Balance at December 31, 2005 (1)	**10.5**	**6**	**$41.91**	**7.8**	**$38.35**

(1) Stock options with a U.S. dollar exercise price have been translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date.

At December 31, 2004 and 2003, the Company had 8.2 million and 7.5 million options exercisable at a weighted-average exercise price of $35.55 and $31.39, respectively.

Compensation cost for awards of employee stock options granted, modified or settled on or after January 1, 2003 was determined using the fair value based approach in accordance with SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, as explained in Note 2 Accounting changes. Prior to 2003, compensation cost was recorded for the intrinsic value of the Companys performance-based stock option awards and no compensation cost was recognized for the Companys conventional stock option awards, in accordance with APB 25, Accounting for Stock Issued to Employees, and related interpretations. Compensation cost recognized for stock option awards was $18 million, $9 million and $16 million in 2005, 2004 and 2003, respectively. Disclosures required under the fair value measurement and recognition method for awards under all plans, as prescribed by SFAS No. 123, Accounting for Stock-Based Compensation, as well as the assumptions used to calculate compensation cost related to stock option awards are presented in Note 1 Summary of significant accounting policies.

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12 Stock plans *(continued)*

E. Vision 2008 Share Unit Plan

In the first quarter of 2005, the Board of Directors of the Company approved a special share unit plan with a four-year term to December 31, 2008, entitling designated senior management employees to receive cash payout in January 2009. The Company granted 0.4 million share units which vest conditionally upon the attainment of targets relating to the Companys share price during the six-month period ending December 31, 2008. Payout is conditional upon the attainment of targets relating to return on invested capital over the four-year period and to the Companys share price during the 20-day period ending on December 31, 2008. The award payout will be equal to the number of share units vested on December 31, 2008 multiplied by the Companys 20-day average share price ending on such date. Due to the nature of the vesting conditions, no compensation cost was recorded for the year ended December 31, 2005. As at December 31, 2005, 0.1 million share units remained authorized for future issuance under this plan.

13 Pensions

The Company has various retirement benefit plans under which substantially all of its employees are entitled to benefits at retirement age, generally based on compensation and length of service and/or contributions. The information in the tables that follow pertains to all such plans. However, the following descriptions relate solely to the Companys main pension plan, the CN Pension Plan (the Plan), unless otherwise specified.

Description of the Plan

The Plan is a contributory defined benefit pension plan that covers the majority of CN employees. It provides for pensions based mainly on years of service and final average pensionable earnings and is generally applicable from the first day of employment. Indexation of pensions is provided after retirement through a gain (loss) sharing mechanism, subject to guaranteed minimum increases. An independent trust company is the Trustee of the Canadian National Railways Pension Trust Funds (CN Pension Trust Funds). As Trustee, the trust company performs certain duties, which include holding legal title to the assets of the CN Pension Trust Funds and ensuring that the Company, as Administrator, complies with the provisions of the Plan and the related legislation. The Company utilizes a measurement date of December 31 for the Plan.

Funding policy

Employee contributions to the Plan are determined by the plan rules. Company contributions are in accordance with the requirements of the Government of Canada legislation, The Pension Benefits Standards Act, 1985, and are determined by actuarial valuations conducted at least on a triennial basis. These valuations are made in accordance with legislative requirements and with the recommendations of the Canadian Institute of Actuaries for the valuation of pension plans. The latest actuarial valuation of the Plan was conducted as at December 31, 2004 and indicated a funding excess. Total contributions for all of the Company's pension plans are expected to be approximately $100 million in each of 2006, 2007 and 2008 based on the plans' current position. All of the Company's contributions are expected to be in the form of cash.

Description of fund assets

The assets of the Plan are accounted for separately in the CN Pension Trust Funds and consist of cash and short-term investments, bonds, mortgages, Canadian and foreign equities, real estate, and oil and gas assets. The assets of the Plan have a fair market value of $14,069 million as at December 31, 2005 ($12,256 million at December 31, 2004). The Plan's target percentage allocation and weighted-average asset allocations as at December 31, 2005 and 2004, by asset category are as follows:

		December 31,	
Plan assets by category	**Target Allocation**	**2005**	2004
Equity securities	**53%**	**56%**	56%
Debt securities	**40%**	**32%**	34%
Real estate	**4%**	**2%**	3%
Other	**3%**	**10%**	7%
	100%	**100%**	100%

The Company follows a disciplined investment strategy, which limits concentration of investments by asset class, foreign currency, sector or company. The Investment Committee of the Board of Directors has approved an investment policy that establishes long-term asset mix targets based on a review of historical returns achieved by worldwide investment markets. Investment managers may deviate from these targets but their performance is evaluated in relation to the market performance of the target mix. The Company does not anticipate the return on plan assets to fluctuate materially from related capital market indices. The Investment Committee reviews investments regularly with specific approval required for major investments in illiquid securities. The policy also permits the use of derivative financial instruments to implement asset mix decisions or to hedge existing or anticipated exposures. The Plan does not invest in the securities of the Company or its subsidiaries.

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

13 Pensions *(continued)*

Weighted-average assumptions

December 31,	**2005**	2004	2003
To determine benefit obligation			
Discount rate	**5.00%**	5.75%	6.00%
Rate of compensation increase	**3.75%**	3.75%	3.75%
To determine net periodic benefit cost			
Discount rate	**5.75%**	6.00%	6.50%
Rate of compensation increase	**3.75%**	3.75%	4.00%
Expected return on plan assets	**8.00%**	8.00%	8.00%

To develop its expected long-term rate of return assumption used in the calculation of net periodic benefit cost applicable to the market-related value of assets, the Company considers both its past experience and future estimates of long-term investment returns, the expected composition of the plans assets as well as the expected long-term market returns in the future. The Company has elected to use a market-related value of assets, whereby realized and unrealized gains/losses and appreciation/depreciation in the value of the investments are recognized over a period of five years, while investment income is recognized immediately.

Information about the Company s defined benefit pension plans:

(a) Change in benefit obligation

In millions *Year ended December 31,*	**2005**	2004
Benefit obligation at beginning of year	**$ 13,137**	$ 12,020
Amendments	**(3)**	-
Acquisition of GLT and BC Rail	**-**	684
Interest cost	**742**	733
Actuarial loss	**1,234**	349
Service cost	**138**	124
Plan participants contributions	**58**	55
Foreign currency changes	**(11)**	(23)
Benefit payments and transfers	**(949)**	(805)
Benefit obligation at end of year	**$ 14,346**	