CANADIAN NATIONAL RAILWAY CO
Form 6-K
February 03, 2012

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, 2012

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's Report on Internal Control over Financial Reporting

Item 1

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2011 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Based on this assessment, management has determined that the Company's internal control over financial reporting was effective as of December 31, 2011.

KPMG LLP, an independent registered public accounting firm, has issued an unqualified audit report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2011 and has also expressed an unqualified audit opinion on the Company's 2011 consolidated financial statements as stated in their Reports of Independent Registered Public Accounting Firm dated February 3, 2012.

Claude Mongeau
President and Chief Executive Officer

February 3, 2012

Luc Jobin
Executive Vice-President and Chief Financial Officer

February 3, 2012

Report of Independent Registered Public Accounting Firm

Item 2

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

We have audited the accompanying consolidated balance sheets of the Canadian National Railway Company (the "Company") as of December 31, 2011 and 2010, and the related 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, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2011 and 2010, and its consolidated results of operations and its consolidated cash flows for each of the years in the three-year period ended December 31, 2011, in conformity with United States generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), and our report dated February 3, 2012 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

KPMG LLP*
Chartered Accountants

Montreal, Canada
February 3, 2012

* CA Auditor permit no. 10892

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.
KPMG Canada provides services to KPMG LLP.

Report of Independent Registered Public Accounting Firm

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

We have audited the Canadian National Railway Company's (the "Company") internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the COSO.

We also have audited, in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2011 and 2010, and the related 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, 2011, and our report dated February 3, 2012 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP*
Chartered Accountants

Montreal, Canada
February 3, 2012

*CA Auditor permit no. 10892

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KPMG Canada provides services to KPMG LLP.

Consolidated Statement of Income U.S. GAAP

Item 3

In millions, except per share data	Year ended December 31,	2011	2010	2009
Revenues		$ 9,028	$ 8,297	$ 7,367
Operating expenses				
Labor and fringe benefits		1,812	1,744	1,696
Purchased services and material		1,120	1,036	1,027
Fuel		1,412	1,048	820
Depreciation and amortization		884	834	790
Equipment rents		228	243	284
Casualty and other		276	368	344
Total operating expenses		5,732	5,273	4,961
Operating income		3,296	3,024	2,406
Interest expense		(341)	(360)	(412)
Other income (Note 13)		401	212	267
Income before income taxes		3,356	2,876	2,261
Income tax expense (Note 14)		(899)	(772)	(407)
Net income		$ 2,457	$ 2,104	$ 1,854
Earnings per share (Note 16)				
Basic		$ 5.45	$ 4.51	$ 3.95
Diluted		$ 5.41	$ 4.48	$ 3.92
Weighted-average number of shares				
Basic		451.1	466.3	469.2
Diluted		454.4	470.1	473.5

See accompanying notes to consolidated financial statements.

Consolidated Statement of Comprehensive Income U.S. GAAP

In millions	Year ended December 31,	2011	2010	2009
Net income	$	2,457	$ 2,104	$ 1,854
Other comprehensive income (loss) (Note 19)				
Foreign exchange gain (loss) on:				
Translation of the net investment in foreign operations		130	(330)	(998)
Translation of US dollar-denominated long-term debt designated as a hedge of the net investment in U.S. subsidiaries		(122)	315	976
Pension and other postretirement benefit plans (Note 12):				
Net actuarial loss arising during the year		(1,541)	(931)	(868)
Prior service cost arising during the year		(28)	(5)	(2)
Amortization of net actuarial loss included in net periodic benefit cost (income)		8	1	2
Amortization of prior service cost included in net periodic benefit cost (income)		4	2	5
Derivative instruments (Note 18)		(2)	(1)	-
Other comprehensive loss before income taxes		(1,551)	(949)	(885)
Income tax recovery		421	188	92
Other comprehensive loss		(1,130)	(761)	(793)
Comprehensive income	$	1,327	$ 1,343	$ 1,061

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet U.S.
GAAP

In millions	December 31,	2011	2010
Assets			
Current assets			
Cash and cash equivalents		$ 101	$ 490
Restricted cash and cash equivalents (Note 9)		499	-
Accounts receivable (Note 4)		820	775
Material and supplies		201	210
Deferred and receivable income taxes (Note 14)		122	53
Other		105	62
Total current assets		1,848	1,590
Properties (Note 5)		23,917	22,917
Intangible and other assets (Note 6)		261	699
Total assets		$ 26,026	$ 25,206
Liabilities and shareholders' equity			
Current liabilities			
Accounts payable and other (Note 7)		$ 1,580	$ 1,366
Current portion of long-term debt (Note 9)		135	540
Total current liabilities		1,715	1,906
Deferred income taxes (Note 14)		5,333	5,152
Pension and other postretirement benefits, net of current portion (Note 12)		1,095	510
Other liabilities and deferred credits (Note 8)		762	823
Long-term debt (Note 9)		6,441	5,531
Shareholders' equity			
Common shares (Note 10)		4,141	4,252
Accumulated other comprehensive loss (Note 19)		(2,839)	(1,709)
Retained earnings		9,378	8,741
Total shareholders' equity		10,680	11,284
Total liabilities and shareholders' equity		$ 26,026	$ 25,206

On behalf of the Board:

David G. A. McLean Director	Claude Mongeau 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 loss	Retained earnings	Total shareholders' equity
Balances at December 31, 2008	468.2	$ 4,179	$ (155)	$ 6,535	$ 10,559
Net income	-	-	-	1,854	1,854
Stock options exercised and other (Notes 10, 11)	2.8	87	-	-	87
Other comprehensive loss (Note 19)	-	-	(793)	-	(793)
Dividends ($1.01 per share)	-	-	-	(474)	(474)
Balances at December 31, 2009	471.0	4,266	(948)	7,915	11,233
Net income	-	-	-	2,104	2,104
Stock options exercised and other (Notes 10, 11)	3.4	124	-	-	124
Share repurchase program (Note 10)	(15.0)	(138)	-	(775)	(913)
Other comprehensive loss (Note 19)	-	-	(761)	-	(761)
Dividends ($1.08 per share)	-	-	-	(503)	(503)
Balances at December 31, 2010	459.4	4,252	(1,709)	8,741	11,284
Net income	-	-	-	2,457	2,457
Stock options exercised and other (Notes 10, 11)	2.6	74	-	-	74
Share repurchase programs (Note 10)	(19.9)	(185)	-	(1,235)	(1,420)
Other comprehensive loss (Note 19)	-	-	(1,130)	-	(1,130)
Dividends ($1.30 per share)	-	-	-	(585)	(585)
Balances at December 31, 2011	442.1	$ 4,141	$ (2,839)	$ 9,378	$ 10,680

See accompanying notes to consolidated
financial statements.

