Q. **Re: NLH Evidence, Section 4, page 4.21, lines 6-13.**

A number of deferral mechanisms are listed.

Please provide schedules indicating the evolution of each of these accounts since 2002.

A. Please refer to the Notes in the Attachments in the following table for the evolution of the deferral mechanisms since 2002.

Year	Attachment	Note
2002	IN-NLH-118 Attachment 1	Note 7
2003	IN-NLH-118 Attachment 2	Note 6
2004	IN-NLH-118 Attachment 3	Note 6
2005	IN-NLH-118 Attachment 4	Note 3
2006	IN-NLH-118 Attachment 5	Note 3
2007	IN-NLH-118 Attachment 6	Note 4
2008	IN-NLH-118 Attachment 7	Note 4
2009	IN-NLH-118 Attachment 8	Note 4
2010	IN-NLH-118 Attachment 9	Note 4
2011	CA-NLH-125 Attachment 1	Note 5
2012	CA-NLH-125 Attachment 2	Note 5

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2002

AUDITORS' REPORT

To the **Lieutenant-Governor in Council**
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of **Newfoundland and Labrador Hydro** as at December 31, 2002 and the consolidated statements of income and retained earnings and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2002 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

St. John's, Newfoundland and Labrador,
Canada,
February 14, 2003.

Ernst & Young LLP
Chartered Accountants

BOARD OF DIRECTORS

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Senior Vice President, Government Relations
Rogers Communications

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Deputy Minister
Mines and Energy

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Professional Engineer (Retired)

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MoneyWit Inc.

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Newfoundland and Labrador Hydro

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Vice-President, Transmission and Rural Operations

PETER A. HICKMAN
Assistant Corporate Secretary

JOHN C. ROBERTS
Corporate Controller

MARK G.S. BRADBURY
Treasurer

GERALD C. BOWERS
Assistant Treasurer

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland
A1B 4K7

(1) Resigned November 25, 2002
(2) Retired December 31, 2002

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2002**	2001 (Note 2)
ASSETS		
Capital assets (Note 3)		
Capital assets in service	**2,604.7**	2,566.8
Less contributions in aid of construction	**108.9**	109.9
	2,495.8	2,456.9
Less accumulated depreciation	**745.7**	707.6
	1,750.1	1,749.3
Construction in progress	**154.6**	88.7
	1,904.7	1,838.0
Current assets		
Cash and cash equivalents	**0.2**	1.1
Short-term investments	**-**	4.0
Accounts receivable	**62.0**	56.4
Current portion of rate stabilization plan	**-**	21.1
Current portion of long-term receivable (Note 4)	**27.5**	10.3
Fuel and supplies at average cost	**48.0**	46.3
Prepaid expenses	**2.5**	2.0
	140.2	141.2
Long-term receivables (Note 4)	**110.6**	33.1
Sinking funds (Note 10)	**48.7**	42.7
Investments (Note 5)	**5.2**	5.2
Rate stabilization plan	**20.5**	63.9
Deferred charges (Note 7)	**89.4**	100.1
	2,319.3	2,224.2

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2002**	2001 (Note 2)
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 8)	**1,354.9**	1,156.7
Current liabilities		
Bank indebtedness	**4.4**	2.1
Short-term borrowing	**3.3**	-
Accounts payable and accrued liabilities	**59.3**	48.7
Accrued interest	**27.7**	25.5
Long-term debt due within one year (Note 8)	**50.2**	146.3
Promissory notes (Note 8)	**181.5**	138.0
	326.4	360.6
Employee future benefits (Note 9)	**29.6**	28.5
Non-controlling interest in LCDC	**14.8**	14.8
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Note 5)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**100.0**	100.0
Retained earnings	**453.5**	523.5
	593.6	663.6
Commitments and contingencies (Note 12)	**-**	-
	2,319.3	2,224.2

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2002**	2001 (Note 2)
Revenue		
Energy sales	**399.6**	374.8
Recovery of costs in rate stabilization plan	**14.0**	11.2
Guaranteed winter availability	**9.5**	7.5
Rentals and royalties	**0.3**	0.3
Other	**4.2**	3.3
	427.6	397.1
Expenses		
Operations and administration	**125.8**	119.1
Fuels	**73.2**	50.2
Amortization of costs in rate stabilization plan	**14.0**	11.2
Power purchased	**15.8**	15.6
Depreciation	**43.0**	44.5
Interest (Note 11)	**97.8**	102.5
	369.6	343.1
Net income	**58.0**	54.0
Retained earnings, beginning of year, as previously reported	**528.6**	528.5
Less CF(L)Co foreign exchange loss (Note 2)	**5.1**	5.7
Retained earnings, as restated	**523.5**	522.8
Dividends	**128.0**	53.3
Retained earnings, end of year	**453.5**	523.5

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2002**	2001 (Note 2)
Cash provided by (used in)		
Operating activities		
Income before non-controlling interest	**58.0**	54.0
Adjusted for items not involving a cash flow		
Depreciation	**43.0**	44.5
Amortization of deferred charges	**4.0**	1.6
Rate stabilization plan	**64.5**	(49.4)
Other	**-**	3.8
Foreign exchange (gain) loss	**(0.1)**	0.5
	169.4	55.0
Change in non-cash balances related to operations		
Accounts receivable	**(5.6)**	(2.3)
Fuel and supplies	**(1.7)**	2.7
Prepaid expenses	**(0.5)**	0.5
Accounts payable and accrued liabilities	**11.8**	6.2
Accrued interest	**2.2**	(1.2)
Employee future benefits	**1.1**	1.4
Long-term receivable	**(104.8)**	2.6
	71.9	64.9
Financing activities		
Long-term debt issued	**250.0**	250.0
Long-term debt retired	**(138.1)**	(185.9)
Foreign exchange loss recovered	**8.5**	7.8
Increase in short-term borrowing	**3.3**	-
Increase in promissory notes	**43.5**	17.2
Dividends	**(128.0)**	(53.3)
	39.2	35.8
Investing activities		
Net additions to capital assets	**(109.7)**	(94.9)
Decrease in short-term investments	**4.0**	0.1
Increase in sinking funds	**(14.1)**	(11.5)
Decrease in investments	**-**	4.1
Reductions (additions) to deferred charges	**6.7**	(2.0)
Change in accounts payable related to investing activities	**(1.2)**	7.4
	(114.3)	(96.8)
Net (decrease) increase in cash	**(3.2)**	3.9
Cash position, beginning of year	**(1.0)**	(4.9)
Cash position, end of year	**(4.2)**	(1.0)
Cash position is represented by		
Cash and cash equivalents	**0.2**	1.1
Bank indebtedness	**(4.4)**	(2.1)
	(4.2)	(1.0)
Supplementary disclosure of cash flow information		
Interest income received	**1.7**	2.3
Interest paid	**104.1**	106.6

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the "Province") as a Crown corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls Power Corporation Limited, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and to conform with recommendations of the Board of Commissioners of Public Utilities ("PUB") of the Province.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates.

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's earnings from its electrical sales to most customers within the Province are regulated on the basis of return on rate base. As well, Hydro's borrowing and capital expenditure programs are subject to review and approval by the PUB.

Rates charged rural customers do not recover the full costs of providing the service but Hydro recovers the resulting deficit from other customers.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited ("GIPCo"), (100% owned) and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co") and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co subsequent to the effective date of the shareholders' agreement.

CF(L)Co is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428,000 kilowatts ("CF(L)Co Project"). A power contract with Hydro-Québec, dated May 12, 1969 ("Power Contract") provides for the sale of substantially all the energy from the CF(L)Co Project until 2041. CF(L)Co receives certain benefits from Hydro-Québec, including significant revenues, under a guaranteed winter availability contract through 2041.

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

Principles of Consolidation (cont'd.)

The cost of Hydro's investment in CF(L)Co exceeded the equity in the book value of the net assets acquired by $77.1 million. This amount is assigned to capital assets and is being amortized on a straight-line basis at the rate of 1.5% per annum. As at December 31, 2002, $32.4 million (2001 - $31.2 million) had been amortized.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co must pay rentals and royalties to the Province annually.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (the "Gull Island Project"), (Note 5).

LCDC is incorporated under the laws of Newfoundland and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (the "Lower Churchill Development"), (see Note 5).

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. There were no investments outstanding at December 31, 2002. There were short-term investments outstanding at December 31, 2001, bearing interest rates of 2.20% to 6.09% per annum.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

Hydro, GIPCo and LCDC

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Hydro has made no provision in its accounts to date for future removal and site restoration costs. The inclusion of these costs in the rate base is subject to the rate setting process.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Capital Assets and Depreciation (cont'd.)

Hydro, GIPCo and LCDC (cont'd.)

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

CF(L)Co

CF(L)Co uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

CF(L)Co has made no provision in its accounts for future removal and site restoration costs as they cannot be estimated at this time.

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Rate Stabilization Plan

On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan ("RSP") which primarily provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan do not require a reference to the PUB and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

In 2002, the PUB ordered changes with respect to the recovery of the balance in the RSP, as well as for any future balances that may accumulate. The RSP balance as at August 31, 2002 has been converted to a long-term receivable and the balance outstanding at December 31, 2002 will be recovered over five years, commencing in 2003 (Note 4). The RSP activity for the period September - December 2002 and all of 2003 will be amortized over two years, commencing in 2004.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Promissory Notes

Promissory Notes bear interest from 2.80% to 3.29% per annum (2001 - 2.15% to 3.90%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recorded on the basis of power deliveries made.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2001 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date.

(i) In the case of Hydro, foreign exchange losses related to long-term debt, including current portion, are subject to the rate setting process. The PUB has accepted the inclusion by Hydro of realized foreign exchange losses in rates charged to customers. Any such loss, net of any gain, not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. This amortization is included in interest expense. Commencing in 2002, the PUB ordered Hydro's deferred foreign exchange losses, net of the $10.0 million provision previously accumulated, be amortized over a forty-year period (Note 7).

(ii) Under the provisions of the Power Contract CF(L)Co's exposure for a foreign exchange loss is limited. CF(L)Co recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 4).

Financial Instruments

Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees, and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately twelve years.

2. ACCOUNTING CHANGE

Foreign Exchange

Churchill Falls has adopted new recommendations of the Canadian Institute of Chartered Accountants with respect to foreign exchange gains and losses. Unrealized gains and losses associated with the First Mortgage Bonds that are not recoverable from Hydro-Quebec under the Power Contract, are included in net income for the current year. Previously, these gains and losses were deferred and amortized on a straight-line basis over the remaining life of the debt. This change has been applied retroactively and prior years have been restated to reflect this change. Accordingly, the impact on the 2002 financial statements is an increase in net income of $1.2 million and the impact on the 2001 financial statements is a reduction in opening retained earnings of $5.7 million and an increase in net income of $0.6 million.

3. CAPITAL ASSETS

	Capital Assets in Service	Contributions In aid of Construction	Accumulated Depreciation	Construction In Progress
millions of dollars			**2002**	
Generation Plant				
Hydroelectric	**1,243.6**	**20.5**	**256.1**	**102.7**
Thermal	**223.5**	**-**	**173.3**	**0.2**
Diesel	**62.5**	**7.9**	**23.1**	**0.1**
Transmission and Distribution	**693.3**	**56.0**	**155.7**	**1.0**
Service facilities	**22.0**	**-**	**9.5**	**-**
Project costs (Note 5)	**96.4**	**-**	**-**	**-**
Capital studies (Note 5)	**25.0**	**-**	**-**	**-**
Other	**238.4**	**24.5**	**128.0**	**50.6**
	2,604.7	**108.9**	**745.7**	**154.6**
millions of dollars			2001	
Generation Plant				
Hydroelectric	1,240.1	20.5	245.2	40.0
Thermal	225.8	-	173.4	-
Diesel	58.7	8.3	21.7	3.3
Transmission and Distribution	666.2	56.7	140.8	1.5
Service facilities	22.0	-	9.1	-
Project costs (Note 5)	96.5	-	-	-
Capital studies (Note 5)	25.0	-	-	-
Other	232.5	24.4	117.4	43.9
	2,566.8	109.9	707.6	88.7

Included in the above amounts are CF(L)Co assets in service amounting to $633.6 million (2001 - $631.3 million) which are pledged as collateral for long-term debt.

4. LONG-TERM RECEIVABLES

millions of dollars	**2002**	2001
Previous Rate Stabilization Plan		
Retail	**76.3**	
Industrial	**28.0**	
	104.3	
Hydro-Québec		
Unrealized foreign exchange	**31.1**	41.2
Other	**2.7**	2.2
	33.8	43.4
Less due within one year	**27.5**	10.3
	110.6	33.1

The receivable arising from the RSP bears interest at the weighted average cost of capital which is approximately 7.2% and is to be recovered over a five-year period, commencing in 2003.

The other long-term receivable from Hydro-Québec bears interest at 7% per annum and is receivable over a four year period which commenced in September 2000.

5. INVESTMENTS

millions of dollars	**2002**	2001
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (the "Principal Agreement"), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo's assets and the hydroelectric development rights to the Lower Churchill River, (the "Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (the "Option Agreement"). The purchase price in respect of GIPCo's assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2003 and it is not anticipated that there will be any loss upon sale of GIPCo's assets to LCDC.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

6. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co's assets and liabilities at December 31, 2002, and its proportionate interest in CF(L)Co's operations for the year ended December 31, 2002.

millions of dollars	**2002**	2001
Current assets	**34.6**	34.9
Long-term assets	**371.7**	389.9
Current liabilities	**45.3**	40.2
Long-term liabilities	**113.9**	148.8
Revenues	**62.9**	58.6
Expenses	**49.0**	47.9
Net income	**13.9**	10.7
Cash provided by (used in)		
Operating activities	**25.4**	28.9
Financing activities	**(24.3)**	(25.0)
Investing activities	**1.6**	1.2

7. DEFERRED CHARGES

millions of dollars	**2002**	2001
Debt discount, financing expenses and other	**19.6**	26.2
Accumulated amortization	**14.3**	12.4
	5.3	13.8
Foreign exchange losses realized	**96.3**	96.3
Accumulated provision	**10.0**	10.0
	86.3	86.3
Accumulated amortization	**2.2**	-
	84.1	86.3
Net deferred charges	**89.4**	100.1

8. LONG-TERM DEBT

	Hydro	CF(L)Co	Total	Hydro	CF(L)Co	Total
millions of dollars		**2002**			2001	
Summary of long-term debt						
Long-term debt	**1,257.1**	**148.0**	**1,405.1**	1,122.3	180.7	1,303.0
Less payments due within one year	**16.1**	**34.1**	**50.2**	114.4	31.9	146.3
	1,241.0	**113.9**	**1,354.9**	1,007.9	148.8	1,156.7

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2003	2004	2005	2006	2007
	50.2	32.8	31.0	230.1	30.1

The payments due within one year include sinking fund requirements of $8.8 million (2001 - $7.3 million).

8. LONG-TERM DEBT (cont'd.)

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity	2002	2001	
millions of dollars						
Z	5.25	1997	2002	-	100.0	
AC	5.05	2001	2006	**200.0**	100.0	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**300.0**	150.0	(a)
Total debentures				**1,275.0**	1,125.0	
Less sinking fund investments in own debentures				**46.0**	37.9	
				1,229.0	1,087.1	
Government of Canada loans at 5.25% to 7.91% maturing in 2006 to 2014				**25.1**	31.0	
Other				**3.0**	4.2	
				1,257.1	1,122.3	
Less payments due within one year				**16.1**	114.4	
				1,241.0	1,007.9	

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

(a) Sinking funds have been established for these issues.

CF(L)Co

millions of dollars	2002	2001
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $63.4; 2001 - U.S. $81.8)	**100.2**	130.2
7.875% Series B due December 15, 2007	**6.4**	8.3
General Mortgage Bonds		
7.500% due December 15, 2010	**41.4**	42.2
	148.0	180.7
Less payments due within one year	**34.1**	31.9
	113.9	148.8

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There has been no contingent repayments in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

8. LONG-TERM DEBT (cont'd.)

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however fixed sinking fund payments are estimated to average $34.0 million in each of the years 2003 to 2007 inclusive.

Under the terms of long-term debt instruments, CF(L)Co may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999 places additional restrictions on dividends, based on cash flow.

9. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employers' contributions of $3.6 million (2001 - $3.4 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. Information about these plans is as follows:

millions of dollars	**2002**	2001
Accrued benefit obligation		
Balance at beginning of year	**28.5**	27.1
Current service cost	**0.9**	0.9
Interest cost	**2.0**	2.0
Actuarial loss	**7.5**	-
Past service cost	**0.4**	-
Benefits paid	**(1.8)**	(1.5)
Balance at end of year	**37.5**	28.5
Plan deficit	**37.5**	28.5
Unamortized actuarial loss	**(7.5)**	-
Unamortized past service cost	**(0.4)**	-
Accrued benefit liability at end of year	**29.6**	28.5

The most recent actuarial valuation was performed as at December 31, 2002. The significant actuarial assumptions used in measuring the company's accrued benefit obligations include a discount rate of 7.0% and an average rate of compensation increase of 3.5%. In addition, in determining the expected cost of healthcare benefits, it was assumed that healthcare costs will increase by 12.0% in 2003 and decrease gradually to 5.0% in 2010 and remain level thereafter.

The net benefit plan expense is as follows:

millions of dollars	**2002**	2001
Current service cost	**0.9**	0.9
Interest cost	**2.0**	2.0
Net benefit plan expense	**2.9**	2.9

10. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2002 and 2001 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	Fair Value	Carrying Value	Fair Value
millions of dollars		**2002**		2001
Financial Assets				
Sinking funds	**48.7**	**54.2**	42.7	43.5
Long-term receivable including amount due in one year	**138.1**	**138.2**	43.4	43.5
Financial Liabilities				
Long-term debt including amount due in one year	**1,405.1**	**1,673.6**	1,303.0	1,489.9

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value. At December 31, 2002 of the total accounts receivable balance outstanding approximately 46.9% (2001 - 45.6%) is due from a regulated utility, and 25.1% (2001 - 28.0%) from Hydro-Québec.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2028. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 5.80% to 10.55% (2001 - 5.80% to 10.55%).

11. INTEREST EXPENSE

millions of dollars	**2002**	2001	
Gross interest			
Long-term debt	**105.3**	105.6	
Promissory notes	**5.0**	6.2	
	110.3	111.8	
Amortization of debt discount and financing expenses	**1.3**	1.3	
Provision for foreign exchange losses	**2.2**	1.0	
Foreign exchange (gain) loss	**(0.1)**	0.5	
	113.7	114.6	
Less			
Recovered from Hydro-Québec	**5.3**	6.3	(a)
Interest capitalized during construction	**7.7**	5.1	
Interest earned	**15.1**	11.8	
Net interest expense	**85.6**	91.4	
Debt guarantee fee	**12.2**	11.1	
Net interest and guarantee fee	**97.8**	102.5	

(a) Under the terms of the Power Contract, CF(L)Co recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, Churchill Falls can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, Churchill Falls can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

12. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is approximately $6.4 million (2001 - $1.6 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have been commenced against Hydro by one of its customers claiming approximately $23.0 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately $23.8 million at December 31, 2002 (2001 - $80.9 million). Hydro has commenced development of a hydroelectric generating station at Granite Canal. Total project cost is expected to be approximately $134.6 million, with an anticipated in-service date of June 2003. As at December 31, 2002, $102.7 million (2001 - $40.0 million) had been expended on this project.

(d) In connection with the Granite Canal development, Hydro has issued an irrevocable Letter of Credit, in the amount of $5.4 million to ensure compliance with the terms of the Fish Habitat Compensation Agreement between Hydro and the Department of Fisheries and Oceans.

13. COMPARATIVE FIGURES

Certain of the 2001 comparative figures have been reclassified to conform with the 2002 financial statement presentation.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2003

Deloitte.

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10 Factory Lane
Fort William Building
St. John's NL A1C 6H5
Canada

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AUDITORS' REPORT

To the **Lieutenant-Governor in Council**
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of **Newfoundland and Labrador Hydro** as at December 31, 2003 and the consolidated statements of loss and retained earnings and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

The financial statements as at December 31, 2002 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated February 14, 2003.

Deloitte & Touche LLP

Chartered Accountants
St. John's, Newfoundland and Labrador
Canada
February 6, 2004

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland and Labrador
A1B 4K7

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2003**	2002
ASSETS		
Capital assets (Note 2)		
Capital assets in service	**2,632.5**	2,604.7
Less contributions in aid of construction	**106.5**	108.9
	2,526.0	2,495.8
Less accumulated depreciation	**780.5**	745.7
	1,745.5	1,750.1
Construction in progress	**47.5**	154.6
	1,793.0	1,904.7
Current assets		
Cash and cash equivalents	**0.1**	0.2
Accounts receivable	**56.5**	62.0
Current portion of long-term receivables (Note 3)	**35.5**	27.5
Fuel and supplies at average cost	**48.5**	48.0
Prepaid expenses	**2.5**	2.5
	143.1	140.2
Long-term receivables (Note 3)	**130.7**	110.6
Sinking funds (Note 9)	**70.1**	48.7
Investments (Note 4)	**5.2**	5.2
Rate stabilization plan	**-**	20.5
Deferred charges (Note 6)	**89.2**	89.4
	2,231.3	2,319.3

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2003**	2002
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 7)	**1,447.8**	1,354.9
Current liabilities		
Bank indebtedness	**6.7**	4.4
Short-term borrowing	**1.8**	3.3
Accounts payable and accrued liabilities	**51.6**	59.3
Accrued interest	**30.5**	27.7
Long-term debt due within one year (Note 7)	**30.7**	50.2
Promissory notes (Note 7)	**149.8**	181.5
	271.1	326.4
Employee future benefits (Note 8)	**32.0**	29.6
Non-controlling interest in LCDC (Note 2)	**2.5**	14.8
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Notes 2 and 4)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**100.0**	100.0
Retained earnings	**337.8**	453.5
	477.9	593.6
Commitments and contingencies (Note 11)		
	2,231.3	2,319.3

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF LOSS AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2003**	2002
Revenue		
Energy sales	**407.8**	399.6
Recovery of costs in rate stabilization plan	**16.7**	14.0
Guaranteed winter availability	**11.9**	9.5
Rentals and royalties	**0.3**	0.3
Other	**4.8**	4.2
	441.5	427.6
Expenses		
Operations and administration	**125.8**	125.8
Fuels	**84.6**	73.2
Amortization of costs in rate stabilization plan	**16.7**	14.0
Power purchased	**26.1**	15.8
Depreciation	**45.0**	43.0
Interest (Note 10)	**99.3**	97.8
	397.5	369.6
Net income before unusual items	**44.0**	58.0
Unusual items (Note 2)		
Write-down of capital assets	**(130.9)**	-
Less non-controlling interest	**12.3**	-
	(118.6)	-
Net (loss) income	**(74.6)**	58.0
Retained earnings, beginning of year	**453.5**	523.5
	378.9	581.5
Dividends	**41.1**	128.0
Retained earnings, end of year	**337.8**	453.5

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2003**	2002
Cash provided by (used in)		
Operating activities		
Net income (loss)	**(74.6)**	58.0
Adjusted for items not involving a cash flow		
Depreciation	**45.0**	43.0
Amortization of deferred charges	**4.1**	4.0
Rate stabilization plan	**20.5**	64.5
Other	**3.4**	-
Foreign exchange gain	**(1.0)**	(0.1)
Write-down of capital assets (net of non-controlling interest)	**118.6**	-
	116.0	169.4
Change in non-cash balances related to operations		
Accounts receivable	**5.5**	(5.6)
Fuel and supplies	**(0.5)**	(1.7)
Prepaid expenses	**-**	(0.5)
Accounts payable and accrued liabilities	**(8.2)**	11.8
Accrued interest	**2.8**	2.2
Employee future benefits	**2.4**	1.1
Long-term receivable	**(49.6)**	(104.8)
	68.4	71.9
Financing activities		
Long-term debt issued	**125.0**	250.0
Long-term debt retired	**(36.8)**	(138.1)
Foreign exchange loss recovered	**5.2**	8.5
Increase (decrease) in short-term borrowing	**(1.5)**	3.3
Increase (decrease) in promissory notes	**(31.7)**	43.5
Dividends	**(41.1)**	(128.0)
	19.1	39.2
Investing activities		
Net additions to capital assets	**(67.3)**	(109.7)
Decrease in short-term investments	**-**	4.0
Increase in sinking funds	**(19.2)**	(14.1)
Reductions (additions) to deferred charges	**(3.9)**	6.7
Change in accounts payable related to investing activities	**0.5**	(1.2)
	(89.9)	(114.3)
Net decrease in cash	**(2.4)**	(3.2)
Cash position, beginning of year	**(4.2)**	(1.0)
Cash position, end of year	**(6.6)**	(4.2)
Cash position is represented by		
Cash and cash equivalents	**0.1**	0.2
Bank indebtedness	**(6.7)**	(4.4)
	(6.6)	(4.2)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**0.6**	1.7
Interest paid	**109.6**	104.1

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the "Province") as a Crown corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls Power Corporation Limited, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates.

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's earnings from its electrical sales to most customers within the Province are regulated on the basis of return on rate base. As well, Hydro's borrowing and capital expenditure programs are subject to review and approval by the PUB.

Rates charged rural customers do not recover the full costs of providing the service but Hydro recovers the resulting deficit from other customers.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited ("GIPCo"), (100% owned) and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co") and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co subsequent to the effective date of the shareholders' agreement.

CF(L)Co is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428,000 kilowatts ("CF(L)Co Project"). A power contract with Hydro-Québec, dated May 12, 1969 ("Power Contract") provides for the sale of substantially all the energy from the CF(L)Co Project until 2041. CF(L)Co receives certain benefits from Hydro-Québec, including significant revenues, under a guaranteed winter availability contract through 2041.

CF(L)Co holds 33.33% of the equity share capital of Twin Falls Power Corporation Limited ("Twin Falls") and is a party with other shareholders in a participation agreement which gives CF(L)Co joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Principles of Consolidation (cont'd.)

The cost of Hydro's investment in CF(L)Co exceeded the equity in the book value of the net assets acquired by $77.1 million. This amount is assigned to capital assets and is being amortized on a straight-line basis at the rate of 1.5% per annum. As at December 31, 2003, $33.6 million (2002 - $32.4 million) had been amortized.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co must pay rentals and royalties to the Province annually.

A portion of Hydro's shareholding in CF(L)Co is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (the "Gull Island Project"), (Note 4).

LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (the "Lower Churchill Development"), (Note 4).

Twin Falls is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. As at December 31, 2003 and 2002 there were no cash equivalents or short-term investments outstanding.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

Hydro, GIPCo and LCDC

Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Hydro makes provision in its accounts for future removal and site restoration costs over the life of new assets, when such costs can be reasonably estimated and it is not expected that the asset will be replaced at the same location. For existing assets which are not expected to be replaced at the same location, net salvage costs are amortized after retirement. If an asset is expected to be replaced at the same location, net salvage costs are amortized over the life of the replacement asset.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Capital Assets and Depreciation (cont'd.)

Hydro, GIPCo and LCDC (cont'd.)

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

CF(L)Co

CF(L)Co uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

CF(L)Co has made no provision in its accounts for future removal and site restoration costs as they cannot be estimated at this time.

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Rate Stabilization Plan

On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan ("RSP") which primarily provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan do not require a reference to the PUB and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

In 2002, the PUB ordered changes with respect to the recovery of the balance in the RSP, as well as for any future balances that may accumulate. The RSP balance as at August 31, 2002 has been converted to a long-term receivable and the balance outstanding at December 31, 2002 is to be recovered over a five-year period, which commenced in 2003 (Note 3). In 2003, the PUB further ordered that the RSP activity for the period September - December 2002 and all of 2003 be consolidated with the August 2002 balance. Any subsequent balances accumulating in the RSP are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered at a rate of twenty-five percent of the outstanding balance at year-end.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Promissory Notes

Promissory Notes bear interest from 2.66% to 2.93% per annum (2002 - 2.80% to 3.29%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recorded on the basis of power deliveries made.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2002 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date.

(i) In the case of Hydro, foreign exchange losses related to long-term debt, including current portion, are subject to the rate setting process. The PUB has accepted the inclusion by Hydro of realized foreign exchange losses in rates charged to customers. Any such loss, net of any gain, not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. This amortization is included in interest expense. Commencing in 2002, the PUB ordered Hydro's deferred foreign exchange losses, net of the $10.0 million provision previously accumulated, be amortized over a forty-year period (Note 6).

(ii) Under the provisions of the Power Contract CF(L)Co's exposure for a foreign exchange loss is limited. CF(L)Co recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 3).

Financial Instruments

From time to time, Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees, and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately twelve years.

2. CAPITAL ASSETS

millions of dollars	Capital Assets in Service	Contributions In aid of Construction	Accumulated Depreciation	Construction In Progress
			2003	
Generation Plant				
Hydroelectric	**1,347.3**	**20.5**	**267.0**	**0.2**
Thermal	**227.0**	**-**	**175.7**	**-**
Diesel	**59.5**	**6.7**	**23.4**	**-**
Transmission and Distribution	**718.2**	**54.9**	**168.5**	**0.6**
Service facilities	**22.0**	**-**	**9.8**	**-**
Project costs (Note 4)	**-**	**-**	**-**	**-**
Capital studies (Note 4)	**-**	**-**	**-**	**-**
Other	**258.5**	**24.4**	**136.1**	**46.7**
	2,632.5	**106.5**	**780.5**	**47.5**

millions of dollars	Capital Assets in Service	Contributions In aid of Construction	Accumulated Depreciation	Construction In Progress
			2002	
Generation Plant				
Hydroelectric	1,243.6	20.5	256.1	102.7
Thermal	223.5	-	173.3	0.2
Diesel	62.5	7.9	23.1	0.1
Transmission and Distribution	693.3	56.0	155.7	1.0
Service facilities	22.0	-	9.5	-
Project costs (Note 4)	96.4	-	-	-
Capital studies (Note 4)	25.0	-	-	-
Other	238.4	24.5	128.0	50.6
	2,604.7	108.9	745.7	154.6

Included in the above amounts are CF(L)Co assets in service amounting to $636.1 million (2002 - $633.6 million) which are pledged as collateral for long-term debt.

Management has reviewed the carrying balance of its Capital Assets in Service and Construction in Progress for hydro-electric developments in Labrador. As Hydro has been unable to successfully conclude development plans at this time, it has decided to write-down project costs related to GIPCo by $96.3 million, capital studies related to LCDC by $25.0 million, and construction in progress by $9.6 million, to its best estimate of the net recoverable amount. The write-down of capital studies also results in a reduction of $12.3 million in the non-controlling interest in LCDC. The project costs in GIPCo and capital studies in LCDC were funded by the shareholder in prior years through the provision of contributed capital.

3. LONG-TERM RECEIVABLES

millions of dollars	**2003**	2002
Rate Stabilization Plan		
Retail	**114.8**	76.3
Industrial	**40.9**	28.0
	155.7	104.3
Hydro-Québec		
Unrealized foreign exchange	**9.5**	31.1
Other	**1.0**	2.7
	10.5	33.8
Less current portion of long-term receivables	**35.5**	27.5
	130.7	110.6

3. LONG-TERM RECEIVABLES (cont'd.)

The receivable arising from the RSP bears interest at the weighted average cost of capital which is approximately 7.2% and is to be recovered over a five-year period, which commenced in 2003.

The other long-term receivable from Hydro-Québec bears interest at 7% per annum and is receivable over a four year period which commenced in September 2000.

4. INVESTMENTS

millions of dollars	**2003**	2002
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (the "Principal Agreement"), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo's assets and the hydroelectric development rights to the Lower Churchill River, (the "Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (the "Option Agreement"). The purchase price in respect of GIPCo's assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo's assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2004.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

5. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co's assets and liabilities at December 31, 2003, and its proportionate interest in CF(L)Co's operations for the year ended December 31, 2003.

millions of dollars	**2003**	2002
Current assets	**24.0**	34.6
Long-term assets	**347.9**	371.7
Current liabilities	**29.4**	45.3
Long-term liabilities	**84.0**	113.9
Revenues	**61.7**	62.9
Expenses	**48.5**	49.0
Net income	**13.2**	13.9
Cash provided by (used in)		
Operating activities	**34.1**	25.4
Financing activities	**(30.4)**	(24.3)
Investing activities	**(2.6)**	1.6

6. DEFERRED CHARGES

millions of dollars	**2003**	2002
Debt discount, financing expenses and other	**20.1**	19.6
Accumulated amortization	**12.9**	14.3
	7.2	5.3
Foreign exchange losses realized	**96.3**	96.3
Accumulated provision	**10.0**	10.0
	86.3	86.3
Accumulated amortization	**4.3**	2.2
	82.0	84.1
Net deferred charges	**89.2**	89.4

7. LONG-TERM DEBT

	Hydro	CF(L)Co	Total	Hydro	CF(L)Co	Total
millions of dollars		**2003**			2002	
Summary of long-term debt						
Long-term debt	**1,377.2**	**101.3**	**1,478.5**	1,257.1	148.0	1,405.1
Less payments due within one year	**13.4**	**17.3**	**30.7**	16.1	34.1	50.2
	1,363.8	**84.0**	**1,447.8**	1,241.0	113.9	1,354.9

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2004	2005	2006	2007	2008
	30.7	29.3	228.3	20.9	213.7

The payments due within one year include sinking fund requirements of $10.0 million (2002 - $8.8 million).

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity	**2003**	2002	
millions of dollars						
AC	5.05	2001	2006	**200.0**	200.0	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**300.0**	300.0	(a)
AD	5.70	2003	2033	**125.0**	-	(a)
Total debentures				**1,400.0**	1,275.0	
Less sinking fund investments in own debentures				**43.8**	46.0	
				1,356.2	1,229.0	
Government of Canada loans at 5.25% to 7.91% maturing in 2006 to 2014				**18.8**	25.1	
Other				**2.2**	3.0	
				1,377.2	1,257.1	
Less payments due within one year				**13.4**	16.1	
				1,363.8	1,241.0	

7. **LONG-TERM DEBT (cont'd.)**

(a) Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

CF(L)Co

millions of dollars	**2003**	2002
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $43.6; 2002 - U.S. $63.4)	**56.4**	100.2
7.875% Series B due December 15, 2007	**4.4**	6.4
General Mortgage Bonds		
7.500% due December 15, 2010	**40.5**	41.4
	101.3	148.0
Less payments due within one year	**17.3**	34.1
	84.0	113.9

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There have been no contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however fixed sinking fund payments are estimated to average $13.2 million in each of the years 2004 to 2008 inclusive.

Under the terms of long-term debt instruments, CF(L)Co may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999 places additional restrictions on dividends, based on cash flow.

8. **EMPLOYEE FUTURE BENEFITS**

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employers' contributions of $4.1 million (2002 - $3.6 million) are expensed as incurred.

8. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. Information about these plans is as follows:

millions of dollars	**2003**	2002
Accrued benefit obligation		
Balance at beginning of year	**37.5**	28.5
Current service cost	**1.3**	0.9
Interest cost	**2.6**	2.0
Actuarial loss	**-**	7.5
Past service cost	**-**	0.4
Benefits paid	**(1.9)**	(1.8)
Balance at end of year	**39.5**	37.5
Plan deficit	**39.5**	37.5
Unamortized actuarial loss	**(7.1)**	(7.5)
Unamortized past service cost	**(0.4)**	(0.4)
Accrued benefit liability at end of year	**32.0**	29.6

The most recent actuarial valuation was performed as at December 31, 2002. The significant actuarial assumptions used in measuring the company's accrued benefit obligations include a discount rate of 7.0% and an average rate of compensation increase of 3.5%. In addition, in determining the expected cost of healthcare benefits, it was assumed that healthcare costs will increase by 12.0% in 2003 and decrease gradually to 5.0% in 2010 and remain level thereafter.

The net benefit plan expense is as follows:

millions of dollars	**2003**	2002
Current service cost	**1.3**	0.9
Interest cost	**2.6**	2.0
Amortization of actuarial loss	**0.4**	-
Net benefit plan expense	**4.3**	2.9

9. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2003 and 2002 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

9. FINANCIAL INSTRUMENTS (cont'd.)

millions of dollars	Carrying Value 2003	Fair Value 2003	Carrying Value 2002	Fair Value 2002
Financial Assets				
Sinking funds	**70.1**	**76.3**	48.7	54.2
Long-term receivable including amount due in one year	**166.2**	**166.2**	138.1	138.2
Financial Liabilities				
Long-term debt including amount due in one year	**1,478.5**	**1,769.6**	1,405.1	1,670.4

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value. At December 31, 2003 of the total accounts receivable balance outstanding approximately 50.0% (2002 - 46.9%) is due from a regulated utility, and 24.0% (2002 - 25.1%) from Hydro-Québec.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2031. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 5.33% to 9.86% (2002 - 5.80% to 10.55%).

10. INTEREST EXPENSE

millions of dollars	2003	2002	
Gross interest			
Long-term debt	**109.9**	105.3	
Promissory notes	**5.7**	5.0	
	115.6	110.3	
Amortization of debt discount and financing expenses	**1.0**	1.3	
Provision for foreign exchange losses	**2.2**	2.2	
Foreign exchange gain	**(1.0)**	(0.1)	
	117.8	113.7	
Less			
Recovered from Hydro-Québec	**3.2**	5.3	(a)
Interest capitalized during construction	**7.3**	7.7	
Interest earned	**21.9**	15.1	
Net interest expense	**85.4**	85.6	
Debt guarantee fee	**13.9**	12.2	
Net interest and guarantee fee	**99.3**	97.8	

(a) Under the terms of the Power Contract, CF(L)Co recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

10. INTEREST EXPENSE (cont'd.)

Also, CF(L)Co can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

11. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

The results of a recent Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicate higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing is to be conducted to determine the extent of contamination, and a remediation plan will be developed in consultation with regulatory agencies. At this time the magnitude of potential liability cannot be estimated due to insufficient knowledge of the extent of contamination. Further, there is uncertainty with respect to whether Twin Falls or CF(L)Co is responsible for any environmental liabilities that are determined to exist.

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is approximately \$16.2 million (2002 - \$6.4 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have been commenced against Hydro by one of its customers claiming approximately \$22.4 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately \$14.1 million at December 31, 2003 (2002 - \$23.8 million).

(d) In connection with the Granite Canal development, Hydro has issued an irrevocable Letter of Credit, in the amount of \$5.4 million to ensure compliance with the terms of the Fish Habitat Compensation Agreement between Hydro and the Department of Fisheries and Oceans.

12. COMPARATIVE FIGURES

Certain of the 2002 comparative figures have been reclassified to conform with the 2003 financial statement presentation.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2004

Deloitte

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Auditors' Report

To the Lieutenant-Governor in Council
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 2004 and the consolidated statements of income and retained earnings and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Deloitte & Touche LLP

Chartered Accountants
February 15, 2005

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland and Labrador
A1B 4K7

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2004**	2003
ASSETS		
Capital assets (Note 2)		
Capital assets in service	**2,653.5**	2,632.5
Less contributions in aid of construction	**106.9**	106.5
	2,546.6	2,526.0
Less accumulated depreciation	**816.3**	780.5
	1,730.3	1,745.5
Construction in progress	**54.2**	47.5
	1,784.5	1,793.0
Current assets		
Cash and cash equivalents	**4.0**	0.1
Accounts receivable	**67.2**	56.5
Current portion of long-term receivables (Note 3)	**41.5**	35.5
Current portion of rate stabilization plan	**8.6**	-
Fuel and supplies at average cost	**48.3**	48.5
Prepaid expenses	**2.0**	2.5
	171.6	143.1
Long-term receivables (Note 3)	**97.7**	130.7
Sinking funds (Note 10)	**87.1**	70.1
Investments (Note 4)	**5.2**	5.2
Deferred charges (Note 6)	**85.0**	89.2
	2,231.1	2,231.3

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2004**	2003
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 7)	**1,422.1**	1,447.8
Current liabilities		
Bank indebtedness	**8.0**	6.7
Short-term borrowing	**-**	1.8
Accounts payable and accrued liabilities	**49.1**	51.6
Accrued interest	**30.3**	30.5
Long-term debt due within one year (Note 7)	**28.4**	30.7
Promissory notes (Note 7)	**157.8**	149.8
	273.6	271.1
Rate stabilization plan	**5.5**	-
Long-term payable (Note 8)	**1.1**	-
Employee future benefits (Note 9)	**35.4**	32.0
Non-controlling interest in LCDC (Note 2)	**2.5**	2.5
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Notes 2 and 4)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**96.4**	100.0
Retained earnings	**354.4**	337.8
	490.9	477.9
Commitments and contingencies (Note 12)		
	2,231.1	2,231.3

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2004**	2003
Revenue		
Energy sales	**439.8**	407.8
Recovery of costs in rate stabilization plan	**34.2**	16.7
Guaranteed winter availability	**14.6**	11.9
Rentals and royalties	**0.3**	0.3
Other	**4.6**	4.8
	493.5	441.5
Expenses		
Operations and administration	**123.4**	125.8
Fuels	**83.1**	84.6
Amortization of costs in rate stabilization plan	**34.2**	16.7
Power purchased	**36.1**	26.1
Depreciation	**45.8**	45.0
Interest (Note 11)	**103.7**	99.3
	426.3	397.5
Net income before unusual items	**67.2**	44.0
Unusual items (Note 2)		
Write-down of capital assets	**-**	(130.9)
Less non-controlling interest	**-**	12.3
	-	(118.6)
Net income (loss)	**67.2**	(74.6)
Retained earnings, beginning of year	**337.8**	453.5
	405.0	378.9
Dividends	**50.6**	41.1
Retained earnings, end of year	**354.4**	337.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2004**	2003
Cash provided by (used in)		
Operating activities		
Net income (loss)	**67.2**	(74.6)
Adjusted for items not involving a cash flow		
Depreciation	**45.8**	45.0
Amortization of deferred charges	**3.7**	4.1
Rate stabilization plan	**(3.1)**	20.5
Loss on disposal of capital assets	**1.7**	3.2
Other	**-**	(0.6)
Foreign exchange gain	**(0.1)**	(1.0)
Write-down of capital assets (net of non-controlling interest)	**-**	118.6
	115.2	115.2
Change in non-cash balances related to operations		
Accounts receivable	**(10.7)**	5.5
Fuel and supplies	**0.2**	(0.5)
Prepaid expenses	**0.5**	-
Accounts payable and accrued liabilities	**(0.2)**	(8.2)
Accrued interest	**(0.2)**	2.8
Employee future benefits	**3.4**	2.4
Long-term receivable	**21.8**	(49.6)
Long-term payable	**1.1**	-
	131.1	67.6
Financing activities		
Long-term debt issued	**-**	125.0
Long-term debt retired	**(20.8)**	(36.8)
Foreign exchange loss recovered	**2.7**	5.2
Increase (decrease) in short-term borrowing	**(1.8)**	(1.5)
Increase (decrease) in promissory notes	**8.0**	(31.7)
Decrease in contributed capital	**(3.6)**	-
Dividends	**(50.6)**	(41.1)
	(66.1)	19.1
Investing activities		
Net additions to capital assets	**(40.1)**	(67.3)
Proceeds from the disposal of capital assets	**1.1**	0.8
Increase in sinking funds	**(21.6)**	(19.2)
Reductions (additions) to deferred charges	**0.5**	(3.9)
Change in accounts payable related to investing activities	**(2.3)**	0.5
	(62.4)	(89.1)
Net decrease in cash	**2.6**	(2.4)
Cash position, beginning of year	**(6.6)**	(4.2)
Cash position, end of year	**(4.0)**	(6.6)
Cash position is represented by		
Cash and cash equivalents	**4.0**	0.1
Bank indebtedness	**(8.0)**	(6.7)
	(4.0)	(6.6)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**0.2**	0.6
Interest paid	**112.0**	109.6

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador ("Province") as a Crown corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls Power Corporation Limited ("Twin Falls"), are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates.