Consolidated Statement of Cash Flows U.S. GAAP

In millions Year ended December 31,	2011	2010	2009
Operating activities			
Net income	$ 2,457	$ 2,104	$ 1,854
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	884	834	790
Deferred income taxes (Note 14)	531	418	138
Gain on disposal of property (Notes 5, 13)	(348)	(152)	(226)
Changes in operating assets and liabilities:			
Accounts receivable	(51)	(3)	39
Material and supplies	11	(43)	32
Accounts payable and other	34	285	(204)
Other current assets	(2)	13	77
Other, net	(540)	(457)	(221)
Net cash provided by operating activities	2,976	2,999	2,279
Investing activities			
Property additions	(1,625)	(1,586)	(1,402)
Acquisitions, net of cash acquired (Note 3)	-	-	(373)
Disposal of property (Note 5)	369	168	231
Change in restricted cash and cash equivalents	(499)	-	-
Other, net	26	35	107
Net cash used in investing activities	(1,729)	(1,383)	(1,437)
Financing activities			
Issuance of debt	1,361	-	1,626
Repayment of debt	(1,083)	(184)	(2,109)
Issuance of common shares due to exercise of stock options and related excess tax benefits realized (Note 11)	77	115	73
Repurchase of common shares (Note 10)	(1,420)	(913)	-
Dividends paid	(585)	(503)	(474)
Net cash used in financing activities	(1,650)	(1,485)	(884)
Effect of foreign exchange fluctuations on US dollar-denominated cash and cash equivalents	14	7	(19)
Net increase (decrease) in cash and cash equivalents	(389)	138	(61)
Cash and cash equivalents, beginning of year	490	352	413
Cash and cash equivalents, end of year	$ 101	$ 490	$ 352
Supplemental cash flow information			
Net cash receipts from customers and other	$ 8,995	$ 8,404	$ 7,505
Net cash payments for:			
Employee services, suppliers and other expenses	(4,643)	(4,334)	(4,323)

Interest	(329)	(366)	(407)
Personal injury and other claims (Note 17)	(97)	(64)	(112)
Pensions (Note 12)	(468)	(427)	(139)
Income taxes (Note 14)	(482)	(214)	(245)
Net cash provided by operating activities	$ 2,976	$ 2,999	$ 2,279

See accompanying notes to consolidated financial statements.

Canadian National Railway Company, together with its wholly-owned subsidiaries, collectively "CN" or "the Company," 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 freight 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 United States generally accepted accounting principles (U.S. GAAP). 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 matters, depreciation, pensions and other postretirement 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. 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 using the percentage of completed service method based on the transit time of freight as it moves from origin to destination. The allocation of revenues between reporting periods is based on the relative transit time in each period with expenses being recorded as incurred. Revenues related to non-rail transportation services are recognized as service is performed or as contractual obligations are met. Revenues are presented net of taxes collected from customers and remitted to governmental authorities.

C. Foreign currency

All of the Company's United States (U.S.) operations are self-contained foreign entities with the US dollar as their functional currency. Accordingly, the U.S. operations' assets and liabilities 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) (see Note 19 – Accumulated other comprehensive loss).

The Company designates the US dollar-denominated long-term debt of the parent company as a foreign currency hedge of its net investment in U.S. subsidiaries. Accordingly, foreign exchange gains and losses, from the dates of designation, on the translation of the US 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. Restricted cash and cash equivalents

The Company has the option, under its bilateral letter of credit facility agreements with various banks, to pledge collateral in the form of cash and cash equivalents for a minimum term of three months, equal to at least the face value of the letters of credit issued. Restricted cash and cash equivalents are shown separately on the balance sheet and include highly liquid investments purchased three months or less from maturity and are stated at cost, which approximates market value.

F. Accounts receivable

Accounts receivable are recorded at cost net of billing adjustments and an allowance for doubtful accounts. The allowance for doubtful accounts is based on expected collectability and considers historical experience as well as known trends or uncertainties related to account collectability. When a receivable is deemed uncollectible, it is written off against the allowance for doubtful accounts. Subsequent recoveries of amounts previously written off are credited to the bad debt expense in the Consolidated Statement of Income.

G. Material and supplies
Material and supplies, which consist mainly of rail, ties, and other items for construction and maintenance of property and equipment, as well as diesel fuel, are valued at weighted-average cost.

H. 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 structures are capitalized to the extent they meet the Company's capitalization criteria. Major overhauls and large refurbishments of equipment are also capitalized when they result in an extension to the service life or increase the functionality of the asset. Repair and maintenance costs are expensed as incurred.
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 service lives, measured in years, except for rail which is measured in millions of gross tons per mile. The Company follows the group method of depreciation whereby a single composite depreciation rate is applied to the gross investment in a class of similar assets, despite small differences in the service life or salvage value of individual property units within the same asset class.
In accordance with the group method of depreciation, upon sale or retirement of properties in the normal course of business, cost less net salvage value is charged to accumulated depreciation. As a result, no gain or loss is recognized in income under the group method as it is assumed that the assets within the group on average have the same life and characteristics and therefore that gains or losses offset over time. For retirements of depreciable properties that do not occur in the normal course of business, a gain or loss may be recognized if the retirement varies significantly from the retirement pattern identified through depreciation studies. A gain or loss is recognized in Other income for the sale of land or disposal of assets that are not part of railroad operations.
Assets held for sale are measured at the lower of their carrying amount or fair value, less cost to sell. Losses resulting from significant rail line sales are recognized in income when the asset meets the criteria for classification as held for sale, whereas losses resulting from significant rail line abandonments are recognized in the statement of income when the asset ceases to be used. Gains are recognized in income when they are realized.
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.

I. Intangible assets
Intangible assets consist mainly of customer contracts and relationships assumed through past acquisitions and are being amortized on a straight-line basis over 40 to 50 years.
The Company reviews the carrying amounts of intangible assets 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.

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 expected long-term return on pension fund assets;
(iv) the amortization of prior service costs and amendments over the expected average remaining service life of the employee group covered by the plans; and
(v)

the amortization of cumulative 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. Postretirement benefits other than pensions

The Company accrues the cost of postretirement benefits other than pensions using actuarial methods. These benefits, which are funded as they become due, include life insurance programs, medical benefits and, for a closed group of employees, free rail travel benefits.

The Company amortizes the cumulative 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 plan.

L. Personal injury and other 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 third-party administration costs.

In the U.S., the Company accrues the expected cost for personal injury, property damage and occupational disease claims, based on actuarial estimates of their ultimate cost.

For all other legal actions in Canada and the U.S., the Company maintains, and regularly updates on a case-by-case basis, provisions for such items when the expected loss is both probable and can be reasonably estimated based on currently available information.

M. Environmental expenditures

Environmental expenditures that relate to current operations, or to an existing condition caused by past operations, are expensed unless they can contribute to current or future operations. Environmental liabilities are recorded when environmental assessments occur, remedial efforts are probable, 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. The Company accrues its allocable share of liability taking into account the Company's alleged responsibility, the number of potentially responsible parties and their ability to pay their respective shares of the liability. Recoveries of environmental remediation costs from other parties are recorded as assets when their receipt is deemed probable and collectability is reasonably assured.

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 or Other comprehensive income (loss). 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 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 net income 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 based on the grant-date fair value using the Black-Scholes option-pricing model. The Company expenses the fair value of its stock option awards on a straight-line basis, over the period during which an employee is required to provide service (requisite service period) or until retirement eligibility is attained, whichever is shorter. The Company also follows the fair value based approach for cash settled awards using a lattice-based valuation model. Compensation cost for cash settled awards is based on the fair value of the awards at period-end and is recognized over the period during which an employee is required to provide service (requisite service period) or until retirement eligibility is attained, whichever is shorter. See Note 11 – Stock plans, for the assumptions used to determine fair value and for other required disclosures.

Q. Recent accounting pronouncement

The Accounting Standards Board of the Canadian Institute of Chartered Accountants requires all publicly accountable enterprises to report under International Financial Reporting Standards (IFRS) for the fiscal years beginning on or after January 1, 2011. However, National Instrument 52-107 issued by the Ontario Securities Commission allows Securities and Exchange Commission (SEC) issuers, as defined by the U.S. Securities and Exchange Commission, such as CN, to file with Canadian securities regulators financial statements prepared in accordance with U.S. GAAP. As such, the Company has decided not to report under IFRS by 2011 and to continue reporting under U.S. GAAP. The SEC has issued a roadmap for the potential convergence to IFRS for U.S. issuers. Should the SEC decide it will move forward with the convergence to IFRS, the Company will convert its reporting to IFRS at that time.

2 – Accounting changes

2011

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, Presentation of Comprehensive Income, giving companies the option to present the components of net income and comprehensive income in either one or two consecutive financial statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income in the statement of changes in shareholders' equity. ASU 2011-05 also requires reclassification adjustments for each component of accumulated other comprehensive income (AOCI) in both net income and other comprehensive income (OCI) to be separately disclosed on the face of the financial statements. In December 2011, the FASB issued ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income, which deferred the effective date to present reclassification adjustments in net income. The effective date of the deferral is consistent with the effective date of ASU 2011-05 which becomes effective for fiscal years beginning on or after December 15, 2011. During the deferral period, the FASB plans to re-evaluate the requirement, with a final decision expected in 2012.

The Company currently presents the components of net income and other comprehensive income in two separate and consecutive financial statements. As such, the Company does not expect any significant changes to its annual consolidated financial statements from implementation of the new standards.

2010

Accounting standard updates effective in 2010 that were issued by the FASB had no significant impact on the Company's consolidated financial statements.

2009

Business Combinations

On January 1, 2009, the Company adopted the new requirements of the FASB Accounting Standards Codification (ASC) 805, "Business Combinations," relating to the accounting for business combinations (previously Statement of Financial Accounting Standards (SFAS) No. 141 (R)), which became effective for acquisitions with an acquisition date on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Until December 31, 2008, the Company was subject to the requirements of SFAS No. 141, "Business Combinations," which required that acquisition-related costs be included as part of the purchase cost of an acquired business. As such, the Company had reported acquisition-related costs in Other current assets pending the closing of its acquisition of the Elgin, Joliet and Eastern Railway Company (EJ&E), which had been subject to an extensive U.S. Surface Transportation Board (STB) approval process. On January 31, 2009, the Company completed its acquisition of the EJ&E and accounted for the acquisition under the revised standard. The Company incurred acquisition-related costs, including costs to obtain regulatory approval of approximately $49 million, which were expensed and reported in Casualty and other in the Consolidated Statement of Income for the year ended December 31, 2009 pursuant to FASB ASC 805 requirements. At the time of adoption, this change in accounting policy had the effect of decreasing net income by $28 million ($0.06 per basic or diluted earnings per share) and Other current assets by $46 million. This change had no effect on the Consolidated Statement of Cash Flows. Disclosures prescribed by FASB ASC 805 are presented in Note 3 – Acquisitions.

3 – Acquisition

2009

On January 31, 2009, the Company acquired the principal rail lines of the EJ&E, a short-line railway that operated over 198 miles of track in and around Chicago, for a total cash consideration of US$300 million (C$373 million), paid with cash on hand. The Company accounted for the acquisition using the acquisition method of accounting pursuant to FASB ASC 805, “Business Combinations,” which the Company adopted on January 1, 2009. As such, the consolidated financial statements of the Company include the assets, liabilities and results of operations of EJ&E as of January 31, 2009, the date of acquisition. The costs incurred to acquire the EJ&E of approximately $49 million were expensed and reported in Casualty and other in the Consolidated Statement of Income for the year ended December 31, 2009 (see Note 2 – Accounting changes).

The following table summarizes the consideration paid for EJ&E and the fair value of the assets acquired and liabilities assumed that were recognized at the acquisition date:

In US millions		At January 31, 2009
Consideration		
Cash	$	300
Fair value of total consideration transferred	$	300
Recognized amounts of identifiable assets acquired and liabilities assumed		
Current assets	$	4
Properties		310
Current liabilities		(4)
Other noncurrent liabilities		(10)
Total identifiable net assets	$	300

The 2009 revenues and net income of EJ&E included in the Company's Consolidated Statement of Income from the acquisition date to December 31, 2009, were $74 million and $12 million, respectively.

4 – Accounts receivable

In millions	December 31,		2011		2010
Freight		$	630	$	585
Non-freight			206		211
Gross accounts receivable			836		796
Allowance for doubtful accounts			(16)		(21)
Net accounts receivable		$	820	$	775

The Company had a five-year agreement to sell an undivided co-ownership interest in a revolving pool of freight receivables to an unrelated trust for maximum cash proceeds of $600 million. The agreement expired on May 31, 2011 and was not renewed. As at December 31, 2010, the Company had no receivables sold under this program.

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5 – Properties

In millions	2011 depreciation rate	December 31, 2011 Cost	Accumulated depreciation	Net	December 31, 2010 Cost	Accumulated depreciation	Net
Track and roadway (1)	2%	$ 25,534	$ 6,903	$ 18,631	$ 24,568	$ 6,744	$ 17,824
Rolling stock	4%	4,923	1,668	3,255	4,843	1,565	3,278
Buildings	2%	1,220	473	747	1,148	467	681
Information technology (2)	12%	931	383	548	854	330	524
Other	6%	1,213	477	736	1,057	447	610
Total properties including capital leases		$ 33,821	$ 9,904	$ 23,917	$ 32,470	$ 9,553	$ 22,917
Capital leases included in properties							
Track and roadway (3)		$ 417	$ 48	$ 369	$ 427	$ 43	$ 384
Rolling stock		1,144	317	827	1,129	287	842
Buildings		109	16	93	108	13	95
Other		102	15	87	130	28	102
Total capital leases included in properties		$ 1,772	$ 396	$ 1,376	$ 1,794	$ 371	$ 1,423

(1) Includes the cost of land of $1,798 million and $1,712 million as at December 31, 2011 and 2010, respectively.

(2) The Company capitalized $94 million in 2011 and $79 million in 2010 of internally developed software costs pursuant to ASC 350-40, "Intangibles – Goodwill and Other, Internal – Use Software."

(3) Includes $108 million of right-of-way access in both years.

Accounting policy for capitalization of costs

The Company's railroad operations are highly capital intensive. The Company's properties consist mainly of a large base of homogeneous or network-type assets such as rail, ties, ballast and other structures, which form the Company's Track and roadway properties, and rolling stock. The Company's capital expenditures are for the replacement of assets and for the purchase or construction of assets to enhance operations or provide new service offerings to customers. A large portion of the Company's capital expenditures are for self-constructed properties including the replacement of existing track and roadway assets and track line expansion, as well as major overhauls and large refurbishments of rolling stock.

Expenditures are generally capitalized if they extend the life of the asset or provide future benefits such as increased revenue-generating capacity, functionality, or physical or service capacity. The Company has a process in place to determine whether its capital programs qualify for capitalization. For Track and roadway properties, the Company establishes basic capital programs to replace or upgrade the track infrastructure assets which are capitalized if they meet the capitalization criteria. These basic capital programs are planned in advance and carried out by the Company's engineering work force.

In addition, for Track and roadway properties, expenditures that meet the minimum level of activity as defined by the Company are also capitalized as detailed below:

- Land: all purchases of land;
- Grading: installation of road bed, retaining walls, drainage structures;
- Rail and related track material: installation of 39 or more continuous feet of rail;
- Ties: installation of 5 or more ties per 39 feet;
- Ballast: installation of 171 cubic yards of ballast per mile.

Expenditures relating to the Company's properties that do not meet the Company's capitalization criteria are considered normal repairs and maintenance and are expensed. For Track and roadway properties, such expenditures include but are not limited to spot tie replacement, spot or broken rail replacement, physical track inspection for detection of rail defects and minor track corrections, and other general maintenance of track infrastructure.