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's earnings from its electrical sales to most customers within the Province are regulated on the basis of return on rate base. As well, Hydro's borrowing and capital expenditure programs are subject to review and approval by the Public Utilities Board ("PUB").

Rates charged rural customers do not recover the full costs of providing the service but Hydro recovers the resulting deficit from other customers.

Hydro has adopted selected accounting treatments that differ from that for enterprises not subject to rate regulation. The more significant of these include the following:

Rate Stabilization Plan
On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan ("RSP") which primarily provides for the deferral of cost variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

RSP balances which accumulated prior to December 31, 2003 (Note 3), have been converted to a long-term receivable. Any subsequent balances accumulating in the RSP including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added or subtracted from the rates that would otherwise be in effect.

Foreign Exchange Losses
Foreign exchange losses related to long-term debt, including current portion, are subject to the rate setting process. The PUB has accepted the inclusion by Hydro of realized foreign exchange losses in rates charged to customers. Any such loss, net of any gain, not recovered due to the operation of the rate setting process is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. This amortization is included in interest expense. Commencing in 2002, the PUB ordered Hydro's deferred foreign exchange losses, net of the $10.0 million provision previously accumulated, be amortized over a forty-year period (Note 6).

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Rates and Regulations (Excluding Sales by Subsidiaries) (cont'd.)

Capital Assets and Depreciation
Hydro follows the capitalization and depreciation policies as described in Note 1, which have been approved by the PUB.

Deferred Regulatory Costs
In 2004, the PUB approved the deferral of external costs associated with the general rate application and hearing, in the amount of $1,800,000, which is to be amortized over a 3 year period.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited ("GIPCo."), (100% owned) and Lower Churchill Development Corporation Limited ("LCDC"), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited ("CF(L)Co.") and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co. be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co., from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co. subsequent to the effective date of the shareholders' agreement.

CF(L)Co. is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428,000 kilowatts ("CF(L)Co. Project"). A power contract with Hydro-Québec, dated May 12, 1969 ("Power Contract") provides for the sale of substantially all the energy from the CF(L)Co. Project until 2041. CF(L)Co. receives certain benefits from Hydro-Québec, including significant revenues, under a guaranteed winter availability contract through 2041.

CF(L)Co. holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives CF(L)Co. joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

The cost of Hydro's investment in CF(L)Co. exceeded the equity in the book value of the net assets acquired by $77.1 million. This amount is assigned to capital assets and is being amortized on a straight-line basis at the rate of 1.5% per annum. As at December 31, 2004, $34.7 million (2003 - $33.6 million) had been amortized.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co. must pay rentals and royalties to the Province annually.

A portion of Hydro's shareholding in CF(L)Co. is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo. is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland ("Gull Island Project"), (Note 4).

LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River ("Lower Churchill Development"), (Note 4).

Twin Falls is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. As at December 31, 2004 and 2003 there were no cash equivalents or short-term investments outstanding.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

During 2004, Hydro adopted the recommendations of the Canadian Institute of Chartered Accountants' (CICA) Handbook Section 3110, *Asset Retirement Obligations*. This new accounting standard requires that the company recognize the fair value of the future expenditures required to settle legal obligations associated with the retirement of capital assets, to the extent that it is reasonably estimable. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

<u>Hydro, GIPCo. and LCDC</u>
Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.
Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

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

Capital Assets and Depreciation (cont'd.)

CF(L)Co.
CF(L)Co. uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Promissory Notes

Promissory Notes bear interest from 2.10% to 2.86% per annum (2003 - 2.66% to 2.93%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recorded on the basis of power deliveries made.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2003 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date.

(i) Under the provisions of the Power Contract CF(L)Co.'s exposure for a foreign exchange loss is limited. CF(L)Co. recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 3).

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Financial Instruments

From time to time, Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees, and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 12 years.

2. CAPITAL ASSETS

millions of dollars	Capital Assets in Service	Contributions In aid of Construction	Accumulated Depreciation	Construction In Progress
			2004	
Generation Plant				
Hydroelectric	**1,350.4**	**20.5**	**278.2**	**0.2**
Thermal	**228.1**	**-**	**177.4**	**-**
Diesel	**56.8**	**6.5**	**24.1**	**0.4**
Transmission and Distribution	**730.9**	**55.1**	**183.2**	**0.2**
Service facilities	**22.0**	**-**	**10.1**	**-**
Project costs (Note 4)	**-**	**-**	**-**	**-**
Capital studies (Note 4)	**-**	**-**	**-**	**-**
Other	**265.3**	**24.8**	**143.3**	**53.4**
	2,653.5	**106.9**	**816.3**	**54.2**

millions of dollars	Capital Assets in Service	Contributions In aid of Construction	Accumulated Depreciation	Construction In Progress
			2003	
Generation Plant				
Hydroelectric	1,347.3	20.5	267.0	0.2
Thermal	227.0	-	175.7	-
Diesel	59.5	6.7	23.4	-
Transmission and Distribution	718.2	54.9	168.5	0.6
Service facilities	22.0	-	9.8	-
Project costs (Note 4)	-	-	-	-
Capital studies (Note 4)	-	-	-	-
Other	258.5	24.4	136.1	46.7
	2,632.5	106.5	780.5	47.5

Included in the above amounts are CF(L)Co. assets in service amounting to $639.3 million (2003 - $636.1 million) which are pledged as collateral for long-term debt.

2. CAPITAL ASSETS (cont'd.)

As at December 31, 2003, Management reviewed the carrying balance of its Capital Assets in Service and Construction in Progress for hydro-electric developments in Labrador. As Hydro had been unable to successfully conclude development plans at that time, it decided to write-down project costs related to GIPCo. by $96.3 million, capital studies related to LCDC by $25.0 million, and construction in progress by $9.6 million, to its best estimate of the net recoverable amount. The write-down of capital studies also resulted in a reduction of $12.3 million in the non-controlling interest in LCDC. The project costs in GIPCo. and capital studies in LCDC were funded by the shareholder in prior years through the provision of contributed capital.

3. LONG-TERM RECEIVABLES

millions of dollars	**2004**	2003
Rate Stabilization Plan		
Retail	**101.7**	114.8
Industrial	**32.3**	40.9
	134.0	155.7
Hydro-Québec		
Unrealized foreign exchange	**4.3**	9.5
Other	**0.9**	1.0
	5.2	10.5
Less current portion of long-term receivables	**41.5**	35.5
	97.7	130.7

The receivable arising from the RSP bears interest at the weighted average cost of capital which is approximately 7.2% and is to be recovered over a five-year period, which commenced in 2003.

4. INVESTMENTS

millions of dollars	**2004**	2003
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement ("Principal Agreement"), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo.'s assets and the hydroelectric development rights to the Lower Churchill River, ("Water Rights"), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, ("Option Agreement"). The purchase price in respect of GIPCo.'s assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo.'s assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2005.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

5. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co.'s assets and liabilities at December 31, 2004, and its proportionate interest in CF(L)Co.'s operations for the year ended December 31, 2004.

millions of dollars	**2004**	2003
Current assets	**25.1**	24.0
Long-term assets	**338.6**	347.9
Current liabilities	**23.8**	29.4
Long-term liabilities	**66.6**	84.0
Revenues	**63.9**	61.7
Expenses	**47.3**	48.5
Net income	**16.6**	13.2
Cash provided by (used in)		
Operating activities	**33.2**	34.1
Financing activities	**(21.0)**	(30.4)
Investing activities	**(5.3)**	(2.6)

6. DEFERRED CHARGES

millions of dollars	**2004**	2003
Debt discount, financing expenses and other	**16.9**	20.1
Accumulated amortization	**11.7**	12.9
	5.2	7.2
Foreign exchange losses realized	**96.3**	96.3
Accumulated provision	**10.0**	10.0
	86.3	86.3
Accumulated amortization	**6.5**	4.3
	79.8	82.0
Net deferred charges	**85.0**	89.2

7. LONG-TERM DEBT

	Hydro	CF(L)Co.	Total	Hydro	CF(L)Co.	Total
millions of dollars		**2004**			2003	
Summary of long-term debt						
Long-term debt	**1,369.3**	**81.2**	**1,450.5**	1,377.2	101.3	1,478.5
Less payments due within one year	**13.8**	**14.6**	**28.4**	13.4	17.3	30.7
	1,355.5	**66.6**	**1,422.1**	1,363.8	84.0	1,447.8

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2005	2006	2007	2008	2009
	28.4	227.3	27.4	213.7	13.8

The payments due within one year include sinking fund requirements of $10.0 million (2003 - $10.0 million).

7. **LONG-TERM DEBT (cont'd.)**

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity			
millions of dollars				**2004**	2003	
AC	5.05	2001	2006	**200.0**	200.0	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**300.0**	300.0	(a)
AD	5.70	2003	2033	**125.0**	125.0	(a)
Total debentures				**1,400.0**	1,400.0	
Less sinking fund investments in own debentures				**48.3**	43.8	
				1,351.7	1,356.2	
Government of Canada loans at 5.25% to 7.91% maturing in 2006 to 2014				**16.4**	18.8	
Other				**1.2**	2.2	
				1,369.3	1,377.2	
Less payments due within one year				**13.8**	13.4	
				1,355.5	1,363.8	

(a) Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

CF(L)Co.

millions of dollars	**2004**	2003
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $32.0; 2003 - U.S. $43.6)	**38.3**	56.4
7.875% Series B due December 15, 2007	**3.2**	4.4
General Mortgage Bonds		
7.500% due December 15, 2010	**39.7**	40.5
	81.2	101.3
Less payments due within one year	**14.6**	17.3
	66.6	84.0

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There have been no contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

7. LONG-TERM DEBT (cont'd.)

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however fixed sinking fund payments are estimated to average $9.2 million in each of the years 2005 to 2009 inclusive.

Under the terms of long-term debt instruments, CF(L)Co. may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999 places additional restrictions on dividends, based on cash flow.

8. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, bears an interest at 7.0% per annum and is repayable over a four-year period which commenced in September 2004. The current portion of $0.4 million (2003 - nil) is included in accounts payable and accrued liabilities.

9. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employers' contributions of $4.1 million (2003 - $4.1 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. The most recent actuarial valuation was performed as at December 31, 2004.

millions of dollars	**2004**	2003
Accrued benefit obligation		
Balance at beginning of year	**39.5**	37.5
Current service cost	**1.6**	1.3
Interest cost	**2.8**	2.6
Actuarial loss	**4.2**	-
Benefits paid	**(1.7)**	(1.9)
Balance at end of year	**46.4**	39.5
Plan deficit	**46.4**	39.5
Unamortized actuarial loss	**(10.7)**	(7.1)
Unamortized past-service cost	**(0.3)**	(0.4)
Accrued benefit liability at end of year	**35.4**	32.0

millions of dollars	**2004**	2003
Current service cost	**1.6**	1.3
Interest cost	**2.8**	2.6
Actuarial losses	**4.2**	-
	8.5	3.9
Adjustments		
Difference between actual actuarial loss and amount recognized	**(3.4)**	0.4
Benefit expense	**5.1**	4.3

9. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2004	2003
Discount rate	**6.3%**	7.0%
Rate of compensation increase	**3.5%**	3.5%

Assumed healthcare trend rates:

	2004	2003
Initial healthcare expense trend rate	**12.0%**	12.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2010**	2010

A 1% change in assumed healthcare trend rates would have had the following effects for 2004:

	Increase	**Decrease**
Current service cost	**0.2**	(0.2)
Interest cost	**0.5**	(0.3)
Accrued benefits obligation	**6.7**	(2.1)

10. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2004 and 2003 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	Fair Value	Carrying Value	Fair Value
millions of dollars		**2004**		2003
Financial Assets				
Sinking funds	**87.1**	**96.9**	70.1	76.3
Long-term receivable including amount due in one year	**139.1**	**139.0**	166.2	166.2
Financial Liabilities				
Long-term debt including amount due in one year	**1,450.5**	**1,766.9**	1,478.5	1,769.6
Long-term payable including amount due in one year	**1.5**	**1.6**	-	-

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value. At December 31, 2004 of the total accounts receivable balance outstanding approximately 51.8% (2003 - 50.0%) is due from a regulated utility, and 19.8% (2003 - 24.0%) from Hydro-Québec.

10. FINANCIAL INSTRUMENTS (cont'd.)

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.77% to 9.86% (2003 - 5.33% to 9.86%).

11. INTEREST EXPENSE

millions of dollars	**2004**	2003	
Gross interest			
Long-term debt	**110.4**	109.9	
Promissory notes	**4.1**	5.7	
	114.5	115.6	
Amortization of debt discount and financing expenses	**1.1**	1.0	
Provision for foreign exchange losses	**2.2**	2.2	
Foreign exchange gain	**(0.2)**	(1.0)	
	117.6	117.8	
Less			
Recovered from Hydro-Québec	**2.2**	3.2	(a)
Interest capitalized during construction	**3.6**	7.3	
Interest earned	**22.7**	21.9	
Net interest expense	**89.1**	85.4	
Debt guarantee fee	**14.6**	13.9	
Net interest and guarantee fee	**103.7**	99.3	

(a) Under the terms of the Power Contract, CF(L)Co. recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co. can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co. can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

12. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co. is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

The results of a recent Environmental Site Assessment ("ESA") conducted at the Twin Falls Generating Station indicate higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing is to be conducted to determine the extent of contamination, and a remediation plan will be developed in consultation with regulatory agencies. At this time potential liability cannot be estimated due to insufficient knowledge of the extent of contamination. Further, there is uncertainty with respect to whether Twin Falls or CF(L)Co. is responsible for any environmental liabilities that are determined to exist.

12. COMMITMENTS AND CONTINGENCIES (cont'd.)

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is approximately $8.5 million (2003 - $16.2 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have been commenced against Hydro by one of its customers claiming approximately $22.2 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately $7.4 million at December 31, 2004 (2003 - $14.1 million).

13. COMPARATIVE FIGURES

Certain of the 2003 comparative figures have been reclassified to conform with the 2004 financial statement presentation.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005

Deloitte.

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Auditors' Report

To the Lieutenant-Governor in Council
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 2005 and the consolidated statements of income and retained earnings and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Deloitte & Touche LLP

Chartered Accountants
February 14, 2006

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland and Labrador
A1B

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2005**	2004
ASSETS		
Capital assets (Note 2)		
Capital assets in service	**2,672.8**	2,653.5
Less contributions in aid of construction	**106.5**	106.9
	2,566.3	2,546.6
Less accumulated depreciation	**851.0**	816.3
	1,715.3	1,730.3
Construction in progress	**66.3**	54.2
	1,781.6	1,784.5
Current assets		
Cash and cash equivalents	**3.0**	4.0
Short-term investments	**6.1**	-
Accounts receivable	**67.9**	67.2
Current portion of long-term receivables (Note 3)	**42.7**	41.5
Current portion of rate stabilization plan (Note 3)	**0.1**	8.6
Fuel and supplies at average cost	**59.7**	48.3
Prepaid expenses	**2.3**	2.0
	181.8	171.6
Long-term receivables (Note 3)	**64.7**	97.7
Sinking funds (Note 10)	**85.8**	72.6
Investments (Note 4)	**5.2**	5.2
Deferred charges (Notes 3 and 6)	**85.0**	85.0
	2,204.1	2,216.6

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2005**	2004
LIABILITIES AND SHAREHOLDER'S EQUITY		
Long-term debt (Note 7)	**1,174.8**	1,407.6
Current liabilities		
Bank indebtedness	**6.0**	8.0
Accounts payable and accrued liabilities	**59.8**	49.1
Accrued interest	**29.5**	30.3
Long-term debt due within one year (Note 7)	**222.6**	28.4
Current portion of rate stabilization plan (Note 3)	**1.3**	-
Promissory notes (Note 7)	**150.8**	157.8
	470.0	273.6
Rate stabilization plan (Note 3)	**10.6**	5.5
Long-term payable (Note 8)	**0.7**	1.1
Employee future benefits (Note 9)	**38.5**	35.4
Non-controlling interest in LCDC	**2.5**	2.5
	52.3	44.5
Shareholder's equity		
Share capital		
Common shares of par value of $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5
Contributed capital (Note 4)		
Lower Churchill Development	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**96.4**	96.4
Retained earnings	**370.5**	354.4
	507.0	490.9
Commitments and contingencies (Note 12)		
	2,204.1	2,216.6

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2005**	2004
Revenue		
Energy sales	**453.9**	439.8
Recovery of costs in rate stabilization plan (Note 3)	**56.5**	34.2
Guaranteed winter availability	**16.4**	14.6
Rentals and royalties	**0.3**	0.3
Other	**5.4**	4.6
	532.5	493.5
Expenses		
Operations and administration	**130.8**	123.4
Fuels	**84.5**	83.1
Amortization of costs in rate stabilization plan (Note 3)	**56.5**	34.2
Power purchased	**35.9**	36.1
Depreciation	**47.0**	45.8
Interest (Note 11)	**105.9**	103.7
	460.6	426.3
Net income	**71.9**	67.2
Retained earnings, beginning of year	**354.4**	337.8
	426.3	405.0
Dividends	**55.8**	50.6
Retained earnings, end of year	**370.5**	354.4

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2005**	2004
Cash provided by (used in)		
Operating activities		
Net income	**71.9**	67.2
Adjusted for items not involving a cash flow		
Depreciation	**47.0**	45.8
Amortization of deferred charges	**4.1**	3.7
Rate stabilization plan	**14.9**	(3.1)
Loss on disposal of capital assets	**3.9**	1.7
Foreign exchange gain	**(0.1)**	(0.1)
Other	**0.1**	-
	141.8	115.2
Change in non-cash balances related to operations		
Accounts receivable	**(0.7)**	(10.7)
Fuel and supplies	**(11.4)**	0.2
Prepaid expenses	**(0.3)**	0.5
Accounts payable and accrued liabilities	**13.0**	(0.2)
Accrued interest	**(0.8)**	(0.2)
Employee future benefits	**3.1**	3.4
Long-term receivable	**29.6**	21.8
Long-term payable	**(0.4)**	1.1
	173.9	131.1
Financing activities		
Long-term debt retired	**(32.4)**	(20.8)
Increase in sinking funds	**(19.5)**	(21.6)
Foreign exchange loss recovered	**1.5**	2.7
Decrease in short-term borrowing	**-**	(1.8)
(Decrease) increase in promissory notes	**(7.0)**	8.0
Decrease in contributed capital	**-**	(3.6)
Dividends	**(55.8)**	(50.6)
	(113.2)	(87.7)
Investing activities		
Net additions to capital assets	**(47.7)**	(40.1)
Proceeds on disposal of capital assets	**0.4**	1.1
Increase in short-term investments	**(6.1)**	-
(Additions) reductions to deferred charges	**(4.1)**	0.5
Change in accounts payable related to investing activities	**(2.2)**	(2.3)
	(59.7)	(40.8)
Net increase in cash	**1.0**	2.6
Cash position, beginning of year	**(4.0)**	(6.6)
Cash position, end of year	**(3.0)**	(4.0)
Cash position is represented by		
Cash and cash equivalents	**3.0**	4.0
Bank indebtedness	**(6.0)**	(8.0)
	(3.0)	(4.0)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**0.3**	0.2
Interest paid	**111.9**	112.0

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and its principal activity is the development, generation and sale of electric power. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls Power Corporation Limited (Twin Falls), are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's earnings from its electrical sales to most customers within the Province are subject to rate regulation. As well, Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB, which as an agency of the Province, is a related party. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.5%. The effects of rate regulation on the financial statements are more fully disclosed in Note 3.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, Gull Island Power Company Limited (GIPCo.), (100% owned) and Lower Churchill Development Corporation Limited (LCDC), (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co.) and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co. be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co., from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co. subsequent to the effective date of the shareholders' agreement.

CF(L)Co. is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (CF(L)Co. Project). A power contract with Hydro-Québec, dated May 12, 1969 (Power Contract) provides for the sale of substantially all the energy from the CF(L)Co. Project until 2041. CF(L)Co. receives certain benefits from Hydro-Québec, including significant revenues, under a guaranteed winter availability contract through 2041.

CF(L)Co. holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives CF(L)Co. joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co. must pay rentals and royalties to the Province annually.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Principles of Consolidation (cont'd.)

A portion of Hydro's shareholding in CF(L)Co. is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

GIPCo. is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project), (Note 4).

LCDC is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (Lower Churchill Development), (Note 4).

Twin Falls is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. There were short-term investments of $6.1 million (2004 - nil) outstanding at December 31, 2005, bearing interest rates of 2.74% to 3.96% (2004 - nil) per annum.

Capital Assets and Depreciation

Expenditures for additions, improvements and renewals are capitalized and normal expenditures for maintenance and repairs are charged to operations.

During 2004, Hydro adopted the recommendations of the Canadian Institute of Chartered Accountants' (CICA) Handbook Section 3110, *Asset Retirement Obligations*. This new accounting standard requires that the company recognize the fair value of the future expenditures required to settle legal obligations associated with the retirement of capital assets, to the extent that it is reasonably estimable. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Hydro, GIPCo. and LCDC
Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of capital assets, or the fair value of assets contributed. Contributions are treated as a reduction to capital assets and the net capital assets are depreciated.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Capital Assets and Depreciation (cont'd.)

Depreciation is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Depreciation on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.
Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

<u>CF(L)Co.</u>
CF(L)Co. uses the group depreciation method for certain capital assets other than the generation plant, transmission and terminals and service facilities.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to depreciation expense.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

Promissory Notes

Promissory Notes bear interest from 2.80% to 3.70% per annum (2004 - 2.10% to 2.86%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. During 2005, a regulated utility customer accounted for 54% (2004 - 53%) of energy sales revenue.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2004 - 7%).

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

(i) Under the provisions of the Power Contract CF(L)Co.'s exposure for a foreign exchange loss is limited. CF(L)Co. recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 3).