For the ballast asset, the Company also engages in "shoulder ballast undercutting" that consists of removing some or all of the ballast, which has deteriorated over its service life, and replacing it with new ballast. When ballast is installed as part of a shoulder ballast undercutting project, it represents the addition of a new asset and not the repair or maintenance of an existing asset. As such, the Company capitalizes expenditures related to shoulder ballast undercutting given that an existing asset is retired and replaced with a new asset. Under the group method of accounting for properties, the deteriorated ballast is retired at its average cost measured using the quantities of new ballast added.

For purchased assets, the Company capitalizes all costs necessary to make the asset ready for its intended use. Expenditures that are capitalized as part of self-constructed properties include direct material, labor, and contracted services, as well as other allocated costs which are not charged directly to capital projects. These allocated costs include, but are not limited to, fringe benefits, small tools and supplies, machinery used on projects and project supervision. The Company reviews and adjusts its allocations, as required, to reflect the actual costs incurred each year.

Costs of deconstruction and removal of replaced assets, referred to herein as dismantling costs, are distinguished from installation costs for self-constructed properties based on the nature of the related activity. For Track and roadway properties, employees concurrently perform dismantling and installation of new track and roadway assets and, as such, the Company estimates the amount of labor and other costs that are related to dismantling. The Company determines dismantling costs based on an analysis of the track and roadway installation process.

Accounting policy for depreciation

Properties are carried at cost less accumulated depreciation including asset impairment write-downs. 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 service lives, measured in years, except for rail which is measured in millions of gross tons per mile. The Company follows the group method of depreciation whereby a single composite depreciation rate is applied to the gross investment in a class of similar assets, despite small differences in the service life or salvage value of individual property units within the same asset class. The Company uses approximately 40 different depreciable asset classes.

For all depreciable assets, the depreciation rate is based on the estimated service lives of the assets. Assessing the reasonableness of the estimated service lives of properties requires judgment and is based on currently available information, including periodic depreciation studies conducted by the Company. The Company's U.S. properties are subject to comprehensive depreciation studies as required by the STB and are conducted by external experts. Depreciation studies for Canadian properties are not required by regulation and are therefore conducted internally. Studies are performed on specific asset groups on a periodic basis. Changes in the estimated service lives of the assets and their related composite depreciation rates are implemented prospectively.

For the rail asset, the estimated service life is measured in millions of gross tons per mile and varies based on rail characteristics such as weight, curvature and metallurgy. The annual composite depreciation rate for rail assets is determined by dividing the estimated annual number of gross tons carried over the rail by the estimated service life of the rail measured in millions of gross tons per mile. For the rail asset, the Company capitalizes the costs of rail grinding which consists of restoring and improving the rail profile and removing irregularities from worn rail to extend the service life. The service life of the rail asset is based on expected future usage of the rail in its existing condition, determined using railroad industry research and testing, less the rail asset's usage to date. The service life of the rail asset is increased incrementally as rail grinding is performed thereon. As such, the costs incurred for rail grinding are capitalized given that the activity extends the service life of the rail asset beyond its original or current condition as additional gross tons can be carried over the rail for its remaining service life. The Company amortizes the cost of rail grinding over the remaining life of the rail asset, which includes the incremental life extension generated by the rail grinding.

Disposal of property
2011
IC RailMarine Terminal
In August 2011, the Company sold substantially all of the assets of IC RailMarine Terminal Company (ICRMT), an indirect subsidiary of the Company, to Raven Energy, LLC, an affiliate of Foresight Energy, LLC (Foresight) and the Cline Group (Cline), for cash proceeds of $70 million (US$73 million) before transaction costs. ICRMT is located on the east bank of the Mississippi River and stores and transfers bulk commodities and liquids between rail, ship and barge, serving customers in North American and global markets. Under the sale agreement, the Company will benefit from a 10-year rail transportation agreement with Savatran LLC, an affiliate of Foresight and Cline, to haul a minimum annual volume of coal from four Illinois mines to the ICRMT transfer facility. The transaction resulted in a gain on disposal of $60 million ($38 million after-tax) that was recorded in Other income.

Lakeshore East

In March 2011, the Company entered into an agreement with Metrolinx to sell a segment of the Kingston subdivision known as the Lakeshore East in Pickering and Toronto, Ontario, together with the rail fixtures and certain passenger agreements (collectively the "Lakeshore East"), for cash proceeds of $299 million before transaction costs. Under the agreement, the Company obtained the perpetual right to operate freight trains over the Lakeshore East at its then current level of operating activity, with the possibility of increasing its operating activity for additional consideration. The transaction resulted in a gain on disposal of $288 million ($254 million after-tax) that was recorded in Other income under the full accrual method of accounting for real estate transactions.

2010

Oakville subdivision

In March 2010, the Company entered into an agreement with Metrolinx to sell a portion of the property known as the Oakville subdivision in Toronto, Ontario, together with the rail fixtures and certain passenger agreements (collectively the "Oakville subdivision"), for proceeds of $168 million before transaction costs, of which $24 million was placed in escrow at the time of disposal and was entirely released by December 31, 2010 in accordance with the terms of the agreement. Under the agreement, the Company obtained the perpetual right to operate freight trains over the Oakville subdivision at its then current level of operating activity, with the possibility of increasing its operating activity for additional consideration. The transaction resulted in a gain on disposal of $152 million ($131 million after-tax) that was recorded in Other income under the full accrual method of accounting for real estate transactions.

2009

Lower Newmarket subdivision

In November 2009, the Company entered into an agreement with Metrolinx to sell the property known as the Lower Newmarket subdivision in Vaughan and Toronto, Ontario, together with the rail fixtures and certain passenger agreements (collectively the "Lower Newmarket subdivision"), for cash proceeds of $71 million before transaction costs. Under the agreement, the Company obtained the perpetual right to operate freight trains over the Lower Newmarket subdivision at its then current level of operating activity, with the possibility of increasing its operating activity for additional consideration. The transaction resulted in a gain on disposal of $69 million ($59 million after-tax) that was recorded in Other income under the full accrual method of accounting for real estate transactions.

Weston subdivision

In March 2009, the Company entered into an agreement with GO Transit to sell the property known as the Weston subdivision in Toronto, Ontario, together with the rail fixtures and certain passenger agreements (collectively the "Weston subdivision"), for cash proceeds of $160 million before transaction costs, of which $50 million placed in escrow at the time of disposal was entirely released by December 31, 2009 in accordance with the terms of the agreement. Under the agreement, the Company obtained the perpetual right to operate freight trains over the Weston subdivision at its then current level of operating activity, with the possibility of increasing its operating activity for additional consideration. The transaction resulted in a gain on disposal of $157 million ($135 million after-tax) that was recorded in Other income under the full accrual method of accounting for real estate transactions.

6 – Intangible and other assets

In millions	December 31,	2011	2010
		$ 98	$ 101

Deferred and long-term receivables		
Intangible assets (A)	54	54
Investments (B)	31	25
Pension asset (Note 12)	-	442
Other	78	77
Total intangible and other assets	$ 261	$ 699

A. Intangible assets

Intangible assets consist mainly of customer contracts and relationships assumed through past acquisitions.

B. Investments

As at December 31, 2011, the Company had $21 million ($21 million as at December 31, 2010) of investments accounted for under the equity method and $10 million ($4 million as at December 31, 2010) of investments accounted for under the cost method.

7 – Accounts payable and other

In millions	December 31,	2011	2010
Trade payables	$	445	$ 383
Payroll-related accruals		343	292
Income and other taxes		130	170
Accrued interest		123	104
Accrued charges		121	97
Personal injury and other claims provisions (Note 17)		84	83
Stock-based incentives liability (Note 11)		84	37
Environmental provisions (Note 17)		63	34
Other postretirement benefits liability (Note 12)		18	18
Other		169	148
Total accounts payable and other	$	1,580	$ 1,366

8 – Other liabilities and deferred credits

In millions	December 31,	2011	2010
Personal injury and other claims provisions, net of current portion (Note 17)	$	226	$ 263
Stock-based incentives liability, net of current portion (Note 11)		180	162
Environmental provisions, net of current portion (Note 17)		89	116
Deferred credits and other		267	282
Total other liabilities and deferred credits	$	762	$ 823

9 – Long-term debt

In millions			Maturity	Outstanding US dollar-denominated amount	December 31, 2011	December 31, 2010
Debentures and notes: (A)						
Canadian National series:						
	6.38%	10-year notes (B)	Oct. 15, 2011	$ -	$ -	$ 398
	4.40%	10-year notes (B)	Mar. 15, 2013	400	407	398
	4.95%	6-year notes (B)	Jan. 15, 2014	325	331	323
	5.80%	10-year notes (B)	June 1, 2016	250	254	249
	1.45%	5-year notes (B)	Dec. 15, 2016	300	305	-
	5.85%	10-year notes (B)	Nov. 15, 2017	250	254	249
	5.55%	10-year notes (B)	May 15, 2018	325	331	323
	6.80%	20-year notes (B)	July 15, 2018	200	203	199
	5.55%	10-year notes (B)	Mar. 1, 2019	550	559	547
	2.85%	10-year notes (B)	Dec. 15, 2021	400	407	-
	7.63%	30-year debentures	May 15, 2023	150	153	149
	6.90%	30-year notes (B)	July 15, 2028	475	483	472
	7.38%	30-year debentures (B)	Oct. 15, 2031	200	203	199
	6.25%	30-year notes (B)	Aug. 1, 2034	500	509	497
	6.20%	30-year notes (B)	June 1, 2036	450	458	448
	6.71%	Puttable Reset Securities PURSSM (B)	July 15, 2036	250	254	249
	6.38%	30-year debentures (B)	Nov. 15, 2037	300	305	298
Illinois Central series:						
	5.00%	99-year income debentures	Dec. 1, 2056	7	7	7
	7.70%	100-year debentures	Sep. 15, 2096	125	127	124
Total US dollar-denominated debentures and notes				$ 5,457	5,550	5,129
BC Rail series:						
	Non-interest bearing 90-year subordinated notes (C)		July 14, 2094		842	842
Total debentures and notes					6,392	5,971
Other:						
	Commercial paper (G) (H)				82	-
	Capital lease obligations and other (D)				957	952
Total debt, gross					7,431	6,923
Less:						
	Net unamortized discount				855	852
Total debt (1) (E)					6,576	6,071

Less:		
Current portion of long-term debt (E)	135	540
Total long-term debt	$ 6,441	$ 5,531

(1) See Note 18 - Financial Instruments, for the fair value of debt.

Footnotes to the table follows on the next page

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

B. 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.

C. The Company records these notes as a discounted debt of $8 million, using an imputed interest rate of 5.75%. The discount of $834 million is included in the net unamortized discount.

D. During 2011, the Company recorded $87 million in assets it acquired through equipment leases ($132 million in 2010), for which an equivalent amount was recorded in debt.
Interest rates for capital lease obligations range from approximately 0.7% to 11.8% with maturity dates in the years 2012 through 2037. The imputed interest on these leases amounted to $299 million as at December 31, 2011 and $342 million as at December 31, 2010.
The capital lease obligations are secured by properties with a net carrying amount of $993 million as at December 31, 2011 and $1,036 million as at December 31, 2010.

E. Long-term debt maturities, including repurchase arrangements and capital lease repayments on debt outstanding as at December 31, 2011, for the next five years and thereafter, are as follows:

In millions	Capital leases	Debt	Total
2012 (1)	$ 53	$ 82	$ 135
2013	108	404	512
2014	209	328	537
2015	81	-	81
2016	269	557	826
2017 and thereafter	235	4,250	4,485
	$ 955	$ 5,621	$ 6,576

(1) Current portion of long-term debt.

F. The aggregate amount of debt payable in US currency as at December 31, 2011 was US$6,295 million (C$6,402 million), including US$757 million relating to capital leases and other, and US$5,914 million (C$5,882 million), including US$757 million relating to capital leases and other, as at December 31, 2010.

G. In May 2011, the Company entered into a $800 million four-year revolving credit facility agreement with a consortium of lenders. The agreement allows for an increase in amount, up to a maximum of $500 million, as well as the option to extend the term by an additional year at each anniversary date, subject to the consent of individual lenders. The credit facility, containing customary terms and conditions, is available for general corporate purposes, including back-stopping the Company’s 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 credit facility agreement has one financial covenant, which limits debt as a percentage of total capitalization, and with which the Company is in compliance. This facility replaces the US$1 billion credit facility that was scheduled to expire in October 2011. As at December 31, 2011 and December 31, 2010, the Company had no outstanding borrowings under its revolving credit facility.

H. The Company has a commercial paper program, which is backed by its revolving credit facility, enabling it to issue commercial paper up to a maximum aggregate principal amount of $800 million, or the US dollar equivalent. As at December 31, 2011, the Company had borrowings of $82 million (US$81 million) of commercial paper (nil as at December 31, 2010) which were presented in Current portion of long-term debt on the Balance Sheet. The weighted-average interest rate on these borrowings was 0.20%.

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I. In April 2011, the Company entered into a series of three-year bilateral letter of credit facility agreements with various banks to support its requirements to post letters of credit in the ordinary course of business. As at December 31, 2011, from a total committed amount of $520 million by the various banks, the Company had letters of credit drawn of $499 million ($436 million as at December 31, 2010, under its previous US$1 billion credit facility). Under these agreements, the Company has the option from time to time to pledge collateral in the form of cash or cash equivalents, for a minimum term of three months, equal to at least the face value of the letters of credit issued. As at December 31, 2011, cash and cash equivalents of $499 million were pledged as collateral and recorded as Restricted cash and cash equivalents.

10 – 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

The following table provides the activity of the issued and outstanding common shares of the Company for the last three years ended December 31, 2011:

In millions	Year ended December 31,	2011	2010	2009
Issued and outstanding common shares at beginning of year		459.4	471.0	468.2
Number of shares repurchased through buyback programs		(19.9)	(15.0)	-
Stock options exercised		2.6	3.4	2.8
Issued and outstanding common shares at end of year		442.1	459.4	471.0

Share repurchase programs

In January 2011, the Board of Directors of the Company approved a share repurchase program which allowed for the repurchase of up to 16.5 million common shares to the end of December 2011 pursuant to a normal course issuer bid, at prevailing market prices plus brokerage fees, or such other prices as may be permitted by the Toronto Stock Exchange. This share repurchase program was completed by September 30, 2011.

In October 2011, the Board of Directors of the Company approved a new share repurchase program which allows for the repurchase of up to 17.0 million common shares between October 28, 2011 and October 27, 2012 pursuant to a normal course issuer bid at prevailing market prices plus brokerage fees, or such other prices as may be permitted by the Toronto Stock Exchange.

The following table provides the activities under such share repurchase programs, as well as the share repurchase programs of the prior years:

In millions, except per share data	2011	2010	2009

	Year ended December 31,		
Number of common shares (1)	19.9	15.0	-
Weighted-average price per share (2)	$ 71.33	$ 60.86	$ -
Amount of repurchase	$ 1,420	$ 913	$ -

(1) Includes common shares purchased in the first and fourth quarters of 2011 and in the second and third quarters of 2010 pursuant to private agreements between the Company and arm's-length third-party sellers.

(2) Includes brokerage fees.