Financial Instruments

From time to time, Hydro enters into interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees, and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 12 years.

2. CAPITAL ASSETS

	Capital Assets in Service	Contributions In aid of Construction	Accumulated Depreciation	Construction In Progress
millions of dollars		2005		
Generation Plant				
Hydroelectric	**1,358.8**	**20.5**	**289.1**	**0.1**
Thermal	**231.7**	**-**	**180.8**	**0.8**
Diesel	**58.5**	**6.3**	**26.0**	**0.1**
Transmission and Distribution	**734.2**	**55.1**	**197.8**	**2.2**
Service facilities	**22.0**	**-**	**10.4**	**-**
Other	**267.6**	**24.6**	**146.9**	**63.1**
	2,672.8	**106.5**	**851.0**	**66.3**

2. CAPITAL ASSETS (cont'd.)

millions of dollars	Capital Assets in Service	Contributions In aid of Construction	Accumulated Depreciation	Construction In Progress
		2004		
Generation Plant				
Hydroelectric	1,350.4	20.5	278.2	0.2
Thermal	228.1	-	177.4	-
Diesel	56.8	6.5	24.1	0.4
Transmission and Distribution	730.9	55.1	183.2	0.2
Service facilities	22.0	-	10.1	-
Other	265.3	24.8	143.3	53.4
	2,653.5	106.9	816.3	54.2

Included in the above amounts are CF(L)Co. assets in service amounting to $641.9 million (2004 - $639.3 million) which are pledged as collateral for long-term debt.

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods, that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process.

Capital Assets and Depreciation

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and depreciated over future periods as part of the total cost of the related asset. Since Hydro's AFUDC (7.6%) is lower that its cost of debt (8.0%), the amount capitalized is $0.2 million (2004 - $0.2 million) lower and interest expense is higher than that which would be permitted in the absence of rate regulation (Note 11).

Hydro depreciates its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be depreciated using the straight-line method (Note 2).

During 2005, pursuant to Order No. P.U. 7 (2002-2003) Hydro engaged an independent consultant to conduct a depreciation study. The scope of this study included a review of Hydro's depreciation methods as well as a statistical analysis of service life estimates and calculation of appropriate depreciation rates and annual and accrued depreciation balances as at December 31, 2004. Based on the results of this study, management estimates that accumulated depreciation is approximately $170-180 million lower than it would otherwise be, and annual depreciation expense is $10-11 million lower, primarily due to the use of sinking fund rather than straight line depreciation for hydroelectric and transmission assets.

Rate Stabilization Plan and Related Long-Term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Rate Stabilization Plan and Related Long-Term Receivable (cont'd.)

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to December 31, 2003, have been converted to a long-term receivable which bears interest at the weighted average cost of capital and is to be recovered over a four-year period, which commenced in 2004. At December 31, 2005 the unamortized balance was $104.9 million (2004 - $134.0 million). Any subsequent balances accumulating in the RSP including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2005, $6.3 million (2004 - $5.9 million) was deferred in the RSP.

Foreign Exchange Losses

The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Notes 6 and 10).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 14 (2004), the PUB approved the deferral of external costs associated with the general rate application and hearing, to be amortized over a 3 year period, which commenced in 2004. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2005, $0.7 million (2004 - $0.4 million) of amortization was recognized in operations and administration expenses (Note 6).

Deferred Major Extraordinary Repair

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station. This program is to be carried out over a three-year period, which commenced in 2005. Pursuant to Order P.U. No. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program will be recognized as a regulatory asset which will be amortized over the subsequent five-year period. In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the costs of the asbestos abatement program in the year in which they were incurred. In 2005, $0.1 million (2004 - nil) of amortization was recognized in operating costs, and $3.9 million (2004 - nil) was deferred in relation to the asbestos abatement program (Note 6).

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application (planned for 2006). Hydro intends to seek, and expects to receive, approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs, in the amount of $0.1 million, have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred (Note 6).

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro Quebec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred. At December 31, 2005 the unamortized balance was $0.8 million, (2004 - $ 0.8 million) and is included in accounts payable and accrued liabilities.

4. INVESTMENTS

millions of dollars	**2005**	2004
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Upon agreement to continue with the Lower Churchill Development, GIPCo.'s assets and the hydroelectric development rights to the Lower Churchill River, (Water Rights), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (Option Agreement). The purchase price in respect of GIPCo.'s assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo.'s assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2006.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

5. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co.'s assets and liabilities at December 31, 2005, and its proportionate interest in CF(L)Co.'s operations for the year ended December 31, 2005.

millions of dollars	**2005**	2004
Current assets	**32.9**	25.1
Long-term assets	**331.8**	338.6
Current liabilities	**24.4**	23.8
Long-term liabilities	**51.7**	66.6
Revenues	**66.4**	63.9
Expenses	**48.6**	47.3
Net income	**17.8**	16.6
Cash provided by (used in)		
Operating activities	**32.1**	33.2
Financing activities	**(19.2)**	(21.0)
Investing activities	**(11.5)**	(5.3)

6. DEFERRED CHARGES

millions of dollars	**2005**	2004
Debt discount, financing expenses and other	**15.1**	15.1
Accumulated amortization	**12.4**	11.3
	2.7	3.8
Regulatory costs	**1.8**	1.8
Major extraordinary repair	**3.9**	-
Study costs	**0.1**	-
Accumulated amortization	**5.8**	1.8
	4.6	1.4
Net Foreign exchange losses realized	**86.3**	86.3
Accumulated amortization	**8.6**	6.5
	77.7	79.8
Net deferred charges	**85.0**	85.0

7. LONG-TERM DEBT

	Hydro	CF(L)Co.	Total	Hydro	CF(L)Co.	Total
millions of dollars		**2005**			2004	
Summary of long-term debt						
Long-term debt	**1,331.5**	**65.9**	**1,397.4**	1,354.8	81.2	1,436.0
Less payments due within one year	**208.4**	**14.2**	**222.6**	13.8	14.6	28.4
	1,123.1	**51.7**	**1,174.8**	1,341.0	66.6	1,407.6

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2006	2007	2008	2009	2010
	222.6	22.5	209.1	9.1	44.1

The payments due within one year include sinking fund requirements of $8.2 million (2004 - $10.0 million).

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity	**2005**	2004	
millions of dollars						
AC	5.05	2001	2006	**200.0**	200.0	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**300.0**	300.0	(a)
AD	5.70	2003	2033	**125.0**	125.0	(a)
Total debentures				**1,400.0**	1,400.0	
Less sinking fund investments in own debentures				**69.2**	62.8	
				1,330.8	1,337.2	
Government of Canada loans at 5.25% to 5.63% maturing in 2006 to 2014				**0.1**	16.4	
Other				**0.6**	1.2	
				1,331.5	1,354.8	
Less payments due within one year				**208.4**	13.8	
				1,123.1	1,341.0	

(a) Sinking funds have been established for these issues.

7. LONG-TERM DEBT (cont'd.)

Hydro (cont'd.)

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

CF(L)Co.

millions of dollars	**2005**	2004
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $21.2; 2004 - U.S. $32.0)	**24.8**	38.3
7.875% Series B due December 15, 2007	**2.2**	3.2
General Mortgage Bonds		
7.500% due December 15, 2010	**38.9**	39.7
	65.9	81.2
Less payments due within one year	**14.2**	14.6
	51.7	66.6

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There have been no contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments and a balloon payment at maturity. Each semi-annual payment is equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date. The General Mortgage Bonds are subordinate to the First Mortgage Bonds.

Due to the contingent nature of the amounts of certain of the sinking fund instalments, it is not possible to be precise concerning long-term debt repayments over the next five years; however fixed sinking fund payments are estimated to be as follows:

millions of dollars	2006	2007	2008	2009	2010
	14.2	14.2	0.7	0.7	35.9

Under the terms of long-term debt instruments, CF(L)Co. may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999 places additional restrictions on dividends, based on cash flow.

8. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, bears an interest at 7.0% per annum and is repayable over a four-year period which commenced in September 2004. The current portion of $0.4 million (2004 - $0.4) is included in accounts payable and accrued liabilities.

9. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employers' contributions of $4.1 million (2004 - $4.1 million) are expensed as incurred.

9. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. The most recent actuarial valuation was performed as at December 31, 2004.

millions of dollars	2005	2004
Accrued benefit obligation		
Balance at beginning of year	**46.4**	39.5
Current service cost	**1.6**	1.6
Interest cost	**3.0**	2.8
Actuarial loss	**-**	4.2
Benefits paid	**(2.0)**	(1.7)
Balance at end of year	**49.0**	46.4
Plan deficit	**49.0**	46.4
Unamortized actuarial loss	**(10.2)**	(10.7)
Unamortized past-service cost	**(0.3)**	(0.3)
Accrued benefit liability at end of year	**38.5**	35.4

millions of dollars	2005	2004
Current service cost	**1.6**	1.6
Interest cost	**3.0**	2.8
Actuarial losses	**-**	4.2
	4.6	8.6
Adjustments		
Difference between actual actuarial loss and amount recognized	**0.5**	(3.4)
Benefit expense	**5.1**	5.2

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2005	2004
Discount rate	**6.3%**	6.3%
Rate of compensation increase	**3.5%**	3.5%

Assumed healthcare trend rates:

	2005	2004
Initial healthcare expense trend rate	**12.0%**	12.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2010**	2010

10. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2005 and 2004 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and capital assets, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

10. FINANCIAL INSTRUMENTS (cont'd.)

Fair Value (cont'd.)

millions of dollars	Carrying Value 2005	Fair Value 2005	Carrying Value 2004	Fair Value 2004
Financial Assets				
Sinking funds	**85.8**	**102.0**	72.6	81.0
Long-term receivable including amount due in one year	**107.4**	**139.2**	139.2	139.0
Financial Liabilities				
Long-term debt including amount due in one year	**1,397.4**	**1,783.8**	1,436.0	1,751.0
Long-term payable including amount due in one year	**1.1**	**1.1**	1.5	1.6

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value. At December 31, 2005 of the total accounts receivable balance outstanding approximately 52.4% (2004 - 51.8%) is due from a regulated utility, and 19.2% (2004 - 19.8%) from Hydro-Québec.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2009 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2004 - 4.77% to 9.86%).

11. INTEREST EXPENSE

millions of dollars	2005	2004	
Gross interest			
Long-term debt	**108.3**	110.4	
Promissory notes	**4.5**	4.1	
	112.8	114.5	
Amortization of debt discount and financing expenses	**1.0**	1.1	
Provision for foreign exchange losses	**2.3**	2.2	
Foreign exchange gain	**(0.1)**	(0.2)	
	116.0	117.6	
Less			
Recovered from Hydro-Québec	**1.5**	2.2	(a)
Interest capitalized during construction	**4.3**	3.6	
Interest earned	**18.7**	22.7	
Net interest expense	**91.5**	89.1	
Debt guarantee fee	**14.4**	14.6	
Net interest and guarantee fee	**105.9**	103.7	

11. INTEREST EXPENSE (cont'd.)

(a) Under the terms of the Power Contract, CF(L)Co. recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co. can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co. can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

12. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co. is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment.

The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out in 2006, 2010 and every five years thereafter. These recommendations are currently under review by the regulatory agencies.

(b) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. The aggregate of these claims, less any amounts that have been provided for in Hydro's financial statements is approximately $1.3 million (2004 - $8.5 million). The final resolution of these matters is currently under negotiation.

Legal proceedings have been commenced against Hydro by one of its customers claiming approximately $22.2 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(c) Outstanding commitments for capital projects total approximately $13.9 million at December 31, 2005 (2004 - $7.4 million).

13. SUBSEQUENT EVENTS

In January 2006, Hydro applied to Hydro-Quebec TransEnergie for transmission service to transmit Lower Churchill power from the Labrador/Quebec border into Quebec and other markets. Hydro-Quebec will conduct an initial assessment and detailed engineering studies to determine feasibility. Hydro's deposit of $17.2 million is refundable if the application is rejected or withdrawn prior to entering into a service agreement.

14. COMPARATIVE FIGURES

Certain of the 2004 comparative figures have been reclassified to conform with the 2005 financial statement presentation.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006

Deloitte.

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Canada

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Auditors' Report

To the Lieutenant-Governor in Council
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 2006 and the consolidated statements of income and retained earnings and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Deloitte & Touche LLP

Chartered Accountants
February 9, 2007

BOARD OF DIRECTORS

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Chief Executive Officer
Persona Inc.

EDMUND J. MARTIN
President and Chief Executive Officer
Newfoundland and Labrador Hydro

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Associate Dean Academic Programs
Faculty of Business
Memorial University of Newfoundland

EDNA TURPIN
Consultant

GERALD J. SHORTALL
Chartered Accountant

WILLIAM KELLY
Retired

LINDA SHEPPARD
Assistant Manager
Newfoundland and Labrador Credit Union

CRAIG TUCKER
Vice-President
M5 Marketing Communications Inc.

KEN MARSHALL
President
Rogers Cable - Atlantic Region

CHRIS KIELEY
Deputy Minister
Department of Natural Resources

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JOHN E. MALLAM
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JIM M. KEATING
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ANDREW E. MacNEILL
Vice-President, Upper Churchill Operations

GERARD V. McDONALD
Vice-President, Human Resources and
Organizational Effectiveness

GILBERT J. BENNETT
Vice-President, Lower Churchill Project

WAYNE D. CHAMBERLAIN
General Counsel and Corporate Secretary

PETER A. HICKMAN
Assistant Corporate Secretary

MARK G.S. BRADBURY
Corporate Controller and Treasurer

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland and Labrador
A1B 4K7

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	2006	2005
ASSETS		
Current assets		
Cash and cash equivalents	**10.0**	3.0
Short-term investments	**11.7**	6.1
Accounts receivable	**72.4**	67.9
Current portion of long-term receivable	**1.1**	1.1
Current portion of regulatory assets (Note 3)	**45.3**	41.8
Fuel and supplies	**54.4**	59.7
Prepaid expenses	**1.5**	2.3
	196.4	181.9
Property, plant and equipment (Note 2)	**1,791.5**	1,781.6
Long-term receivables (Note 4)	**19.2**	1.4
Sinking funds (Note 12)	**97.3**	85.8
Regulatory Assets (Note 3)	**102.9**	145.5
Investments (Note 5)	**5.2**	5.2
Deferred charges (Note 7)	**3.5**	2.7
	2,216.0	2,204.1
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness	**6.5**	6.0
Accounts payable and accrued liabilities	**49.2**	59.0
Accrued interest	**30.8**	29.5
Current portion of long-term debt (Note 8)	**22.5**	222.6
Current portion of regulatory liabilities (Note 3)	**33.7**	1.3
Promissory notes (Note 8)	**58.8**	150.8
	201.5	469.2
Long-term debt (Note 8)	**1,378.4**	1,174.8
Regulatory liabilities (Note 3)	**16.6**	11.4
Long-term payable (Note 9)	**0.3**	0.7
Employee future benefits (Note 10)	**42.3**	38.5
	59.2	50.6
Non-controlling interest in Lower Churchill Development Corporation	**2.5**	2.5
Shareholder's equity (Note 11)		
Share capital	**22.5**	22.5
Contributed capital	**114.0**	114.0
Retained earnings	**437.9**	370.5
	574.4	507.0
Commitments and contingencies (Note 16)		
	2,216.0	2,204.1

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2006**	2005
Revenue		
Energy sales	**439.3**	453.9
Recovery of costs in rate stabilization plan (Note 3)	**83.6**	56.5
Guaranteed winter availability	**18.9**	16.4
Rentals and royalties	**0.3**	0.3
Other	**5.9**	5.4
	548.0	532.5
Expenses		
Operations and administration	**130.4**	130.8
Fuels	**71.0**	84.5
Amortization of costs in rate stabilization plan (Note 3)	**83.6**	56.5
Power purchased	**38.8**	35.9
Amortization	**48.5**	47.0
Interest (Note 13)	**105.7**	105.9
	478.0	460.6
Net income	**70.0**	71.9
Retained earnings, beginning of year	**370.5**	354.4
	440.5	426.3
Dividends	**2.6**	55.8
Retained earnings, end of year	**437.9**	370.5

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2006**	2005
Cash provided by (used in)		
Operating activities		
Net income	**70.0**	71.9
Adjusted for items not involving a cash flow		
Amortization	**48.5**	47.0
Amortization of deferred charges	**1.0**	1.0
Loss on disposal of property, plant and equipment	**1.6**	3.9
Foreign exchange gain	**-**	(0.1)
Other	**0.4**	0.2
	121.5	123.9
Change in non-cash balances (Note 14)	**55.4**	44.7
	176.9	168.6
Financing activities		
Long-term debt issued	**225.0**	-
Long-term debt retired	**(215.1)**	(32.4)
Foreign exchange loss recovered	**0.7**	1.5
Decrease in promissory notes	**(92.0)**	(7.0)
Dividends	**(2.6)**	(55.8)
	(84.0)	(93.7)
Investing activities		
Additions to property, plant and equipment	**(60.9)**	(47.7)
Proceeds on disposal of property, plant and equipment	**0.5**	0.4
Increase in sinking funds	**(18.5)**	(19.5)
Increase in short-term investments	**(5.6)**	(6.1)
Additions to deferred charges	**(1.9)**	(1.0)
	(86.4)	(73.9)
Net increase in cash	**6.5**	1.0
Cash position, beginning of year	**(3.0)**	(4.0)
Cash position, end of year	**3.5**	(3.0)
Cash position is represented by		
Cash and cash equivalents	**10.0**	3.0
Bank indebtedness	**(6.5)**	(6.0)
	3.5	(3.0)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**1.7**	0.3
Interest paid	**111.3**	111.9

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and its principal activity is the development, generation and sale of electric power.

Gull Island Pond Corporation (GIPCo.) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project). Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (Lower Churchill Development). Both GIPCo. and LCDC are inactive.

CF(L)Co. is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (CF(L)Co. Project). Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, litigation, environmental and asset retirement obligations, and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. As well, Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. In December, 2006, the PUB approved interim rates effective January 1, 2007, reflecting an allowed rate of return on rate base of 7.4%. A final order from the PUB is anticipated in 2007. Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 3.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, GIPCo., (100% owned) and LCDC, (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co.) and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co. be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co., from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co. subsequent to the effective date of the shareholders' agreement.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Principles of Consolidation (cont'd.)

A portion of Hydro's shareholding in CF(L)Co. is deposited in a voting trust pursuant to an agreement with Hydro-Québec.

CF(L)Co. holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives CF(L)Co. joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. There were short-term investments of $11.7 million (2005 - $6.1 million) outstanding at December 31, 2006, bearing interest rates of 4.28% to 4.35% (2005 - 2.74% to 3.96%) per annum.

Fuel and Supplies

Fuel and supplies inventories are recorded at average cost.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that it is reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment, or the fair value of assets contributed. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment are amortized.

<u>Hydro, GIPCo. and LCDC</u>
Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Gains or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors, and generators, as well as water conveying and control structures, including dams, dykes, the tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks, and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners, and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kV. Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductor.

Other assets would include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

<u>CF(L)Co.</u>
CF(L)Co. uses the group amortization method for certain property, plant and equipment other than the generation plant, transmission and terminals and service facilities.

Amortization is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to amortization expense.

Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Debt Discount and Financing Expenses

These costs are amortized on a straight-line basis over the lives of the respective debt issues.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Promissory Notes

Promissory Notes bear interest from 4.25% to 4.55% per annum (2005 - 2.80% to 3.70%) with carrying value approximating fair value due to their short-term nature.

Revenue Recognition

Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB. Sales to Hydro-Québec and certain major industrial customers are at rates under the terms of applicable contracts.

A power contract with Hydro-Québec, dated May 12, 1969 (Power Contract) provides for the sale of substantially all the energy from the CF(L)Co. Project until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The base rate is predetermined in the Contract and decreases from the existing rate of 2.5425 mills per kWh to 2.0 mills per kWh upon renewal in 2016.

CF(L)Co. receives revenues from Hydro-Québec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of additional availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

Deferred revenue represents amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2005 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

   (i) Under the provisions of the Power Contract CF(L)Co.'s exposure for a foreign exchange loss is limited. CF(L)Co. recovers a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract. The portion of the unrealized foreign exchange loss which is recoverable on the settlement dates, is included in long-term receivables (Note 4).

Financial Instruments

As part of its risk management, Hydro may use derivative instruments in the form of interest rate swap agreements to manage interest rate risk. Net receipts or payments under the swap agreements are recorded as adjustments to interest expense on an accrual basis. The company formally designates its hedges, documents and all hedging relationships and formally assesses hedge effectiveness. Derivative instruments designated as hedges in effective hedging relationships are accounted for using hedge accounting. In the event a hedging relationship is extinguished or the relationship is found to be ineffective, realized or unrealized gains or losses are recognized in the results of operations. For derivative instruments to which hedge accounting cannot be applied, realized and unrealized changes in fair value are charged to operations in the periods in which they occur. There were no interest rate swap agreements outstanding as at December 31, 2006.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Credit Risk

Hydro is exposed to credit risk associated with trade receivables. Although a significant portion of the total accounts receivable balance are due from one customer, management does not consider Hydro to be exposed to a material credit risk since that customer is another regulated utility.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis, and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees, and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 12 years.

Changes to Accounting Policies

In 2005, the CICA released Handbook sections 3855, 3865 and 1530, respectively entitled Financial Instruments - Recognition and Measurement, Hedges and Comprehensive Income.

Section 3855 specifies when a financial instrument should be accounted for on the balance sheet and at what amount: In some cases at fair value, while in other cases at a value based on cost. It also specifies how gains and losses on financial instruments should be presented.

Section 3865 replaces the guidance for hedging relationships that previously was included in Accounting Guideline 13, in particular the guidance for the designation and documentation of hedging relationships. These new recommendations specify how hedge accounting is applied and the required disclosures to be made by an entity applying hedge accounting.

Section 1530 establishes standards for the presentation and disclosure of comprehensive income. Comprehensive income for a reporting period includes, in addition to net income, the entire change in net assets attributable to transactions and other events from non-owner sources. Comprehensive income and its components will have to be presented in a financial statement with the same prominence as the other financial statements.