11 – Stock plans

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

A. Employee Share Investment Plan

The Company has an Employee Share Investment Plan (ESIP) giving eligible employees the opportunity to subscribe for up to 10% 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.

The following table provides the number of participants holding shares, the total number of ESIP shares purchased on behalf of employees, including the Company's contributions, as well as the resulting expense recorded for the years ended December 31, 2011, 2010 and 2009:

Year ended December 31,	2011	2010	2009
Number of participants holding shares	16,218	14,997	14,152
Total number of ESIP shares purchased on behalf of employees (millions)	1.3	1.3	1.6
Expense for Company contribution (millions)	$ 21	$ 19	$ 18

B. Stock-based compensation plans

The following table provides the total stock-based compensation expense for awards under all plans, as well as the related tax benefit recognized in income, for the years ended December 31, 2011, 2010 and 2009:

In millions Year ended December 31,	2011	2010	2009
Cash settled awards			
Restricted share unit plan	$ 81	$ 77	$ 43
Voluntary Incentive Deferral Plan (VIDP)	21	18	33
	102	95	76
Stock option awards	10	9	14
Total stock-based compensation expense	$ 112	$ 104	$ 90
Tax benefit recognized in income	$ 24	$ 27	$ 26

(i) Cash settled awards

Restricted share units

The Company has granted restricted share units (RSUs), 0.5 million in 2011, 0.5 million in 2010 and 0.9 million in 2009, 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 ("plan period") and vest conditionally upon the attainment of a target relating to return on invested capital (ROIC) over the plan period. Such performance vesting criteria results in a performance vesting factor that ranges from 0% to 150% depending on the level of ROIC attained.

Payout is conditional upon the attainment of a minimum share price, calculated using the average of the last three months of the plan period. In addition, commencing at various dates, for senior and executive management employees (“executive employees”), payout for RSUs is also conditional on compliance with the conditions of their benefit plans, award or employment agreements, including but not limited to non-compete, non-solicitation and non-disclosure of confidential information conditions. Current or former executive employees who breach such conditions of their benefit plans, award or employment agreements will forfeit the RSU payout. Should the Company reasonably determine that a current or former executive employee may have violated the conditions of their benefit plans, award or employment agreement, the Company may at its discretion change the manner of vesting of the RSUs to suspend payout on any RSUs pending resolution of such matter.

The value of the payout is equal to the number of RSUs awarded multiplied by the performance vesting factor and by the 20-day average closing share price ending on January 31 of the following year. On December 31, 2011, for the 2009 grant, the level of ROIC attained resulted in a performance vesting factor of approximately 120%. As the minimum share price condition was met, payout under the plan of approximately $80 million, calculated using the Company's average share price during the 20-day period ending on January 31, 2012 and will be paid to employees meeting the conditions of their benefit plans, award or employment agreements in the first quarter of 2012. In addition, the Company has suspended the RSU payout of approximately $18 million included in the above amount, to its former Chief Executive Officer (CEO) pending resolution with the former CEO of issues relating to his compliance with the non-compete, non-solicitation and non-disclosure of confidential information conditions contained in the former CEO's employment agreement and in respect of which the Company has commenced legal proceedings.
As at December 31, 2011, 0.2 million RSUs remained authorized for future issuance under this plan.

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 four 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. The Company's liability for DSUs is marked-to-market at each period-end based on the Company's closing stock price.

The following table provides the 2011 activity for all cash settled awards:

	RSUs		VIDP	
In millions	Nonvested	Vested	Nonvested	Vested
Outstanding at December 31, 2010	1.3	0.7	-	1.5
Granted (Payout)	0.5	(0.7)	-	(0.1)
Vested during year	(0.9)	0.9	-	-
Outstanding at December 31, 2011	0.9	0.9	-	1.4

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The following table provides valuation and expense information for all cash settled awards:

In millions, unless otherwise indicated	RSUs (1)						VIDP (2)	Total
Year of grant	2011	2010	2009	2008	2007	2006		
Stock-based compensation expense (recovery) recognized over requisite service period								
Year ended December 31, 2011	$ 19	$ 27	$ 35	$ -	N/A	N/A	$ 21	$ 102
Year ended December 31, 2010	N/A	$ 17	$ 34	$ 26	$ -	N/A	$ 18	$ 95
Year ended December 31, 2009	N/A	N/A	$ 13	$ 3	$ 29	$ (2)	$ 33	$ 76
Liability outstanding								
December 31, 2011	$ 19	$ 44	$ 82	N/A	N/A	N/A	$ 119	$ 264
December 31, 2010	N/A	$ 17	$ 46	$ 37	N/A	N/A	$ 99	$ 199
Fair value per unit								
December 31, 2011 ($)	$ 60.48	$ 77.59	$ 80.15	N/A	N/A	N/A	$ 80.15	N/A
Fair value of awards vested during the year								
Year ended December 31, 2011	$ -	$ -	$ 82	N/A	N/A	N/A	$ 1	$ 83
Year ended December 31, 2010	N/A	$ -	$ -	$ 37	N/A	N/A	$ 1	$ 38
Year ended December 31, 2009	N/A	N/A	$ -	$ -	$ 38	N/A	$ 3	$ 41
Nonvested awards at December 31, 2011								
Unrecognized compensation cost	$ 20	$ 14	$ -	N/A	N/A	N/A	$ 1	$ 35
Remaining recognition period (years)	2.0	1.0	N/A	N/A	N/A	N/A	N/A (3)	N/A
Assumptions (4)								
Stock price ($)	$ 80.15	$ 80.15	$ 80.15	N/A	N/A	N/A	$ 80.15	N/A
	18%	18%	N/A	N/A	N/A	N/A	N/A	N/A

Expected stock price volatility (5)								
Expected term (years) (6)	2.0	1.0	N/A	N/A	N/A	N/A	N/A	N/A
Risk-free interest rate (7)	0.95%	0.92%	N/A	N/A	N/A	N/A	N/A	N/A
Dividend rate ($) (8)	$ 1.30	$ 1.30	$ N/A	N/A	N/A	N/A	N/A	N/A

(1) Compensation cost is based on the fair value of the awards at period-end using the lattice-based valuation model that uses the assumptions as presented herein.
(2) Compensation cost is based on intrinsic value.
(3) The remaining recognition period has not been quantified as it relates solely to the 25% Company grant and the dividends earned thereon, representing a minimal number of units.
(4) Assumptions used to determine fair value are at December 31, 2011.
(5) Based on the historical volatility of the Company's stock over a period commensurate with the expected term of the award.
(6) Represents the remaining period of time that awards are expected to be outstanding.
(7) Based on the implied yield available on zero-coupon government issues with an equivalent term commensurate with the expected term of the awards.
(8) Based on the annualized dividend rate.

(ii) Stock option awards

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, 2011, 11.0 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; and performance-accelerated stock options. As at December 31, 2011, the performance-accelerated stock options were fully vested.

For 2011, 2010 and 2009, the Company granted 0.6 million, 0.7 million and 1.2 million, respectively, of conventional stock options to designated senior management employees that vest over a period of four years of continuous employment.

The total number of options outstanding at December 31, 2011, for conventional and performance-accelerated options was 5.3 million and 1.6 million, respectively.

The following table provides the activity of stock option awards during 2011, and for options outstanding and exercisable at December 31, 2011, the weighted-average exercise price.