These sections will apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007. Hydro is currently examining the impact on its consolidated financial statements of applying these new standards.

2. PROPERTY, PLANT AND EQUIPMENT

	Property Plant and Equipment in Service	Contributions In aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
millions of dollars			2006		
Generation Plant					
Hydroelectric	1,362.0	20.5	300.8	70.4	1,111.1
Thermal	235.7	0.8	184.3	1.0	51.6
Diesel	59.7	6.1	27.9	1.0	26.7
Transmission and Distribution	753.0	60.8	213.9	2.3	480.6
Service facilities	22.0	-	10.8	-	11.2
Other	289.9	29.1	155.5	5.0	110.3
	2,722.3	117.3	893.2	79.7	1,791.5

2. PROPERTY, PLANT AND EQUIPMENT (cont'd.)

millions of dollars	Property Plant and Equipment in Service	Contributions In aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
			2005		
Generation Plant					
Hydroelectric	1,358.8	20.5	289.1	54.8	1,104.0
Thermal	231.7	-	180.8	0.8	51.7
Diesel	58.5	6.3	26.0	0.1	26.3
Transmission and Distribution	734.2	55.1	197.8	2.2	483.5
Service facilities	22.0	-	10.4	-	11.6
Other	267.6	24.6	146.9	8.4	104.5
	2,672.8	106.5	851.0	66.3	1,781.6

Included in the above amounts are CF(L)Co. assets in service amounting to $651.9 million (2005 - $641.9 million) which are pledged as collateral for long-term debt.

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods, that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities are no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations.

millions of dollars	2006	2005	Remaining Recovery Settlement Period (years)
Regulatory assets			
Long-term Receivable	**63.1**	105.0	2
Rate Stabilization Plan	-	0.1	n/a
Foreign Exchange Losses	**75.5**	77.6	36
Deferred Regulatory costs	**0.6**	0.7	3
Deferred Major Extraordinary Repairs	**8.7**	3.8	5
Deferred Study Costs	**0.3**	0.1	3
Total regulatory assets	**148.2**	187.3	
Less current portion	**45.3**	41.8	
	102.9	145.5	
Regulatory liabilities			
Rate Stabilization Plan	**49.6**	11.9	n/a
Deferred Purchased Power Savings	**0.7**	0.8	21
Total regulatory liabilities	**50.3**	12.7	
Less current portion	**33.7**	1.3	
	16.6	11.4	

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Rate Stabilization Plan and Related Long-Term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to December 31, 2003, have been converted to a long-term receivable which bears interest at the weighted average cost of capital and is to be recovered over a four-year period, which commenced in 2004. Any subsequent balances accumulating in the RSP including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2006, $3.9 million was deferred (2005 - $6.3 million) in the RSP.

Foreign Exchange Losses

The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses, be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 13).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 14 (2004), the PUB approved the deferral of external costs associated with the general rate application and hearing, to be amortized over a 3 year period, which commenced in 2004. In its 2006 general rate application, Hydro sought and expects to receive approval for the deferral and amortization of external costs associated with that application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2006, $0.7 million (2005 - $0.7 million) of amortization was recognized in operations and administration expenses.

Deferred Major Extraordinary Repair

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program is being carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program will be recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the costs of the asbestos abatement program and the boiler tube repairs in the year in which they were incurred. In 2006, $1.1 million (2005 - $0.1 million) of amortization was recognized in operating costs.

3. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. In its 2006 general rate application, Hydro sought, and expects to receive, approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2006, \$0.2 million (2005 - \$0.1 million) was deferred in relation to studies.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro Quebec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. Since Hydro's AFUDC (7.6%) is lower that its cost of debt (8.0%), the amount capitalized is lower and interest expense is higher by \$0.3 million (2005 - \$0.2 million) than that which would be permitted in the absence of rate regulation (Note 13).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

During 2005, pursuant to Order No. P.U. 7 (2002-2003) Hydro engaged an independent consultant to conduct a amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management estimates that accumulated amortization is approximately \$170-180 million lower than it would otherwise be, and annual amortization expense is \$10-11 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets.

4. LONG-TERM RECEIVABLES

Included in long-term receivables is a refundable deposit associated with an application for transmission service into Québec, which bears interest at prime, in the amount of \$18.1 million (2005 - nil).

5. INVESTMENTS

millions of dollars	**2006**	2005
Lower Churchill Option	5.2	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

5. **INVESTMENTS (cont'd.)**

If LCDC is chosen as the ownership and financing vehicle for further development of the Lower Churchill Project, GIPCo.'s assets and the hydroelectric development rights to the Lower Churchill River, (Water Rights), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (Option Agreement). The purchase price in respect of GIPCo.'s assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo.'s assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2007.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

6. **JOINT VENTURE**

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co.'s assets and liabilities at December 31, 2006, and its proportionate interest in CF(L)Co.'s operations for the year ended December 31, 2006.

millions of dollars	**2006**	2005
Current assets	**44.0**	32.9
Long-term assets	**325.1**	331.8
Current liabilities	**24.8**	24.4
Long-term liabilities	**37.4**	51.7
Revenues	**70.6**	66.4
Expenses	**48.7**	48.6
Net income	**21.9**	17.8
Cash provided by (used in)		
Operating activities	**33.6**	32.1
Financing activities	**(19.8)**	(19.2)
Investing activities	**(10.1)**	(11.5)

7. **DEFERRED CHARGES**

millions of dollars	**2006**	2005
Debt discount, financing expenses and other	**16.7**	14.9
Accumulated amortization	**13.2**	12.2
Net deferred charges	**3.5**	2.7

8. LONG-TERM DEBT

millions of dollars	Hydro	CF(L)Co.	Total	Hydro	CF(L)Co.	Total
		2006			2005	
Summary of long-term debt						
Long-term debt	**1,349.3**	**51.6**	**1,400.9**	1,331.5	65.9	1,397.4
Less current portion	**8.3**	**14.2**	**22.5**	208.4	14.2	222.6
	1,341.0	**37.4**	**1,378.4**	1,123.1	51.7	1,174.8

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2007	2008	2009	2010	2011
Sinking fund requirements	8.1	8.1	8.1	8.2	8.2
Long-term debt repayments	14.4	201.0	1.0	35.9	-
	22.5	209.1	9.1	44.1	8.2

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity	**2006**	2005	
millions of dollars						
AC	5.05	2001	2006	-	200.0	
AA	5.50	1998	2008	**200.0**	200.0	
V	10.50	1989	2014	**125.0**	125.0	(a)
X	10.25	1992	2017	**150.0**	150.0	(a)
Y	8.40	1996	2026	**300.0**	300.0	(a)
AB	6.65	2001	2031	**300.0**	300.0	(a)
AD	5.70	2003	2033	**125.0**	125.0	(a)
AE	4.30	2006	2016	**225.0**	-	
Total debentures				**1,425.0**	1,400.0	
Less sinking fund investments in own debentures				**76.2**	69.2	
				1,348.8	1,330.8	
Government of Canada loans at 5.25% to 5.63% maturing in 2006				**-**	0.1	
Other				**0.5**	0.6	
				1,349.3	1,331.5	
Less current portion				**8.3**	208.4	
				1,341.0	1,123.1	

(a) Sinking funds have been established for these issues.

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

Hydro maintains a $50 million Canadian or US equivalent unsecured operating credit facility with its banker. The facility is a requirement of Hydro's short term promissory note program and is intended primarily to be a source of short-term funding in the event of disruptions in normal money market operations. Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance with interest calculated at the Prime Rate or prevailing Government BA Fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate.

8. LONG-TERM DEBT (cont'd.)

CF(L)Co.

millions of dollars	**2006**	2005
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (U.S. $10.6; 2005 - U.S. $21.2)	**12.4**	24.8
7.875% Series B due December 15, 2007	**1.1**	2.2
General Mortgage Bonds		
7.500% due December 15, 2010	**38.1**	38.9
	51.6	65.9
Less current portion	**14.2**	14.2
	37.4	51.7

The First Mortgage Bonds, Series A and B, are repayable in fixed semi-annual and in contingent annual sinking fund instalments. There have been no contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments which commenced in June 1980. Each payment will be an amount equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date with a final principal payment of $35.9 million due in 2010. These bonds are subordinate to the First Mortgage Bonds.

Under the terms of long-term debt instruments, CF(L)Co. may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999 places additional restrictions on dividends based on cash flow.

9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, arising from the difference between energy deliveries and the Annual Energy Base (AEB) pursuant to the Power Contract, bears an interest at 7.0% per annum and is repayable over a four-year period which commenced in September 2004. The current portion of $0.4 million (2005 - $0.4 million) is included in accounts payable and accrued liabilities.

10. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employers' contributions of $4.2 million (2005 - $4.1 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2006, cash payments to beneficiaries for its unfunded other employee future benefits was $2.4 million (2005 - $2.0 million). The most recent actuarial valuation was performed as at December 31, 2006.

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

millions of dollars	2006	2005
Accrued benefit obligation		
Balance at beginning of year	49.0	46.4
Current service cost	2.0	1.6
Interest cost	3.0	3.0
Actuarial loss	16.2	-
Benefits paid	(2.4)	(2.0)
Balance at end of year	67.8	49.0
Plan deficit at end of year	67.8	49.0
Unamortized actuarial loss	(25.2)	(10.2)
Unamortized past-service cost	(0.3)	(0.3)
Accrued benefit liability at end of year	42.3	38.5

millions of dollars	2006	2005
Components of benefit cost		
Current service cost	2.0	1.6
Interest cost	3.0	3.0
Actuarial losses	16.2	-
	21.2	4.6
Adjustments		
Difference between actual actuarial loss and amount recognized	(15.0)	0.5
Benefit expense	6.2	5.1

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2006	2005
Discount rate	5.3%	6.3%
Rate of compensation increase	3.5%	3.5%

Assumed healthcare trend rates:

	2006	2005
Initial healthcare expense trend rate	12.0%	12.0%
Cost trend decline to	5.0%	5.0%
Year that rate reaches the rate it is assumed to remain at	2010	2010

A 1% change in assumed healthcare trend rates would have had the following effects for 2006:

millions of dollars	Increase	Decrease
Current service cost	0.2	(0.2)
Interest cost	0.5	(0.3)
Accrued benefits obligation	6.7	(2.1)

11. SHAREHOLDERS' EQUITY

Share Capital

millions of dollars	2006	2005
Common shares of par value $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	22.5	22.5

11. SHAREHOLDERS' EQUITY (cont'd.)

Contributed Capital

millions of dollars	**2006**	2005
Lower Churchill Development Corporation	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**96.4**	96.4
	114.0	114.0

12. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31, 2006 and 2005 are based on relevant market prices and information available at the time. The fair value of long-term receivable, long-term debt and the long-term payable is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	Fair Value	Carrying Value	Fair Value
millions of dollars	**2006**		2005	
Financial Assets				
Sinking funds	**97.3**	**113.6**	85.8	102.0
Long-term receivable including current portion	**20.3**	**20.3**	2.5	2.5
Financial Liabilities				
Long-term debt including current portion	**1,400.9**	**1,759.1**	1,397.4	1,783.8
Long-term payable including current portion	**0.7**	**0.8**	1.1	1.1

Cash and cash equivalents, short-term investments, accounts receivable, bank indebtedness, accounts payable, accrued interest and promissory notes are all short-term in nature and as such, their carrying value approximates fair value.

Sinking Funds

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2005 - 4.50% to 9.86%).

13. INTEREST EXPENSE

millions of dollars	**2006**	2005	
Gross interest			
Long-term debt	**106.6**	108.3	
Promissory notes	**5.1**	4.5	
	111.7	112.8	
Amortization of debt discount and financing expenses	**1.1**	1.0	
Provision for foreign exchange losses	**2.1**	2.3	
Foreign exchange gain	**-**	(0.1)	
	114.9	116.0	
Less			
Recovered from Hydro-Québec	**1.1**	1.5	(a)
Interest capitalized during construction	**4.9**	4.3	
Interest earned	**17.2**	18.7	
Net interest expense	**91.7**	91.5	
Debt guarantee fee	**14.0**	14.4	
Net interest and guarantee fee	**105.7**	105.9	

(a) Under the terms of the Power Contract, CF(L)Co. recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co. can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co. can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

14. CHANGES IN NON-CASH BALANCES

millions of dollars	**2006**	2005
Accounts receivable	**(4.5)**	(0.7)
Fuel and supplies	**5.3**	(11.4)
Prepaid expenses	**0.8**	(0.3)
Accounts payable and accrued liabilities	**(9.8)**	10.8
Regulated assets	**39.1**	36.5
Regulated liabilities	**37.6**	6.4
Accrued interest	**1.3**	(0.8)
Employee future benefits	**3.8**	3.1
Long-term receivable	**(17.8)**	1.5
Long-term payable	**(0.4)**	(0.4)
	55.4	44.7

15. SEGMENT INFORMATION

Hydro operates in three business segments. Regulated operations encompass sales of power and energy to most customers within the province of Newfoundland and Labrador while non-regulated operations are primarily engaged in energy project development and sales relative to markets outside the province. Churchill Falls operates a hydro-electric generating facility and sells electricity primarily to Hydro-Québec. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those described in Note 2.

millions of dollars	Regulated Operations	Non-Regulated Operations	Churchill Falls	Inter Segment Eliminations	Total
			2006		
Revenue - External customers	**416.5**	**57.4**	**70.6**		**548.0**
- Inter segment		**10.1**	**3.9**	**(10.5)**	
Amortization	**36.6**	**-**	**11.9**		**48.5**
Interest	**102.4**	**(1.3)**	**4.5**	**0.1**	**105.7**
Net income (loss)	**(6.9)**	**50.5**	**26.4**		**70.0**
Assets	**1,716.5**	**97.5**	**402.0**		**2,216.0**
Capital expenditures	**41.6**	**14.7**	**4.6**		**60.9**
millions of dollars			2005		
Revenue - External customers	408.7	54.3	66.4		532.5
- Inter segment		9.1	3.9	(9.9)	
Amortization	35.5	-	11.5		47.0
Interest	99.5	-	6.4		105.9
Net income	3.3	47.2	21.4		71.9
Assets	1,740.4	64.7	399.0		2,204.1
Capital expenditures	36.4	5.3	6.0		47.7

In 2006, sales to Hydro's two largest customers amounted to 61% and 14% of total revenue (2005 - 59% and 13%). At December 31, 2006 approximately 53.1% (2005 – 49.2%) of the total accounts receivable balance outstanding is due from one customer.

Geographic Information

Revenues by geographic area:

millions of dollars	2006	2005
Newfoundland and Labrador	**426.8**	413.7
Québec	**121.2**	118.8
	548.0	532.5

Substantially all of Hydro's assets are located in the Province.

16. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co. is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of Twin Falls will revert to Churchill Falls, and Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out in 2006, 2010 and every five years thereafter. The results of the 2006 monitoring are not yet available.

16. COMMITMENTS AND CONTINGENCIES (cont'd.)

(b) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls will commence the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls will acquire the permitted investments in six consecutive tranches during the 30-day period commencing on each of the following dates:

January 1, 2007	17.0 million
January 1, 2008	17.0 million
January 1, 2009	17.0 million
January 1, 2010	8.0 million
January 1, 2011	8.0 million
January 1, 2012	8.0 million

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced.

(c) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $1.4 million (2005 - $0.5 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $22.2 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(d) Outstanding commitments for capital projects total approximately $9.9 million at December 31, 2006 (2005 - $13.9 million).

(e) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	15 years
Hydroelectric	3 MW	1995	25 years
Hydroelectric	15 MW	1998	25 years
Hydroelectric	4 MW	1998	25 years
Hydroelectric	32 MW	2003	30 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years

Estimated payments due in each of the next 5 years are as follows:

millions of dollars	2007	2008	2009	2010	2011
Power purchases	35.3	37.1	43.7	50.2	55.4

17. RELATED PARTY TRANSACTIONS

The Province, CF(L)Co, LCDC and GIPCo are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

(a) Hydro has entered into a long-term power contract with CF(L)Co. for the purchase of $6.1 million (2005 -$6.1 million) of the power produced by CF(L)Co.

17. RELATED PARTY TRANSACTIONS (cont'd.)

(b) Under an agreement between Hydro and CF(L)Co., Hydro provides certain engineering, technical, management and administrative services to CF(L)Co. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. For the year ended December 31, 2006 the fees paid to Hydro for these services amounted to approximately $1.9 million (2005 - $2.2 million).

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2006, Hydro paid $0.8 million (2005 - $0.7 million) to the PUB, including $0.4 million which was in accrued liabilities reflected at December 31 (2005 - nil).

(d) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co. must pay rentals and royalties to the Province annually.

18. COMPARATIVE FIGURES

Certain of the 2005 comparative figures have been reclassified to conform with the 2006 financial statement presentation.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007

Deloitte.

Deloitte & Touche LLP
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Independent Auditors' Report

To the Lieutenant-Governor in Council
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro as at December 31, 2007 and the consolidated statements of income and retained earnings and comprehensive income and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 2.

Deloitte & Touche LLP

Chartered Accountants
February 25, 2008

BOARD OF DIRECTORS

DEAN T. MacDONALD[1]
Chief Executive Officer
Persona Inc.

EDMUND J. MARTIN
President and Chief Executive Officer
Newfoundland and Labrador Hydro

EDNA TURPIN
Consultant

GERALD J. SHORTALL
Chartered Accountant

TOM CLIFT
Associate Dean Academic Programs
Faculty of Business
Memorial University of Newfoundland

KEN MARSHALL
President
Rogers Cable - Atlantic Region

CHRIS KIELEY
Deputy Minister
Department of Natural Resources

CATHY BENNETT
Business Person

OFFICERS

DEAN T. MacDONALD[1]
Chairman

EDMUND J. MARTIN
President and Chief Executive Officer

DERRICK F. STURGE
Vice-President, Finance and Chief Financial Officer

JAMES R. HAYNES
Vice-President, Regulated Operations

JOHN E. MALLAM
Vice-President, Engineering Services

JIM M. KEATING
Vice-President, Business Development

ANDREW E. MacNEILL
Vice-President, Upper Churchill Operations

GERARD V. McDONALD
Vice-President, Human Resources and
Organizational Effectiveness

GILBERT J. BENNETT
Vice-President, Lower Churchill Project

WAYNE D. CHAMBERLAIN
General Counsel and Corporate Secretary

PETER A. HICKMAN
Assistant Corporate Secretary

MARK G.S. BRADBURY
Corporate Treasurer

GLENN H. MITCHELL
Corporate Controller

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland and Labrador
A1B 4K7

[1] Resigned effective December 18, 2007

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	2007	2006
ASSETS		
Current assets		
Cash and cash equivalents	**7.2**	10.0
Short-term investments	**11.5**	11.7
Accounts receivable	**80.6**	72.4
Current portion of long-term receivable (Note 5)	**0.5**	1.1
Current portion of regulatory assets (Note 4)	**12.1**	45.3
Fuel and supplies	**69.7**	54.4
Prepaid expenses	**1.2**	1.5
	182.8	196.4
Property, plant and equipment (Note 3)	**1,825.7**	1,791.5
Long-term receivables (Note 5)	**23.3**	19.2
Sinking funds (Notes 8 and 12)	**151.8**	117.1
Regulatory assets (Note 4)	**86.4**	102.9
Investments (Note 6)	**5.2**	5.2
Reserve fund (Note 17)	**11.1**	-
	2,286.3	2,232.3
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness	**9.1**	6.5
Accounts payable and accrued liabilities	**75.9**	49.2
Accrued interest	**30.7**	30.8
Current portion of long-term debt (Note 8)	**209.1**	22.5
Current portion of regulatory liabilities (Note 4)	**23.5**	33.7
Promissory notes (Note 8)	**7.0**	58.8
	355.3	201.5
Long-term debt (Note 8)	**1,187.8**	1,394.7
Regulatory liabilities (Note 4)	**15.5**	16.6
Long-term payable (Note 9)	**-**	0.3
Employee future benefits (Note 10)	**47.4**	42.3
	62.9	59.2
Non-controlling interest in Lower Churchill Development Corporation	**2.5**	2.5
Shareholder's equity (Note 11)		
Share capital	**22.5**	22.5
Contributed capital	**114.0**	114.0
Retained earnings	**521.8**	437.9
Accumulated other comprehensive income (Note 12)	**19.5**	-
	677.8	574.4
Commitments and contingencies (Note 17)		
	2,286.3	2,232.3

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2007**	2006
Revenue		
Energy sales	**546.5**	522.9
Guaranteed winter availability	**21.0**	18.9
Rentals and royalties	**0.3**	0.3
Other	**5.6**	5.9
	573.4	548.0
Expenses		
Operations and administration	**143.1**	130.4
Fuels	**159.2**	154.6
Power purchased	**38.4**	38.8
Amortization	**50.7**	48.5
Interest (Note 14)	**100.4**	105.7
	491.8	478.0
Net income	**81.6**	70.0
Retained earnings, beginning of year	**437.9**	370.5
Add: adjustment to opening retained earnings (Note 2)	**2.3**	-
	521.8	440.5
Dividends	**-**	2.6
Retained earnings, end of year	**521.8**	437.9

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31 (millions of dollars)	**2007**	2006
Net Income	**81.6**	70.0
Other Comprehensive income		
Change in fair value of sinking fund investments	**0.2**	-
Comprehensive income	**81.8**	70.0

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2007**	2006
Cash provided by (used in)		
Operating activities		
Net income	**81.6**	70.0
Adjusted for items not involving a cash flow		
Amortization	**50.7**	48.5
Accretion of long-term debt	**0.8**	1.0
Loss on disposal of property, plant and equipment	**1.0**	1.6
Foreign exchange gain	**(0.3)**	-
Other	**(0.1)**	0.4
	133.7	121.5
Change in non-cash balances (Note 15)	**42.1**	55.4
	175.8	176.9
Financing activities		
Decrease in promissory notes	**(51.8)**	(92.0)
Long-term debt issued	**-**	225.0
Long-term debt retired	**(13.1)**	(215.1)
Dividends	**-**	(2.6)
Foreign exchange loss recovered	**0.1**	0.7
	(64.8)	(84.0)
Investing activities		
Additions to property, plant and equipment	**(86.5)**	(60.9)
Increase in sinking funds	**(19.6)**	(18.5)
Decrease (increase) in short-term investments	**0.2**	(5.6)
Additions to regulatory assets	**-**	(1.9)
Increase in reserve fund	**(11.1)**	-
Proceeds on disposal of property, plant and equipment	**0.6**	0.5
	(116.4)	(86.4)
Net (decrease) increase in cash	**(5.4)**	6.5
Cash position, beginning of year	**3.5**	(3.0)
Cash position, end of year	**(1.9)**	3.5
Cash position is represented by		
Cash and cash equivalents	**7.2**	10.0
Bank indebtedness	**(9.1)**	(6.5)
	(1.9)	3.5
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**1.2**	1.7
Interest paid	**105.4**	111.3

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Newfoundland and Labrador Hydro (Hydro) is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and its principal activity is the development, generation and sale of electricity.