	Options outstanding		Nonvested options	
	Number of options In millions	Weighted-average exercise price	Number of options In millions	Weighted-average grant date fair value
Outstanding at December 31, 2010 (1)	8.9	$ 34.23	2.3	$ 12.80
Granted	0.6	$ 68.94	0.6	$ 15.66
Exercised	(2.6)	$ 26.94	N/A	N/A
Vested	N/A	N/A	(0.9)	$ 12.83
Outstanding at December 31, 2011 (1)	6.9	$ 40.80	2.0	$ 13.71
Exercisable at December 31, 2011 (1)	4.9	$ 35.58	N/A	N/A

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

The following table provides the number of stock options outstanding and exercisable as at December 31, 2011 by range of exercise price and their related intrinsic value, and for options outstanding, the weighted-average years to expiration. The table also provides the aggregate intrinsic value for in-the-money stock options, which represents the value that would have been received by option holders had they exercised their options on December 31, 2011 at the Company's closing stock price of $80.15.

	Options outstanding				Options exercisable		
Range of exercise prices	Number of options	Weighted-average years to expiration	Weighted-average exercise price	Aggregate intrinsic value	Number of options	Weighted-average exercise price	Aggregate intrinsic value

	In millions			In millions	In millions		In millions
\$ 11.63 - \$ 20.51	1.5	1.1	\$ 20.42	\$ 92	1.5	\$ 20.42	\$ 92
\$ 20.52 - \$ 30.19	0.6	1.0	\$ 26.67	29	0.6	\$ 26.67	29
\$ 30.20 - \$ 40.22	0.9	5.9	\$ 35.18	40	0.5	\$ 35.46	24
\$ 40.23 - \$ 50.69	2.0	5.6	\$ 46.11	69	1.6	\$ 46.28	54
\$ 50.70 - \$ 78.24	1.9	7.5	\$ 58.74	40	0.7	\$ 52.50	18
Balance at December 31, 2011 (1)	6.9	4.8	\$ 40.80	\$ 270	4.9	\$ 35.58	\$ 217

(1) Stock options with a US dollar exercise price have been translated to Canadian dollars using the foreign exchange rate in effect at the balance sheet date. As at December 31, 2011, all stock options outstanding were in-the-money. The weighted-average years to expiration of exercisable stock options is 3.5 years.

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Notes to Consolidated Financial Statements U.S. GAAP

The following table provides valuation and expense information for all stock option awards:

In millions, unless otherwise indicated Year of grant	2011	2010	2009	2008	2007	2006	2005	Total
Stock-based compensation expense recognized over requisite service period (1)								
Year ended December 31, 2011	$ 5	$ 2	$ 2	$ 1	$ -	N/A	N/A	$ 10
Year ended December 31, 2010	N/A	$ 4	$ 2	$ 2	$ 1	$ -	N/A	$ 9
Year ended December 31, 2009	N/A	N/A	$ 9	$ 1	$ 2	$ 2	$ -	$ 14
Fair value per unit								
At grant date ($)	$ 15.66	$ 13.09	$ 12.60	$ 12.44	$ 13.37	$ 13.80	$ 9.19	N/A
Fair value of awards vested during the year								
Year ended December 31, 2011	$ -	$ 2	$ 4	$ 3	$ 3	N/A	N/A	$ 12
Year ended December 31, 2010	N/A	$ -	$ 4	$ 3	$ 3	$ 3	N/A	$ 13
Year ended December 31, 2009	N/A	N/A	$ -	$ 3	$ 3	$ 3	$ 3	$ 12
Nonvested awards at December 31, 2011								
Unrecognized compensation cost	$ 5	$ 3	$ 2	$ -	$ -	N/A	N/A	$ 10
Remaining recognition period (years)	3.0	2.0	1.0	-	-	N/A	N/A	N/A
Assumptions								
Grant price ($)	$ 68.94	$ 54.76	$ 42.14	$ 48.51	$ 52.79	$ 51.51	$ 36.33	N/A
Expected stock price volatility (2)	26%	28%	39%	27%	24%	25%	25%	N/A
Expected term (years) (3)	5.3	5.4	5.3	5.3	5.2	5.2	5.2	N/A
Risk-free interest rate (4)	2.53%	2.44%	1.97%	3.58%	4.12%	4.04%	3.50%	N/A

Dividend rate ($) (5)	$ 1.30	$ 1.08	$ 1.01	$ 0.92	$ 0.84	$ 0.65	$ 0.50	N/A

(1) Compensation cost is based on the grant date fair value using the Black-Scholes option-pricing model that uses the assumptions at the grant date.

(2) Based on the average of the historical volatility of the Company's stock over a period commensurate with the expected term of the award and the implied volatility from traded options on the Company's stock.

(3) Represents the period of time that awards are expected to be outstanding. The Company uses historical data to estimate option exercise and employee termination, and groups of employees that have similar historical exercise behavior are considered separately.

(4) Based on the implied yield available on zero-coupon government issues with an equivalent term commensurate with the expected term of the awards.

(5) Based on the annualized dividend rate.

The following table provides information related to stock options exercised during the years ended December 31, 2011, 2010 and 2009:

In millions	Year ended December 31,	2011	2010	2009
Total intrinsic value		$ 122	$ 125	$ 93
Cash received upon exercise of options		$ 68	$ 87	$ 53
Related excess tax benefit realized		$ 9	$ 28	$ 20

(iii) Stock price volatility

Compensation cost for the Company’s RSU plans is based on the fair value of the awards at period end using the lattice-based valuation model for which a primary assumption is the Company’s share price. In addition, the Company’s liability for the VIDP is marked-to-market at period-end and, as such, is also reliant on the Company’s share price. Fluctuations in the Company’s share price cause volatility to stock-based compensation expense as recorded in net income. The Company does not currently hold any derivative financial instruments to manage this exposure. A $1 increase in the Company’s share price at December 31, 2011 would have increased stock-based compensation expense by $3 million, whereas a $1 decrease in the price would have reduced it by $4 million.

12 – Pensions and other postretirement benefits

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. Senior and executive management ("executive employees") subject to certain minimum service and age requirements, are also eligible for an additional retirement benefit under their Special Retirement Stipend Agreements ("SRS"), the Supplemental Executive Retirement Plan ("SERP") or the Defined Contribution Supplemental Executive Retirement Plan ("DC SERP"). Executive employees who breach the non-compete, non-solicitation and non-disclosure of confidential information conditions of the SRS, SERP or DC SERP plans or other employment agreement will forfeit the retirement benefit under these plans. Should the Company reasonably determine that a current or former executive employee may have violated the conditions of their SRS, SERP, or DC SERP plan or other employment agreement, the Company may at its discretion withhold or suspend payout of the retirement benefit pending resolution of such matter. The Company has suspended payment of the $1.5 million annual retirement benefit due to its former Chief Executive Officer (CEO) pending resolution with the former CEO of issues relating to his compliance with the non-compete, non-solicitation and non-disclosure of confidential information conditions contained in the former CEO's employment agreement and in respect of which the Company has commenced legal proceedings.
The Company also offers postretirement benefits to certain employees providing life insurance, medical benefits and, for a closed group of employees, free rail travel benefits during retirement. These postretirement benefits are funded as they become due. The information in the tables that follow pertains to all of the Company's defined benefit plans. However, the following descriptions relate solely to the Company's main pension plan, the CN Pension Plan, unless otherwise specified.

A. Description of the CN Pension Plan

The CN Pension 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 Company's pension trust funds (including the CN Pension Trust Fund). As Trustee, the trust company performs certain duties, which include holding legal title to the assets of the CN Pension Trust Fund and ensuring that the Company, as Administrator, complies with the provisions of the CN Pension Plan and the related legislation. The Company utilizes a measurement date of December 31 for the CN Pension Plan.

B. Funding policy

Employee contributions to the CN Pension 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, including amendments thereto, and are determined by actuarial valuations. Due to recent legislative changes, actuarial valuations will be required on an annual basis effective for years ending on or after December 31, 2011 for all Canadian plans, or when deemed appropriate by the Office of the Superintendent of Financial Institutions (OSFI). These actuarial valuations are prepared in accordance with legislative requirements and with the recommendations of the Canadian Institute of Actuaries for the valuation of pension plans. The most recently filed actuarial valuation of the CN Pension Plan was conducted as at December 31, 2008 and indicated a funding excess on a going concern and solvency basis. The Company's next actuarial valuation required as at December 31, 2011 will be performed in 2012. While this actuarial valuation is expected to identify a going concern surplus of approximately $1 billion, on a solvency basis a funding deficit of approximately $1.4 billion is expected due to the level of interest rates applicable during that measurement period and the pension plan asset returns. The federal pension legislation requires funding deficits, as calculated under current pension regulations, to be paid over a number of years. Actuarial valuations are also required annually for the Company's U.S. pension plans.

In 2011, in anticipation of its future funding requirements, the Company made voluntary contributions of $350 million in excess of the required contributions mainly to strengthen the financial position of its main pension plan, the CN Pension Plan. The Company has been advised by the OSFI that this contribution can be treated as a prepayment against its 2012 pension deficit funding requirements. As a result, the Company's cash contributions for 2012 are expected to be in the range of approximately $275 million to $575 million for all its pension plans and include a voluntary contribution of approximately $150 million to $450 million. As at February 3, 2012, the Company contributed $250 million to its defined benefit pension plans including a $150 million voluntary contribution.

C. Plan assets

The assets of the Company's various plans are held in separate trust funds which are diversified by asset type, country and investment strategies. Each year, the CN Board of Directors reviews and confirms or amends the Statement of Investment Policies and Procedures (SIPP) which includes the plans' long-term asset class mix and related benchmark indices (Policy). This Policy is based on a long-term forward-looking view of the world economy, the dynamics of the plans' benefit liabilities, the market return expectations of each asset class and the current state of financial markets. The Policy mix in 2011 was: 2% cash and short-term investments, 38% bonds, 47% equities, 4% real estate, 5% oil and gas and 4% infrastructure assets.

Annually, the CN Investment Division, a division of the Company created to invest and administer the assets of the plans, proposes a short-term asset mix target (Strategy) for the coming year, which is expected to differ from the Policy, because of current economic and market conditions and expectations. The Investment Committee of the Board (Committee) regularly compares the actual asset mix to the Policy and Strategy asset mixes and evaluates the actual performance of the trust funds in relation to the performance of the Policy, calculated using Policy asset mix and the performance of the benchmark indices.

The Committee's approval is required for all major investments in illiquid securities. The SIPP allows for the use of derivative financial instruments to implement strategies or to hedge or adjust existing or anticipated exposures. The SIPP prohibits investments in securities of the Company or its subsidiaries. Investments held in the trust funds consist mainly of the following:

(i) Cash, short-term investments and bonds consist primarily of highly liquid securities which ensure adequate cash flows are available to cover near-term benefit payments. Short-term securities are almost exclusively obligations issued by Canadian chartered banks. As at December 31 2011, 93% of bonds were issued or guaranteed by Canadian, U.S. or other governments.

(ii) Mortgages consist of mortgage products which are primarily conventional or participating loans secured by commercial properties and publicly traded REITs (Real Estate Investment Trust).

(iii) Equity investments are well diversified by country, issuer and industry sector. The most significant allocation either to an individual issuer or industry sector was approximately 4% and 21%, respectively, in 2011.

(iv) Real estate is a diversified portfolio of Canadian land and commercial properties.

(v) Oil and gas investments include petroleum and natural gas properties operated by the trusts' wholly-owned subsidiaries and Canadian marketable securities.

(vi) Infrastructure investments are publically traded trust units, participations in private infrastructure funds and public debt and equity securities of infrastructure and utility companies.

(vii) Absolute return investments are a portfolio of units of externally managed hedge funds.

The plans' investment manager monitors market events and exposures to markets, currencies and interest rates daily. When investing in foreign securities, the plans are exposed to foreign currency risk that may be adjusted or hedged; the effect of which is included in the valuation of the foreign securities. Net of the effects mentioned above, the plans were 71% exposed to the Canadian dollar, 7% to European currencies, 11% to the US dollar and 11% to various other currencies as at December 31, 2011. Interest rate risk represents the risk that the fair value of the investments will fluctuate due to changes in market interest rates. Sensitivity to interest rates is a function of the timing and amount of cash flows of the assets and liabilities of the plans. To manage credit risk, established policies require dealing with counterparties considered to be of high credit quality. Derivatives are used from time to time to adjust asset mix or exposures to foreign currencies, interest rate or market risks of the portfolio or anticipated transactions. Derivatives are contractual agreements whose value is derived from interest rates, foreign exchange rates, equity or commodity prices. When derivatives are used for hedging purposes, the gains or losses on the derivatives are offset by a corresponding change in the value of the hedged assets. Derivatives may include forwards, futures, swaps and options.

The tables on the following page present the fair value of plan assets excluding the economic exposure of derivatives as at December 31, 2011 and 2010 by asset class, their level within the fair value hierarchy and the valuation techniques and inputs used to measure such fair value.

In millions, unless otherwise indicated			Fair value measurements at December 31, 2011		
Asset class	Total	Percentage of total assets	Level 1	Level 2	Level 3
Cash and short-term investments (1)	$ 1,026	7.0%	$ 21	$ 1,005	$ -
Bonds (2)					
Canada and supranational	1,650	11.2%	-	1,650	-
Provinces of Canada	1,937	13.1%	-	1,937	-
Emerging market debt	288	2.0%	-	288	-
Mortgages (3)	178	1.2%	8	170	-
Equities (4)					
Canadian	2,395	16.3%	2,373	-	22
U.S.	1,125	7.6%	1,087	38	-
International	2,712	18.4%	2,680	32	-
Real estate (5)	214	1.5%	-	-	214
Oil and gas (6)	1,232	8.4%	343	-	889
Infrastructure (7)	707	4.8%	9	79	619
Absolute return (8)				-	-
Multi-strategy funds	358	2.4%	-	358	-
Fixed income funds	214	1.5%	-	214	-
Equity funds	260	1.8%	-	260	-
Global macro funds	368	2.5%	-	368	-
	$ 14,664	99.7%	$ 6,521	$ 6,399	$ 1,744
Other (9)	55	0.3%			
Total plan assets	$ 14,719	100%			

In millions, unless otherwise indicated			Fair value measurements at December 31, 2010		
Asset class	Total	Percentage of total assets	Level 1	Level 2	Level 3
Cash and short-term investments (1)	$ 429	2.8%	$ 429	$ -	$ -
Bonds (2)					
Canada and supranational	2,013	13.3%	-	2,013	-
Provinces of Canada	1,292	8.6%	-	1,292	-
Corporate	92	0.6%	-	92	-
Emerging market debt	318	2.1%	-	318	-
Mortgages (3)	205	1.4%	30	175	-
Equities (4)					
Canadian	3,228	21.4%	3,204	-	24
U.S.	1,316	8.7%	1,316	-	-
International	3,076	20.4%	3,076	-	-
Real estate (5)	318	2.1%	-	-	318

Oil and gas (6)	1,141	7.6%	289	-	852
Infrastructure (7)	607	4.0%	29	85	493
Absolute return (8)					
Multi-strategy funds	311	2.1%	-	106	205
Fixed income funds	197	1.3%	-	197	-
Commodity funds	75	0.5%	-	75	-
Equity funds	148	1.0%	-	147	1