Gull Island Pond Corporation (GIPCo.) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland (Gull Island Project). Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River (Lower Churchill Development). Both GIPCo. and LCDC are inactive.

CF(L)Co. is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (CF(L)Co. Project). Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974. Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, litigation, environmental and asset retirement obligations, amortization, property, plant, and equipment and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB).

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's revenues from electricity sales to most customers within the Province are subject to rate regulation by the PUB. As well, Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4%. Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 4.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, GIPCo., (100% owned) and LCDC, (51% owned).

Effective June 18, 1999, Hydro, Churchill Falls (Labrador) Corporation Limited (CF(L)Co.) and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of CF(L)Co. be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to CF(L)Co., from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in CF(L)Co. subsequent to the effective date of the shareholders' agreement.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Principles of Consolidation (cont'd.)

A portion of Hydro's shareholding in CF(L)Co. is deposited in a voting trust pursuant to an agreement with Hydro-Québec, in relation to CF(L)Co's General Mortgage Bonds. Effective February 25, 2008, the bonds were retired, removing the requirement for the shares to be held in trust.

CF(L)Co. holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives CF(L)Co. joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

Cash Equivalents and Short-Term Investments

Cash equivalents and short-term investments consist primarily of Canadian treasury bills and banker's acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. The short-term investments outstanding at December 31, 2007 bear interest rates of 4.12% to 5.00% (2006 - 4.28% to 4.35%) per annum.

Fuel and Supplies

Fuel and supplies inventories are recorded at average cost.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that it is reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment, or the fair value of assets contributed. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment are amortized.

Hydro, GIPCo. and LCDC
Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Gains or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Estimated service lives of the major assets are as follows:

Generation Plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution System	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors, and generators, as well as water conveying and control structures, including dams, dykes, tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks, and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners, and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kV. Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductor.

Other assets would include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

<u>CF(L)Co.</u>
CF(L)Co. uses the group amortization method for certain property, plant and equipment other than the generation plant, transmission and terminals and service facilities.

Amortization is provided on a straight-line basis over the following estimated useful lives:

Generation Plant	
Hydroelectric	67 years
Transmission and Terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to amortization expense.

Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Revenue Recognition

Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB. Sales to Hydro-Québec and certain major industrial customers are at rates under the terms of applicable contracts.

A power contract with Hydro-Québec, dated May 12, 1969 (Power Contract) provides for the sale of substantially all the energy from the CF(L)Co. Project until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The base rate is predetermined in the Contract and decreases from the existing rate of 2.5425 mills per kWh to 2.0 mills per kWh upon renewal in 2016.

CF(L)Co. receives revenues from Hydro-Québec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of additional availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

Also included in revenue are amounts billed under the Power Contract in excess of energy delivered. Amounts related to energy delivered in excess of the base amount, as defined by the Power Contract, are recorded as receivables. Differences between amounts related to energy delivered and the base amounts are determined annually and are subject to interest at 7% per annum (2006 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

   (i) Foreign exchange gains and losses are included in income in the current year except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract. The First Mortgage Bonds were paid out during the year. Churchill Falls recovered a portion of the difference between actual foreign exchange rates prevailing at the settlement dates of its First Mortgage Bonds and a Weighted Average Exchange Rate as defined in the Power Contract.

Credit Risk

Hydro is exposed to credit risk associated with trade receivables. Although a significant portion of the total accounts receivable balance are due from one customer, management does not consider Hydro to be exposed to a material credit risk since that customer is another regulated utility.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

2. NEW ACCOUNTING POLICIES

Effective January 1, 2007, Hydro adopted four new accounting standards issued by The Canadian Institute of Chartered Accountants' (CICA). Section 1530, "Comprehensive Income," introduces a new financial statement which shows the change in net assets of an enterprise attributable to transactions and other events from non-owner sources. Section 3855, "Financial Instruments - Recognition and Measurement," establishes standards for recognizing and measuring financial instruments, namely financial assets, financial liabilities and derivatives. The new standards prescribe how financial instruments are to be recognized on the balance sheet and the measurement of such amount. Depending on financial instruments' classification, changes in subsequent measurements are recognized in net income or Other Comprehensive Income (OCI). Section 3861, "Financial Instruments - disclosure and presentation" establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them. Section 3865, "Hedges" specifies when and how hedge accounting may be applied. Hydro did not engage in any hedging relationships during this period.

Under the new standards, all financial instruments are classified into one of the following five categories: held-to-maturity, loans and receivables, available-for-sale, held-for-trading or other liabilities. All financial instruments, including derivatives, are carried at fair value on the consolidated balance sheet except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in OCI until the instrument is derecognized or impaired.

The Company has classified its financial instruments as follows:

Cash and cash equivalents	Held-for- trading
Short-term investments	Held-to-maturity
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available for sale
Reserve fund	Available for sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities

These new standards have been applied prospectively without restatement of prior period amounts. Hydro recognized an increase to opening retained earnings of $2.3 million upon adoption of these standards. This adjustment arose from the measurement of outstanding long-term debt at amortized cost, using the effective interest method. As well, Hydro recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of $19.3 million.

3. PROPERTY, PLANT AND EQUIPMENT

millions of dollars	Property Plant and Equipment in Service	Contributions In aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
			2007		
Generation Plant					
Hydroelectric	**1,363.5**	**20.5**	**313.2**	**114.4**	**1,144.2**
Thermal	**244.2**	**0.8**	**188.3**	**0.8**	**55.9**
Diesel	**61.3**	**5.9**	**29.7**	**0.1**	**25.8**
Transmission and Distribution	**767.2**	**60.7**	**229.2**	**0.8**	**478.1**
Service facilities	**22.0**	**-**	**11.1**	**-**	**10.9**
Other	**306.0**	**32.0**	**167.5**	**4.3**	**110.8**
	2,764.2	**119.9**	**939.0**	**120.4**	**1,825.7**

3. PROPERTY, PLANT AND EQUIPMENT (cont'd.)

millions of dollars	Property Plant and Equipment in Service	Contributions In aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
			2006		
Generation Plant					
Hydroelectric	1,362.0	20.5	300.8	70.4	1,111.1
Thermal	235.7	0.8	184.3	1.0	51.6
Diesel	59.7	6.1	27.9	1.0	26.7
Transmission and Distribution	753.0	60.8	213.9	2.3	480.6
Service facilities	22.0	-	10.8	-	11.2
Other	289.9	29.1	155.5	5.0	110.3
	2,722.3	117.3	893.2	79.7	1,791.5

Included in the above amounts are CF(L)Co. assets in service amounting to $653.7 million (2006 - $651.9 million) which are pledged as collateral for long-term debt.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

millions of dollars	**2007**	2006	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Long-term receivable	**12.1**	63.1	0.5
Foreign exchange losses	**73.3**	75.5	35.0
Deferred regulatory costs	**0.4**	0.6	2.0
Deferred major extraordinary repairs	**12.3**	8.7	5.0
Deferred study costs	**0.4**	0.3	2.0
Total regulatory assets	**98.5**	148.2	
Less current portion	**12.1**	45.3	
	86.4	102.9	
Regulatory liabilities			
Rate stabilization plan	**38.3**	49.6	n/a
Deferred purchased power savings	**0.7**	0.7	20.0
Total regulatory liabilities	**39.0**	50.3	
Less current portion	**23.5**	33.7	
	15.5	16.6	

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods, that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities are no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Rate Stabilization Plan and Related Long-Term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to March 31, 2003, have been converted to a long-term receivable which bears interest at the weighted average cost of capital and is to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007 and any remaining balances were transferred to the current plan. The recovery period for the utility customer will end on June 30, 2008. Any subsequent balances accumulating in the RSP including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2007, $31.5 million was recognized (2006 - $3.9 million deferred) in the RSP and $8.9 million (2006 - $83.6 million) was recovered through rates, and included in energy sales with a corresponding cost amortized in fuel expenses.

Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 14).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 14 (2004), the PUB approved the deferral of external costs associated with the general rate application and hearing, to be amortized over a three-year period, which commenced in 2004. Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2007, $0.2 million (2006 - $0.7 million) of amortization was recognized in operations and administration expenses.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program will be recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, Hydro incurred $2.0 million in expenses to repair a turbine at Holyrood Thermal Generating Station. These costs have been deferred as a major extraordinary repair. Subject to PUB approval, these costs will be amortized over a five-year period commencing in 2008. In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube and turbine repairs in the year in which they were incurred. In 2007, $2.1 million (2006 - $1.1 million) of amortization was recognized in operating costs.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2007, $0.2 million (2006 - $0.2 million) was deferred in relation to these studies and $0.1 million (2006 - nil) of amortization was recognized in operating costs.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro Quebec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. Since Hydro's AFUDC (7.6%) is lower that its cost of debt (8.0%), the amount capitalized is lower and interest expense is higher by $0.3 million (2006 - $0.3 million) than that which would be permitted in the absence of rate regulation (Note 14).

Hydro depreciates its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

During 2005, pursuant to Order No. P.U. 7 (2002-2003) Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management estimated that accumulated amortization is approximately $170-180 million lower than it would otherwise be, and annual amortization expense is $10-11 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets. An update to this study is planned for 2008.

5. LONG-TERM RECEIVABLES

Included in long-term receivables are two refundable deposits associated with an application for transmission service into Québec, bearing interest at prime until April, 2007 and at one year Guaranteed Income Certificate (GIC) rates thereafter.

6. INVESTMENTS

millions of dollars	**2007**	2006
Lower Churchill Option	**5.2**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

If LCDC is chosen as the ownership and financing vehicle for further development of the Lower Churchill Project, GIPCo.'s assets and the hydroelectric development rights to the Lower Churchill River, (Water Rights), will be acquired by LCDC pursuant to the provisions of an agreement between LCDC and the Province, (Option Agreement). The purchase price in respect of GIPCo.'s assets will be a maximum of $100.0 million less $5.2 million representing the value assigned to 520 Class A common shares of LCDC issued pursuant to the signing of the Option Agreement. As consideration for GIPCo.'s assets, LCDC will issue a 10% Convertible Demand Debenture in the amount of $94.8 million. LCDC will issue 3,000 Class B common shares, without nominal or par value, to the Province in consideration of the Water Rights and the Province will transfer such shares to Hydro. The parties have agreed that the value of each Class B common share is $10,000. The Option Agreement expires November 24, 2008.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. Five hundred and twenty shares were acquired in 1979 pursuant to signing of the Option Agreement and five hundred and ten shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

7. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of CF(L)Co.'s assets and liabilities at December 31, 2007, and its proportionate interest in CF(L)Co.'s operations for the year ended December 31, 2007.

millions of dollars	**2007**	2006
Current assets	**39.5**	44.0
Long-term assets	**328.9**	325.1
Current liabilities	**12.5**	24.8
Long-term liabilities	**36.6**	37.4
Revenues	**70.6**	70.6
Expenses	**51.0**	48.7
Net income	**19.6**	21.9
Cash provided by (used in)		
Operating activities	**40.4**	33.6
Financing activities	**(19.7)**	(19.8)
Investing activities	**(16.3)**	(10.1)

8. LONG-TERM DEBT

	Hydro	CF(L)Co.	Total	Hydro	CF(L)Co.	Total
millions of dollars		**2007**			2006	
Summary of long-term debt						
Long-term debt	**1,359.4**	**37.5**	**1,396.9**	1,365.6	51.6	1,417.2
Less current portion	**208.3**	**0.8**	**209.1**	8.3	14.2	22.5
	1,151.1	**36.7**	**1,187.8**	1,357.3	37.4	1,394.7

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

millions of dollars	2008	2009	2010	2011	2012
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	200.9	0.9	35.9	-	-
	209.1	9.1	44.1	8.2	8.2

Details of long-term debt are as follows:

Hydro

Series	Interest Rate %	Year of Issue	Year of Maturity			
millions of dollars				**2007**	2006	
AA	5.50	1998	2008	**199.9**	199.6	
V	10.50	1989	2014	**124.4**	124.7	(a)
X	10.25	1992	2017	**149.0**	149.4	(a)
Y	8.40	1996	2026	**292.7**	294.5	(a)
AB	6.65	2001	2031	**307.1**	306.6	(a)
AD	5.70	2003	2033	**123.5**	123.6	(a)
AE	4.30	2006	2016	**223.3**	223.2	
Total debentures				**1,419.9**	1,421.6	
Less sinking fund investments in own debentures				**60.8**	56.5	
				1,359.1	1,365.1	
Other				**0.3**	0.5	
				1,359.4	1,365.6	
Less current portion				**208.3**	8.3	
				1,151.1	1,357.3	

(a) Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2006 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31.

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end the promissory notes outstanding were at an interest rates ranging from 4.30 to 4.45% (2006 - 4.25% - 4.55%).

Hydro maintains a $50 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a prime rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the prime rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate.

8. LONG-TERM DEBT (cont'd.)

CF(L)Co.

millions of dollars	**2007**	2006
First Mortgage Bonds		
7.750% Series A due December 15, 2007 (2006 - U.S. $10.6)	-	12.4
7.875% Series B due December 15, 2007	-	1.1
General Mortgage Bonds		
7.500% due December 15, 2010	**37.5**	38.1
	37.5	51.6
Less current portion	**0.8**	14.2
	36.7	37.4

The First Mortgage Bonds, Series A and B, were repayable in fixed semi-annual and in contingent annual sinking fund instalments. There were contingent repayments required in the last five years.

The Deed of Trust and Mortgage securing the General Mortgage Bonds provides for semi-annual sinking fund payments which commenced in June 1980. Each payment will be an amount equal to 1% of the aggregate principal amount outstanding on January 1, preceding each payment date with a final principal payment of $35.9 million due in 2010. These bonds were subordinate to the First Mortgage Bonds (Note 19).

Churchill Falls maintains a $10.0 million Canadian or US equivalent unsecured operating credit facility with its banker. Advances may take the form of a prime rate advance or the issuance of a BA with interest calculated at the prime rate or prevailing Government BA Fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the prime rate.

Under the terms of long-term debt instruments, CF(L)Co. may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June, 1999 places additional restrictions on dividends based on cash flow.

9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec, arising from the difference between energy deliveries and the Annual Energy Base (AEB) pursuant to the Power Contract, bears an interest at 7.0% per annum and is repayable over a four-year period which commenced in September 2004. The current portion of $0.4 million (2006 - $0.4 million) is included in accounts payable and accrued liabilities.

10. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multiemployer defined benefit plan. The employers' contributions of $4.6 million (2006 - $4.2 million) are expensed as incurred.

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2007, cash payments to beneficiaries for its unfunded other employee future benefits was $2.3 million (2006 - $2.4 million). The most recent actuarial valuation was performed as at December 31, 2007.

millions of dollars	**2007**	2006
Accrued benefit obligation		
Balance at beginning of year	**67.8**	49.0
Current service cost	**2.3**	2.0
Interest cost	**3.6**	3.0
Actuarial (gain) loss	**(2.8)**	16.2
Benefits paid	**(2.3)**	(2.4)
Balance at end of year	**68.6**	67.8
Plan deficit at end of year	**68.6**	67.8
Unamortized actuarial loss	**(20.9)**	(25.2)
Unamortized past-service cost	**(0.3)**	(0.3)
Accrued benefit liability at end of year	**47.4**	42.3

millions of dollars	**2007**	2006
Components of benefit cost		
Current service cost	**2.3**	2.0
Interest cost	**3.6**	3.0
Actuarial (gain) loss	**(2.8)**	16.2
	3.1	21.2
Adjustments		
Difference between actual actuarial loss and amount recognized	**4.3**	(15.0)
Benefit expense	**7.4**	6.2

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2007	2006
Discount rate	**5.5%**	5.3%
Rate of compensation increase	**3.5%**	3.5%

Assumed health care trend rates:

	2007	2006
Initial healthcare expense trend rate	**8.0%**	12.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2011**	2010

A 1% change in assumed healthcare trend rates would have had the following effects for 2007:

millions of dollars	**Increase**	**Decrease**
Current service cost	**0.5**	**(0.4)**
Interest cost	**0.7**	**(0.4)**
Accrued benefit obligation	**11.9**	**(9.2)**

11. SHAREHOLDERS' EQUITY

Share Capital

millions of dollars	**2007**	2006
Common shares of par value $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5

Contributed Capital

millions of dollars	**2007**	2006
Lower Churchill Development Corporation	**15.4**	15.4
Muskrat Falls Project	**2.2**	2.2
Gull Island Project	**96.4**	96.4
	114.0	114.0

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

millions of dollars	**2007**	2006
Adjusted opening balance arising from adoption of new accounting policies regarding financial instruments	**19.3**	-
Changes in fair value of sinking funds	**0.2**	-
Balance, end of year	**19.5**	-

There were no material changes in the fair market value of the reserve fund investments.

13. FINANCIAL INSTRUMENTS

Fair Value

The estimated fair values of financial instruments as at December 31 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	Fair Value	Carrying Value	Fair Value
millions of dollars	**2007**		2006	
Long-term debt including current portion	**1,396.9**	**1,731.2**	1,417.2	1,781.9

14. INTEREST EXPENSE

millions of dollars	**2007**	2006	
Gross interest			
Long-term debt	**105.0**	106.6	
Promissory notes	**0.9**	5.1	
	105.9	111.7	
Accretion of long-term debt	**0.8**	1.1	
Provision for foreign exchange losses	**2.2**	2.1	
	108.9	114.9	
Less			
Recovered from Hydro-Québec	**1.0**	1.1	(a)
Interest capitalized during construction	**6.3**	4.9	
Interest earned	**14.3**	17.2	
Net interest expense	**87.3**	91.7	
Debt guarantee fee	**13.1**	14.0	
Net interest and guarantee fee	**100.4**	105.7	

(a) Under the terms of the Power Contract, CF(L)Co. recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

Also, CF(L)Co. can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such request fails to attract sufficient advances, CF(L)Co. can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

15. CHANGE IN NON-CASH BALANCES

millions of dollars	**2007**	2006
Accounts receivable	**(8.2)**	(4.5)
Fuel and supplies	**(15.3)**	5.3
Prepaid expenses	**0.3**	0.8
Accounts payable and accrued liabilities	**26.7**	(9.8)
Regulated assets	**49.7**	39.1
Regulated liabilities	**(11.3)**	37.6
Accrued interest	**(0.1)**	1.3
Employee future benefits	**5.1**	3.8
Long-term receivable	**(4.5)**	(17.8)
Long-term payable	**(0.3)**	(0.4)
	42.1	55.4

16. SEGMENT INFORMATION

Hydro operates in three business segments. Regulated operations encompass sales of power and energy to most customers within the province of Newfoundland and Labrador while Churchill Falls operates a hydro-electric generating facility and sells electricity primarily to Hydro-Québec. Other energy activities are primarily engaged in energy project development and sales to markets outside the province. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those described in Note 1.

16. SEGMENT INFORMATION (cont'd.)

	Regulated Operations	Other Energy Activities	Churchill Falls	Inter Segment Eliminations	Total
millions of dollars			**2007**		
Revenue - External customers	**440.7**	**58.5**	**70.7**		**573.4**
- Inter segment		**10.4**	**3.9**	**(10.8)**	
Amortization	**38.4**	**-**	**12.3**		**50.7**
Interest	**103.2**	**(5.0)**	**2.1**	**0.1**	**100.4**
Net income (loss)	**2.9**	**53.6**	**25.1**		**81.6**
Assets	**1,733.4**	**148.4**	**404.5**		**2,286.3**
Capital expenditures	**36.0**	**45.7**	**4.8**		**86.5**
millions of dollars			2006		
Revenue - External customers	416.5	57.4	70.6		548.0
- Inter segment		10.1	3.9	(10.5)	
Amortization	36.6	-	11.9		48.5
Interest	102.4	(1.3)	4.5	0.1	105.7
Net income (loss)	(6.9)	50.5	26.4		70.0
Assets	1,732.8	97.5	402.0		2,232.3
Capital expenditures	41.6	14.7	4.6		60.9

At December 31, 2007, sales to Hydro's two largest customers amounted to 60% and 10% of total energy sales revenue (2006 - 61% and 14%). At December 31, 2007 approximately 59.7% (2006 – 56.6%) of the total accounts receivable balance outstanding is due from one customer.

Geographic Information

Revenues by geographic area:

millions of dollars	**2007**	2006
Newfoundland and Labrador	**445.1**	426.8
Québec	**128.3**	121.2
	573.4	548.0

Substantially all of Hydro's assets are located in the Province.

17. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, CF(L)Co. is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of Twin Falls will revert to Churchill Falls, and Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out. Further monitoring is recommended for 2010 and every five years thereafter.

17. COMMITMENTS AND CONTINGENCIES (cont'd.)

(b) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls completed the first of six consecutive tranches on January 7, 2007. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2008	$17.0 million
January 1, 2009	$17.0 million
January 1, 2010	$8.0 million
January 1, 2011	$8.0 million
January 1, 2012	$8.0 million

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Hydro's share of this commitment is 65.8%.

(c) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $1.2 million (2006 - $1.4 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.8 million related to outages and plant shutdowns. Hydro is defending this claim and Management believes that this claim will not be successful.

(d) Outstanding commitments for capital projects total approximately $16.8 million at December 31, 2007 (2006 - $5.1 million).

(e) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	15 years
Hydroelectric	3 MW	1995	25 years
Hydroelectric	15 MW	1998	25 years
Hydroelectric	4 MW	1998	25 years
Hydroelectric	32 MW	2003	30 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2008	20 years

Estimated payments due in each of the next 5 years are as follows:

millions of dollars	**2008**	**2009**	**2010**	**2011**	**2012**
Power purchases	37.3	56.0	59.0	65.8	66.5

(f) Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to New Brunswick System Operator as credit support related to application for point to point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement. Churchill Falls has issued an irrevocable letter of credit, in the amount of $1.0 million to ensure compliance with a certificate of approval for the transportation of special/hazardous wastes, granted by the Department of Environment and Conservation.

18. RELATED PARTY TRANSACTIONS

The Province, CF(L)Co, LCDC and GIPCo are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

(a) Hydro has entered into a long-term power contract with CF(L)Co. for the purchase of $6.1 million (2006 -$6.1 million) of the power produced by CF(L)Co.

(b) Under an agreement between Hydro and CF(L)Co., Hydro provides certain engineering, technical, management and administrative services to CF(L)Co. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. For the year ended December 31, 2007 the fees paid to Hydro for these services amounted to approximately $2.2 million (2006 - $1.9 million).

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2007, Hydro paid $1.2 million to the PUB (2006 - $0.8 million, of which $0.1 million was included in accrued liabilities reflected at December 31, 2006).

(d) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, CF(L)Co. must pay rentals and royalties to the Province annually.

19. SUBSEQUENT EVENTS

(a) Effective January 1, 2008, the Province created a new crown corporation to hold its investments in the energy sector. Hydro is in the process of transferring its non-regulated assets and personnel including its investments in CF(L)Co GIPCo and LCDC to the new parent company. The segment information related to regulated operations in Note 16 is indicative of the operations that will remain in Hydro.

(b) On February 25, 2008 CF(L)Co. completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.50% (6.00% net of subsidies) were retired and replaced with a 4.40% fixed rate credit agreement with The Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds.

20. COMPARATIVE FIGURES

Certain of the 2006 comparative figures have been reclassified to conform with the 2007 financial statement presentation. Specifically, deferred charges in the amount of $3.4 million have been reclassified to debt as a result of the adoption of CICA Section 3855. In addition, a reclassification of investments of $19.8 million is reported with the sinking funds as opposed to an offset against debt.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2008

Deloitte.

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Auditors' Report

To the Lieutenant-Governor in Council
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro (the "Company") as at December 31, 2008 and the consolidated statements of income and retained earnings and comprehensive income and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year, except as disclosed in Note 2.

Deloitte & Touche LLP

Chartered Accountants
February 20, 2009

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Lawyer and Corporate Director

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Corporate Treasurer

GLENN H. MITCHELL
Corporate Controller

HEAD AND CORPORATE OFFICE
P.O. Box 12400
St. John's, Newfoundland and Labrador
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NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	2008	2007
ASSETS		
Current assets		
Cash and cash equivalents	4.1	7.2
Short-term investments	14.6	11.5
Accounts receivable	76.6	80.2
Current portion of long-term receivable	-	0.5
Current portion of regulatory assets (Note 4)	5.0	17.2
Fuel and supplies	52.7	69.7
Prepaid expenses	1.6	1.2
	154.6	187.5
Property, plant and equipment (Notes 3 and 19(e))	1,702.4	1,825.7
Long-term receivables (Note 5)	26.7	23.3
Sinking funds (Notes 8 and 14)	163.9	151.8
Regulatory assets (Note 4)	74.6	81.3
Investments (Note 6)	-	5.2
Reserve fund (Note 18(b))	23.4	11.5
	2,145.6	2,286.3
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Bank indebtedness (Note 8)	5.7	9.1
Accounts payable and accrued liabilities	55.1	75.9
Accrued interest	28.7	30.7
Current portion of long-term debt (Note 8)	9.1	209.1
Current portion of regulatory liabilities (Note 4)	22.3	23.5
Deferred capital contribution (Note 19(f))	2.2	-
Promissory notes (Note 8)	163.0	7.0
Due to related parties (Notes 14 and 19)	2.9	-
	289.0	355.3
Long-term debt (Notes 8 and 14)	1,175.7	1,187.8
Regulatory liabilities (Note 4)	31.5	15.5
Employee future benefits (Notes 10 and 19(e))	49.9	47.4
Long-term payable (Note 9)	0.7	-
	82.1	62.9
Non-controlling interest in Lower Churchill Development Corporation (Note 6)	-	2.5
Shareholder's equity		
Share capital (Note 11)	22.5	22.5
Contributed capital (Notes 11 and 19(e))	111.8	114.0
Accumulated other comprehensive income (Notes 13 and 14)	16.5	19.5
Retained earnings (Note 19(e))	448.0	521.8
	598.8	677.8
Commitments and contingencies (Note 18)		
	2,145.6	2,286.3

See accompanying notes

On behalf of the Board:

JOHN OTTENHEIMER
DIRECTOR

ED MARTIN
DIRECTOR

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2008**	2007
Revenue		
Energy sales (Notes 1 and 21)	**563.3**	567.5
Other	**5.6**	5.9
	568.9	573.4
Expenses		
Operations and administration	**141.8**	143.1
Fuels	**164.8**	159.2
Power purchased	**41.0**	38.4
Amortization	**53.0**	50.7
Interest (Note 15)	**78.8**	100.4
Write-down of investment (Note 6)	**2.7**	-
	482.1	491.8
Net income	**86.8**	81.6
Retained earnings, beginning of year	**521.8**	437.9
Add: adjustment to long-term debt (Note 14)	**-**	2.3
Deduct: adjustment to retained earnings (Note 19(e))	**160.6**	-
Retained earnings, end of year	**448.0**	521.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31 (millions of dollars)	**2008**	2007
Net income	**86.8**	81.6
Other comprehensive income		
Change in fair value of sinking fund and reserve fund investments	**(3.0)**	0.2
Comprehensive income	**83.8**	81.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2008**	2007
Cash provided by (used in)		
Operating activities		
Net income	**86.8**	81.6
Adjusted for items not involving a cash flow		
Amortization	**53.0**	50.7
Accretion of long-term debt	**0.5**	0.8
Loss on disposal of property, plant and equipment	**2.5**	1.0
Foreign exchange gain	**-**	(0.3)
Write-down of investments	**2.7**	-
Other	**-**	(0.1)
	145.5	133.7
Changes in non-cash working capital balances (Note 16)	**31.7**	42.5
	177.2	176.2
Financing activities		
Increase (decrease) in promissory notes	**156.0**	(51.8)
Long-term debt retired	**(207.5)**	(13.1)
Advance to Nalcor (Note 19(e))	**(3.0)**	-
Foreign exchange loss recovered	**-**	0.1
Increase in deferred capital contribution	**2.2**	-
	(52.3)	(64.8)
Investing activities		
Additions to property, plant and equipment	**(90.1)**	(86.5)
Increase in sinking funds	**(20.8)**	(19.6)
(Increase) decrease in short-term investments	**(3.1)**	0.2
Increase in reserve fund	**(11.3)**	(11.5)
Proceeds on disposal of property, plant and equipment	**0.7**	0.6
	(124.6)	(116.8)
Net increase (decrease) in cash	**0.3**	(5.4)
Cash position, beginning of year	**(1.9)**	3.5
Cash position, end of year	**(1.6)**	(1.9)
Cash position is represented by		
Cash and cash equivalents	**4.1**	7.2
Bank indebtedness	**(5.7)**	(9.1)
	(1.6)	(1.9)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.1**	0.2
Interest income received	**0.9**	1.2
Interest paid	**101.6**	105.4

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Newfoundland and Labrador Hydro ("Hydro") is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador ("Province") as a Crown corporation and its principal activity is the development, generation and sale of electricity.

Gull Island Power Corporation ("GIPCo.") is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the Lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland. Lower Churchill Development Corporation ("LCDC") is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River ("Lower Churchill Development"). Both GIPCo. and LCDC are inactive.

Churchill Falls (Labrador) Corporation Limited ("Churchill Falls") is incorporated under the laws of Canada and has completed and commissioned a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts ("Churchill Falls Project"). Twin Falls Power Corporation ("Twin Falls") is incorporated under the laws of Canada and has developed a 225 megawatt hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, litigation, environmental and asset retirement obligations, amortization, property, plant, and equipment and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities ("PUB").

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service ("COS") methodology. The allowed rate of return on rate base is 7.4% (2007 - 7.4%). Hydro applies various accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 4.

Principles of Consolidation

The consolidated financial statements include the financial statements of Hydro and its subsidiary companies, GIPCo., (100% owned) and LCDC, (51% owned). Intercompany transactions and balances have been upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec. Although Hydro retains its 65.8%

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Principles of Consolidation (cont'd.)

ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

A portion of Hydro's shareholding in Churchill Falls was deposited in a voting trust pursuant to an agreement with Hydro-Québec, in relation to Churchill Falls' General Mortgage Bonds. Effective February 25, 2008, the bonds were retired, removing the requirement for the shares to be held in trust.

Churchill Falls holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives Churchill Falls joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and bankers' acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. Both are stated at cost, which approximates market value. The short-term investments bear interest rates of 1.58% to 3.60% (2007 - 4.12% to 5.00%) per annum.

Fuel and Supplies

Fuel and supplies inventories are recorded at the lower of average cost or net realizable value.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment, or the fair value of assets contributed. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Hydro
Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Gains or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors, and generators, as well as water conveying and control structures, including dams, dykes, tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks, and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners, and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kV. Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators, and conductors.

Other assets would include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

Churchill Falls
Churchill Falls uses the group amortization method for certain property, plant and equipment other than the generation plant, transmission and terminals and service facilities.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Amortization is calculated on a straight-line basis over the following estimated useful lives:

Hydroelectric generation plant	67 years
Transmission and terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to amortization expense.

Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying value of the property and assets. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition

Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB. Sales to Hydro-Québec and certain major industrial customers are at rates under the terms of applicable contracts.

A power contract with Hydro-Québec, dated May 12, 1969 ("Power Contract") provides for the sale of substantially all the energy from the Churchill Falls Project until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The base rate is predetermined in the Contract and decreases from the existing rate of 2.5425 mills per kWh to 2.0 mills per kWh upon renewal in 2016.

Churchill Falls receives revenues from Hydro-Québec, under a guaranteed winter availability contract ("GWAC") through 2041. The GWAC provides for the sale of 682 MW of additional availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base ("AEB"), as defined in the Power Contract, are tracked over a four year period and then either recovered from or refunded to Hydro-Québec over the subsequent four year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2007 - 7%).

Foreign Currency Translation

Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Foreign Currency Translation (cont'd.)

(b) At the date of settlement and at each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

(c) Foreign exchange gains and losses are included in income in the current year except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract.

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation are amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

2. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2008, Hydro adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA").

Inventories

Section 3031, Inventory requires inventories to be measured at the lower of cost or net realizable value; disallows the use of last-in-first-out inventory costing methodology; and requires that, when circumstances which previously caused inventories to be written down no longer exist, the amount of the write-down is to be reversed. This new standard did not have any impact on Hydro's financial results or disclosures.

Disclosure and Presentation of Financial Instruments

Section 3862, Financial Instruments, Disclosures and Section 3863, Financial Instruments, Presentation sets out new accounting recommendations for disclosure and presentation of financial instruments. The new recommendations require disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate the nature and extent of exposure to risks from financial instruments. These new standards did not have any impact on Hydro's financial results. The additional disclosure is included in Note 14.

Capital Disclosures

Section 1535, Capital Disclosures requires Hydro to include additional information in the notes to the financial statements about its capital and the manner in which it is managed. This additional disclosure includes quantitative and qualitative information regarding objectives, policies and processes for managing capital. The additional required disclosure is provided in Note 12 to these financial statements.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. PROPERTY, PLANT AND EQUIPMENT

(millions of dollars)	Property Plant and Equipment in Service	Contributions in aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
			2008		
Generation plant					
Hydroelectric	**1,364.7**	**20.5**	**325.5**	**1.5**	**1,020.2**
Thermal	**247.5**	**0.8**	**190.6**	**1.9**	**58.0**
Diesel	**62.1**	**6.0**	**31.7**	**0.8**	**25.2**
Transmission and distribution	**781.2**	**60.2**	**245.3**	**4.2**	**479.9**
Service facilities	**22.0**	**-**	**11.4**	**-**	**10.6**
Other	**316.6**	**32.4**	**179.8**	**4.1**	**108.5**
	2,794.1	**119.9**	**984.3**	**12.5**	**1,702.4**

(millions of dollars)			2007		
Generation plant					
Hydroelectric	1,363.5	20.5	313.2	114.4	1,144.2
Thermal	244.2	0.8	188.3	0.8	55.9
Diesel	61.3	5.9	29.7	0.1	25.8
Transmission and distribution	767.2	60.7	229.2	0.8	478.1
Service facilities	22.0	-	11.1	-	10.9
Other	306.0	32.0	167.5	4.3	110.8
	2,764.2	119.9	939.0	120.4	1,825.7

At the end of 2008, pursuant to an asset transfer agreement ("the Transfer Agreement") between Hydro and Nalcor Energy ("Nalcor"), Hydro's parent company, $157.2 million of property, plant and equipment was transferred from Hydro to Nalcor for consideration equal to net book value (Note 19(e)).

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

(millions of dollars)	**2008**	2007	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Long-term receivable	-	12.1	-
Foreign exchange losses	**71.1**	73.3	34.0
Deferred regulatory costs	**0.2**	0.4	1.0
Deferred major extraordinary repairs	**7.6**	12.3	4.0
Deferred study costs	**0.2**	0.4	1.0
Deferred wind power costs	**0.5**	-	1.0
Total regulatory assets	**79.6**	98.5	
Less current portion	**5.0**	17.2	
	74.6	81.3	
Regulatory liabilities			
Rate stabilization plan	**53.2**	38.3	n/a
Deferred purchased power savings	**0.6**	0.7	19.0
Total regulatory liabilities	**53.8**	39.0	
Less current portion	**22.3**	23.5	
	31.5	15.5	

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event. Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods, that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities are no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations.

Rate Stabilization Plan and Related Long-Term Receivable

Fuel expenses are included in allowed rates on a forecast basis. On January 1, 1986, Hydro, having received the concurrence of the PUB, implemented a rate stabilization plan ("RSP") which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments are required in retail rates to cover the amortization of the balance in the plan and are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003) RSP balances which accumulated prior to March 31, 2003, were converted to a long-term receivable bearing interest at the weighted average cost of capital to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007 and for the utility customers on June 30, 2008. Any remaining balances were transferred to the current plan. Any subsequent balances accumulating in the RSP including financing charges are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, generally accepted accounting principles would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2008, $9.1 million was recognized (2007 - $31.5 million) in the RSP and $14.9 million (2007 - $8.9 million) was recovered through rates and included in energy sales, with a corresponding cost amortized in fuels expenses.

Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 15).

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Regulatory Costs

Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred. In 2008, $0.2 million (2007 - $0.2 million) of amortization was recognized in operations and administration expenses.

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station ("HTGS"). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset which will be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006) the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007 $2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, has been expensed in 2008 (Note 20). In the absence of rate regulation, generally accepted accounting principles would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year in which they were incurred. In 2008, $2.7 million (2007 - $2.1 million) of amortization was recognized in operating costs.

Deferred Wind Power Costs

Pursuant to Order No. P.U. 20 (2008) the PUB has agreed to allow Hydro to defer $0.5 million in costs associated with connecting the wind farms at St. Lawrence and Fermeuse to the Island Interconnected Grid through Newfoundland Power's transmission system and accordingly, these costs have been recognized as a regulatory asset. These costs will be expensed in 2009. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include these costs in operating costs in the year in which they were incurred.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004) the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the cost of these studies in operating costs in the year in which they were incurred. In 2008, there were no additions (2007 - $0.2 million) and $0.2 million (2007 - $0.1 million) of amortization was recognized in operating and administration expenses.

Deferred Purchased Power Savings

In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of $0.6 million (2007 - $0.7 million) are recognized as a regulatory liability. In the absence of rate regulation, generally accepted accounting principles would require that Hydro include the actual cost of purchased power in operating costs in the year in which they were incurred.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Property, Plant and Equipment

The PUB permits an allowance for funds used during construction ("AFUDC"), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2008, Hydro's AFUDC of 7.6% is higher than its cost of debt of 7.3% the amount capitalized is higher and interest expense is lower by $0.4 million than that which would be permitted in the absence of rate regulation. In 2007, Hydro's AFUDC of 7.6% is lower than its cost of debt of 8.0%, the amount capitalized is lower and interest expense is higher by $0.3 million than that which would be permitted in the absence of rate regulation (Note 15).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method.

During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately $170.0 - $180.0 million lower than it would otherwise be, and annual amortization expense is $10.0 - $11.0 million lower, primarily due to the use of sinking fund rather than straight line amortization for hydroelectric and transmission assets. An update to this study began in 2008 and is presently ongoing.

5. LONG-TERM RECEIVABLES

Included in long-term receivables are two refundable deposits in the amount of $25.4 million (2007 - $23.3 million) associated with an application for transmission service into Québec, bearing interest at prime until April, 2007 and at one year Guaranteed Income Certificate ("GIC") rates thereafter. The remaining portion of $1.3 million (2007 - nil is a long-term receivable from Hydro- Québec.

6. INVESTMENTS

(millions of dollars)	**2008**	2007
Lower Churchill Development Corporation Limited	**-**	5.2

LCDC was incorporated in 1978 pursuant to the provisions of an agreement ("Principal Agreement"), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as nearly as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Pursuant to the provisions of the Principal Agreement, Newfoundland agreed to enter into an Option Agreement, dated November 24, 1978, with LCDC in respect of the GIPCo. assets and the hydroelectric development rights to the Lower Churchill River, (the Water Rights). In consideration of the option granted from the Province, LCDC issued 520 Class A common shares to Hydro, valued at $5.2 million.

The option provided that upon agreement to continue with the Project, LCDC would have acquired the GIPCo. assets for the amount of $94.8 million ($100.0 million less the amount of $5.2 million representing the shares issued pursuant to the signing of the Option Agreement). A 10% convertible demand debenture in the amount of $94.8 million would

6. INVESTMENTS (cont'd.)

have been issued as consideration for the GIPCo. assets and LCDC would have acquired the Water Rights from the Province with the consideration having been the issue of 3,000 Class B common shares without nominal or par value. On November 20, 2008, LCDC was advised by the Province that it would not be extending the Option Agreement. As a consequence, LCDC's option expired on November 24, 2008, which had the effect of terminating the Option Agreement and Hydro's share of the option in the amount of $2.7 million was expensed as an asset write-down in 2008 and the liability to the Government of Canada for non controlling interest in the amount of $2.5 million was eliminated.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. Five hundred and twenty shares were acquired in 1979 pursuant to signing of the Option Agreement and five hundred and ten shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

7. JOINT VENTURE

The following amounts included in the consolidated financial statements represent Hydro's proportionate share of Churchill Falls' assets and liabilities at December 31, 2008, and its proportionate interest in Churchill Falls' operations for the year ended December 31, 2008.

(millions of dollars)	**2008**	2007
Current assets	**37.0**	39.5
Long-term assets	**334.2**	328.9
Current liabilities	**10.5**	12.5
Long-term liabilities	**29.3**	36.6
Revenues	**65.3**	70.6
Expenses	**50.3**	51.0
Net Income	**15.0**	19.6
Cash provided by (used in)		
Operating activities	**30.4**	40.4
Financing activities	**(12.9)**	(19.7)
Investing activities	**(20.0)**	(16.3)

Income tax expense in the amount of $0.2 million (2007 - $0.2 million) related to a jointly controlled subsidiary, Twin Falls has been grouped with operating expenses.

8. LONG-TERM DEBT

Summary of long-term debt	**Hydro**	**Churchill Falls**	**Total**	Hydro	Churchill Falls	Total
(millions of dollars)		**2008**			2007	
Long-term debt	**1,154.7**	**30.1**	**1,184.8**	1,359.4	37.5	1,396.9
Less current portion	**8.3**	**0.8**	**9.1**	208.3	0.8	209.1
	1,146.4	**29.3**	**1,175.7**	1,151.1	36.7	1,187.8

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. LONG-TERM DEBT (cont'd.)

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	**2009**	**2010**	**2011**	**2012**	**2013**
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayments	0.9	29.3	-	-	-
	9.1	37.5	8.2	8.2	8.2

Details of long-term debt are as follows:

Hydro

Series	**Face Value**	**Coupon Rate %**	**Year of Issue**	**Year of Maturity**			
(millions of dollars)					**2008**	2007	
AA	200.0	5.50	1998	2008	-	199.9	
V	125.0	10.50	1989	2014	**124.5**	124.4	(a)
X	150.0	10.25	1992	2017	**149.1**	149.0	(a)
Y	300.0	8.40	1996	2026	**292.9**	292.7	(a)
AB	300.0	6.65	2001	2031	**306.9**	307.1	(a)
AD	125.0	5.70	2003	2033	**123.5**	123.5	(a)
AE	225.0	4.30	2006	2016	**223.5**	223.3	
Total debentures	1,425.0				**1,220.4**	1,419.9	
Less sinking fund investments in own debentures					**65.9**	60.8	
					1,154.5	1,359.1	
Other					**0.2**	0.3	
					1,154.7	1,359.4	
Less payments due within one year					**8.3**	208.3	
					1,146.4	1,151.1	

(a) Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures which Management intends to hold to maturity are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2007 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of 1% annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. During 2008, the Province waived the payment of this fee.

Hydro uses promissory notes to fulfill its short-term funding requirements. At year-end the promissory notes outstanding were at interest rates ranging from 1.40% to 2.90% (2007 – 4.30% to 4.45%).

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. LONG-TERM DEBT (cont'd.)

Hydro (cont'd.)

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year end, there were no amounts drawn on the facility (2007 - nil). Advances may take the form of a prime rate advance or the issuance of a Bankers' Acceptance ("BA") with interest calculated at the prime rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the prime rate. At year end, Hydro had two letters of credit outstanding (Note 18(f)) reducing the availability of the credit facility by $7.5 million.

Churchill Falls

(millions of dollars)	**2008**	2007
General Mortgage Bonds		
7.5% due December 15, 2010	**-**	37.5
Less: current portion	**-**	0.8
Total long-term debt	**-**	36.7
Bank of Nova Scotia Credit Agreement		
4.4% due December 15, 2010	**30.1**	-
Less: current portion	**0.8**	-
Total long-term debt	**29.3**	-

Refinancing

On February 25, 2008 Churchill Falls completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.5% (6.0% net of subsidies) were retired and replaced with a 4.4% fixed rate credit agreement with the Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds which provided for semi-annual payments in an amount equal to 1.0% of the aggregate principal amount outstanding on January 1 preceding each payment date with a final principal payment due in 2010.

Churchill Falls exercised its prepayment privileges under the new credit agreement by prepaying $10.0 million principal on March 25, 2008. Hydro's share of this repayment was $6.6 million.

Dividend Restriction

Under the terms of the long-term debt instruments, Churchill Falls may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June 1999 places additional restrictions on dividends based on cash flow.

Operating Credit Facility

Churchill Falls maintains a $10.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year end, there were no amounts drawn on the facility (2007 - $0.3 million). Advances may take the form of a Prime Rate advance or the issuance of a BA's with interest calculated at the Prime Rate or prevailing Government BA fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. At year end, Churchill Falls had two letters of credit outstanding (Note 18(f)) reducing the availability of the credit facility by $1.4 million.

9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec as of December 31, 2008 is the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of $0.7 million (2007 - nil) is long-term. The final amount will be determined on August 31, 2012 and will be paid/collected monthly beginning September 2012 and ending August 2016.

10. EMPLOYEE FUTURE BENEFITS

Pension Plan

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.6 million (2007 - $4.6 million) are expensed as incurred.

Other Benefits

Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2008, cash payments to beneficiaries for its unfunded other employee future benefits was $3.0 million (2007 - $2.3 million). The most recent actuarial valuation was performed as at December 31, 2006 with an extrapolation of the December 31, 2006 valuation to December 31, 2008. The next actuarial valuation will be performed as at December 31, 2009.

(millions of dollars)	**2008**	2007
Accrued benefit obligation		
Balance at beginning of year	**68.6**	67.8
Transfer to Nalcor (Note 19)	**(1.4)**	-
Current service cost	**2.1**	2.3
Interest cost	**3.7**	3.6
Actuarial gain	**(18.9)**	(2.8)
Benefits paid	**(3.0)**	(2.3)
Balance at end of year	**51.1**	68.6
Plan deficit	**51.1**	68.6
Unamortized actuarial loss	**(0.5)**	(20.9)
Unamortized past service cost	**(0.2)**	(0.3)
Transfer to Nalcor (Note 19)	**(0.5)**	-
Accrued benefit liability at end of year	**49.9**	47.4

(millions of dollars)	**2008**	2007
Components of benefit cost		
Current service cost	**2.1**	2.3
Interest cost	**3.7**	3.6
Actuarial gain	**(18.9)**	(2.8)
	(13.1)	3.1
Adjustments		
Difference between actual actuarial gain and amount recognized	**20.0**	4.3
Benefit expense	**6.9**	7.4

NEWFOUNDLAND AND LABRADOR HYDRO
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10. EMPLOYEE FUTURE BENEFITS (cont'd)

The significant actuarial assumptions used in measuring the company's accrued benefit obligations and benefit expense are as follows:

	2008	2007
Discount rate	**7.5%**	5.5%
Rate of compensation increase	**3.5%**	3.5%

Assumed health care trend rates:

	2008	2007
Initial health care expense trend rate	**7.0%**	8.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2011**	2011

A 1% increase in assumed health care trend rates would have had the following effect:

(millions of dollars)	**2008**	2007
Current service and interest cost	**1.2**	1.2
Accrued benefits obligation	**6.9**	11.9

A 1% decrease in assumed health care trend rates would have had the following effect:

(millions of dollars)	**2008**	2007
Current service and interest cost	**(0.8)**	(0.8)
Accrued benefits obligation	**(5.5)**	(9.2)

11. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	**2008**	2007
Common shares of par value $1 each		
Authorized 25,000,000 shares; issued 22,503,942 shares	**22.5**	22.5

Contributed Capital

(millions of dollars)	**2008**	2007
Total contributed capital	**111.8**	114.0

The contributed capital related to the Muskrat Falls project was transferred to Nalcor as at December 31, 2008 pursuant to the Transfer Agreement (Note 19(e)).

12. CAPITAL MANAGEMENT

Hydro

Hydro's primary objectives when managing capital are to minimize Hydro's cost of capital within the confines of established risk parameters, and to safeguard Hydro's ability to continue as a going concern. Hydro requires access to capital due to the capital intensive nature of the business which is required to ensure the continued delivery of safe and reliable service to its customers.

12. CAPITAL MANAGEMENT (cont'd.)

Hydro (cont'd.)

The capital managed by Hydro is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes ("EBIT") coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the shareholder, cash infusion via contributed equity and new debt issuance or debt issuance with differing characteristics. Hydro's goal is to achieve a capital structure and cash flow to support debt.

A summary of the capital structure is outlined below:

(millions of dollars)	**2008**		2007	
Debt				
Long-term debt	**1,175.7**		1,187.8	
Current portion of long-term debt	**9.1**		209.1	
Promissory notes	**163.0**		7.0	
Sinking funds	**(163.9)**		(151.8)	
	1,183.9	**66.4%**	1,252.1	64.9%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**111.8**		114.0	
Accumulated other comprehensive income	**16.5**		19.5	
Retained earnings	**448.0**		521.8	
	598.8	**33.6%**	677.8	35.1%
Total debt and equity	**1,782.7**	**100.0%**	1,929.9	100.0%

Churchill Falls

Churchill Falls' objective when managing capital is to maintain its ability to continue as a going concern. Churchill Falls' requirements for capital in the future are expected to increase, coincident with the aging of the plant and related infrastructure. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing the level of dividend payments is a key aspect of ensuring the availability of funding to maintain the plant and infrastructure.

At present, the capital position of the Churchill Falls is weighted heavily toward equity capital (share capital and retained earnings). The only remaining long-term debt at the end of the year consisted of a loan from the Bank of Nova Scotia, the balance of which comprised less than 10% of the total capital structure. This loan carries the same terms of repayment as the former General Mortgage Bonds and will mature in December of 2010, with any remaining principal due at that time. The Company has the right to prepay under certain conditions and has already taken advantage of the opportunity to do so. On March 19, 2008 Churchill Falls exercised its prepayment rights under the Credit Agreement to prepay $10.0 million in principal effective March 25, 2008. The corporate strategy is to ensure that funding is in place to extinguish the entire debt by the end of 2010 without re-financing. The capital structure is adjusted through the amount of dividends paid to shareholders.

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13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the fair value of sinking fund and reserve fund investments comprise the items in other comprehensive income.

(millions of dollars)	**2008**	2007
Balance, beginning of year	**19.5**	-
Adjustment due to the adoption of new accounting policies	**-**	19.3
Change in fair value of sinking fund investments	**(3.6)**	0.2
Change in fair value of reserve fund investments	**0.6**	-
Balance, end of year	**16.5**	19.5

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Held-to-maturity
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available for sale
Reserve fund	Available for sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities

Each of these financial instruments is measured at amortized cost, except for the reserve fund, sinking fund – other investments and cash and cash equivalents which are measured at fair value.

In 2007, Hydro recognized an increase to opening retained earnings of $2.3 million resulting from the measurement of outstanding long-term debt at amortized cost, using the effective interest method. As well, Hydro recognized an opening balance of accumulated other comprehensive income arising from unrealized gains on sinking fund investments of $19.3 million.

Fair Value

The estimated fair values of financial instruments as at December 31, 2008 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	**2008**		2007	
Long-term debt including current portion	**1,184.8**	**1,484.8**	1,396.9	1,731.2

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Fair Value (cont'd.)

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Risk Management

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Hydro's business.

Hydro

(a) Credit Risk

Hydro is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of Hydro's receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers.

Hydro manages its investment credit risk exposure by restricting its investments to high quality securities such as Canada Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks.

(b) Liquidity Risk

Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Hydro manages this risk by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cashflows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and a $50.0 million operating credit facility. Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues.

(c) Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates.

<u>Interest Rates</u>
Interest rate risk is managed within the corporate financing strategy where floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management are the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Hydro (cont'd)

(d) Market Risk (cont'd.)

Interest Rates (cont'd.)
Exposure to changes in interest rates exists on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios. Hydro estimates that an increase of 100 basis points from the actual average yield on the short-term debt portfolio in 2008 would have resulted in a change in interest expense of $1.3 million (2007 - $0.2 million). Similarly, an increase of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2008 would have resulted in a change in interest income of $2.0 million (2007 - $1.8 million) and a decrease in other comprehensive income of $16.1 million (2007 - $16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

Foreign Currency and Commodity Exposure
Fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Hydro's primary exposure to both foreign exchange and commodity price risk arise from its purchases of No. 6 fuel for consumption at the HTGS.

During 2008, Hydro had total purchases of No. 6 fuel of $103.9 million (2007 - $122.0 million). These purchases are denominated in U.S. dollars.

Hydro's exposure to both the foreign exchange and commodity price risk associated with these purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates as compared to that approved in Hydro's most recent COS used to set rates, are captured in the RSP and are either refunded to or collected from customers via automatic rate adjustments. Hydro also employs the periodic use of forward currency contracts as a means by which exposure to exchange rates on a particular day can be avoided. As at December 31, 2008 there were no forward contracts outstanding.

Churchill Falls

(a) Liquidity Risk

Churchill Falls is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Churchill Falls manages this risk by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within its operations and by continuously monitoring cash flows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations and the $10.0 million unsecured credit facility. Long-term liquidity risk is managed by maintenance of the reserve fund in accordance with the June 1999 shareholders' agreement and dividend management policy to meet long term liquidity requirements associated with debt retirement and the company's capital expenditure program.

(b) Market Risk

Market risk refers primarily to the risk of loss resulting from changes in commodity prices, foreign exchange rates and interest rates.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Churchill Falls (cont'd)

(b) Market Risk (cont'd.)

Interest Rates
Interest rate risk is mitigated on the company's long-term debt by virtue of a fixed interest rate to maturity. Exposure to changes in interest rates exists on investment income related to the short-term and reserve fund investment portfolios. Churchill Falls estimates that an increase of 100 basis points from the actual average yield earned on the short-term investment portfolio in 2008 would have resulted in a change in interest income of $0.2 million (2007 - $0.2 million). Similarly, an increase of 100 basis points from the actual average yield earned on the reserve fund investment portfolio in 2008 would have resulted in a change in interest income of $0.2 million (2007 - $0.1 million) and an increase in other comprehensive income of $0.5 million (2007 - $0.2 million). Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated.

Foreign Currency Exposure
The fair value or future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rate between a foreign currency and the Canadian dollar. Churchill Falls is exposed to foreign exchange risk when it enters into transactions to procure goods and services denominated in a foreign currency however this exposure to foreign exchange rate fluctuations is immaterial.

Commodity
Churchill Falls does not hold any financial instrument whose value would vary due to changes in a commodity price.

15. INTEREST EXPENSE

(millions of dollars)	**2008**	2007
Gross interest		
Long-term debt	**96.0**	105.0
Promissory notes	**4.2**	0.9
	100.2	105.9
Accretion of long-term debt	**0.5**	0.8
Provision for foreign exchange losses	**2.2**	2.2
	102.9	108.9
Less		
Recovered from Hydro-Québec	**0.1**	1.0
Interest capitalized during construction	**9.6**	6.3
Interest earned	**14.4**	14.3
Net interest expense	**78.8**	87.3
Debt guarantee fee	**-**	13.1
Net interest and guarantee fee	**78.8**	100.4

Under the terms of the Power Contract, Churchill Falls recovers the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt. In addition, with the refinancing of the General Mortgage Bonds, Churchill Falls is required to share with Hydro-Québec any benefits it receives resulting from the refinancing.

15. INTEREST EXPENSE (cont'd.)

Also, Churchill Falls can request Hydro and Hydro-Québec to make advances against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such requests fail to attract sufficient advances, Churchill Falls can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

16. CHANGE IN NON-CASH WORKING CAPITAL BALANCES

(millions of dollars)	**2008**	2007
Accounts receivable	**3.6**	(7.8)
Fuel and supplies	**17.0**	(15.3)
Prepaid expenses	**(0.4)**	0.3
Accounts payable and accrued liabilities	**(20.8)**	26.7
Regulatory assets	**18.9**	49.7
Regulatory liabilities	**14.8**	(11.3)
Accrued interest	**(2.0)**	(0.1)
Employee future benefits	**3.0**	5.1
Long-term receivable	**(2.9)**	(4.5)
Long-term payable	**0.7**	(0.3)
Due from related parties	**(0.2)**	-
	31.7	42.5

17. SEGMENT INFORMATION

Hydro operates in three business segments. Regulated operations encompass sales of power and energy to most customers within the province of Newfoundland and Labrador while Churchill Falls operates a hydro-electric generating facility and sells electricity primarily to Hydro-Québec. Other energy activities are primarily engaged in sales to markets outside the province. The designation of segments has been based on a combination of regulatory status and management accountability. The segment's accounting policies are the same as those described in Note 1.

Geographic Information

Revenues by geographic area:

(millions of dollars)	**2008**	2007
Newfoundland and Labrador	**447.3**	445.1
Québec	**121.6**	128.3
	568.9	573.4

All of Hydro's assets are located in the Province.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. SEGMENT INFORMATION (cont'd.)

Segments

(millions of dollars)	**Regulated**	**Other Energy Activities**	**Churchill Falls**	**Inter-segment**	**Total**
			2008		
Revenue					
Energy sales	**440.1**	**58.2**	**68.9**	**(3.9)**	**563.3**
Other	**2.2**		**0.3**	**3.1**	**5.6**
	442.3	**58.2**	**69.2**	**(0.8)**	**568.9**
Expenses					
Operations and administration	**99.1**	**3.9**	**38.8**	**-**	**141.8**
Fuels	**164.8**	**-**	**-**	**-**	**164.8**
Power purchased	**41.4**	**3.5**	**-**	**(3.9)**	**41.0**
Amortization	**40.4**	**-**	**11.4**	**1.2**	**53.0**
Interest	**87.6**	**(8.9)**	**0.1**	**-**	**78.8**
Write-down of investment	**-**	**2.7**	**-**	**-**	**2.7**
	433.3	**1.2**	**50.3**	**(2.7)**	**482.1**
Net income before equity in Churchill Falls	**9.0**	**57.0**	**18.9**	**1.9**	**86.8**
Equity in Churchill Falls	**-**	**11.8**	**-**	**(11.8)**	**-**
Preferred dividends	**-**	**9.0**	**-**	**(9.0)**	**-**
Net income	**9.0**	**77.8**	**18.9**	**(18.9)**	**86.8**
Capital expenditures	**45.6**	**40.2**	**4.3**	**-**	**90.1**
Total assets	**1,711.5**	**385.2**	**371.2**	**(322.3)**	**2,145.6**

(millions of dollars)	Regulated	Other Energy Activities	Churchill Falls	Inter-segment	Total
			2007		
Revenue					
Energy sales	438.7	58.5	74.2	(3.9)	567.5
Other	2.0		0.3	3.6	5.9
	440.7	58.5	74.5	(0.3)	573.4
Expenses					
Operations and administration	98.5	6.0	38.6	-	143.1
Fuels	159.2	-	-	-	159.2
Power purchased	38.5	3.9	-	(4.0)	38.4
Amortization	38.4	-	11.2	1.1	50.7
Interest	103.2	(5.0)	2.1	0.1	100.4
Write-down of investment	-	-	-	-	-
	437.8	4.9	51.9	(2.8)	491.8
Net income before equity in Churchill Falls	2.9	53.6	22.6	2.5	81.6
Equity in Churchill Falls	-	14.7	-	(14.7)	-
Preferred dividends	-	10.4	-	(10.4)	-
Net income	2.9	78.7	22.6	(22.6)	81.6
Capital expenditures	36.0	45.7	4.8	-	86.5
Total assets	1,733.3	498.9	368.4	(314.3)	2,286.3

During 2008, sales to Hydro's two largest customers amounted to 60% and 10% of total energy sales revenue (2007 - 60% and 10%). At December 31, 2008 approximately 63.2% (2007 - 59.7%) of the total accounts receivable balance outstanding is due from one customer.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of Twin Falls will revert to Churchill Falls, and Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

The results of an Environmental Site Assessment ("ESA") conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out. Further monitoring is recommended for 2010 and every five years thereafter.

(b) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested $17.0 million in each of 2007 and 2008. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2009	$17.0	million
January 1, 2010	$8.0	million
January 1, 2011	$8.0	million
January 1, 2012	$8.0	million

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holding consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 Canadian Chartered Accounts. Hydro's share of this commitment is 65.8%.

A summary of Hydro's 65.8% share of the reserve fund is as follows:

(millions of dollars)	**2008**	2007
Opening balance	**11.2**	-
Contribution	**11.2**	11.2
Total contribution to reserve fund	**22.4**	11.2
Net interest earned	**0.4**	0.3
Mark-to-market adjustment	**0.6**	-
Fair value of reserve fund	**23.4**	11.5

(c) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.2 million (2007 - $1.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $22.2 million (2007 - $21.8 million) related to outages and plant shutdowns. Hydro is defending this claim and management believes that this claim will not be successful.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. COMMITMENTS AND CONTINGENCIES (cont'd.)

(d) Outstanding commitments for capital projects total approximately $7.1 million (2007 - $16.8 million).

(e) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-Service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

During 2008, the enactment of the Abitibi - Consolidated Rights and Assets Act resulted in the cancelation of two long-term power purchase agreements (Note 21).

Estimated payments due in each of the next five years are as follows:

(millions of dollars)	**2009**	**2010**	**2011**	**2012**	**2013**
Power purchases	25.6	26.4	29.6	30.0	30.6

(f) Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to New Brunswick System Operator as credit support related to an application for point to point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement. Churchill Falls has issued two irrevocable letters of credit, in the amount of $0.7 million each to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes, granted by the Department of Environment and Conservation.

19. RELATED PARTY TRANSACTIONS

The Province, Nalcor, Churchill Falls, LCDC and GIPCo. are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province.

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.0 million (2007 - $6.1 million) of the power produced by Churchill Falls and Hydro's 65.8% share is estimated upon consolidation.

(b) For the year ended December 31, 2008, approximately $1.8 million (2007 - $2.2 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties and Hydro's 65.8% share is eliminated upon consolidation.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2008, Hydro incurred $0.6 million in costs related to the PUB (2007 - $1.2 million) of which $0.1 million (2007 - $0.1 million) was included in accrued liabilities.

(d) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually.

19. RELATED PARTY TRANSACTIONS (cont'd.)

(e) As at December 31, 2008, certain non-regulated assets and liabilities and the related debt and equity were transferred from Hydro to Nalcor. Details of the transactions are noted below which resulted in a payable of $6.1 million by Hydro to Nalcor. In June, 2008, an advance payment was made by Hydro to Nalcor resulting in a $3.1 million liability as at December 31, 2008 which is recorded in Due to related parties.

(millions of dollars)	**2008**
Capital assets	**157.2**
Contributed capital	**(2.2)**
Employee future benefits	**(0.5)**
Retained earnings from non-regulated activity in Hydro	**(160.6)**
Sub total	**(6.1)**
Payment made in 2008	**3.0**
Total due to Nalcor	**(3.1)**

In addition to the $0.5 million transfer for employee future benefits noted above, in January, 2008, there was a transfer of a $0.9 million liability from Hydro to Nalcor for a total transferred amount of $1.4 million (Note 10).

(f) During 2008, Nalcor advanced $4.5 million as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. As at December 31, 2008, $1.7 million of this funding has not been utilized to cover the costs of the associated capital project and has been recorded as a deferred contribution. Hydro also received contribution in aid of construction from the Province related to wind feasibility studies. As at December 31, 2008, the full amount of $0.5 million has been recorded as a deferred capital contribution.

(g) During 2008, Hydro received $0.4 million (2007 - nil) as a rate subsidy for rural isolated customers from the Province and $1.5 million (2007 - $0.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.1 million (2007 - $0.6 million) recorded as accounts receivable at year end.

20. CHANGE IN ESTIMATE

In 2007, Hydro incurred $2.0 million in expenses to repair a turbine at HTGS and these costs were deferred as a major extraordinary repair. Pursuant to Order No. P.U. 31 (2008) the PUB denied Hydro's request to treat the repair of the turbine as a major extraordinary repair and therefore, the full cost of the repair, net of insurance proceeds of $0.8 million, was recorded in operations and administration expense during 2008.

21. SIGNIFICANT OCCURRENCES

(a) In late 2008, Abitibi Consolidated announced a shut down of the Grand Falls Pulp and Paper Mill resulting in a loss of a major industrial customer. Revenue from Abitibi Grand Falls for the year ended December 31, 2008 was $5.1 million (2007 - $4.9 million). The Abitibi - Consolidated Rights and Assets Act was enacted on December 16, 2008 resulting in the cancellation of two power purchase agreements from two non-utility generator in which Abitibi was a partner.

21. SIGNIFICANT OCCURRENCES (cont'd.)

(b) On November 3, 2008, a fire occurred in a cable shaft at Churchill Falls causing extensive damage to two sets of high voltage cables in two units of the cable shaft.

Repair work has begun on one unit with work expected to be completed in February 2009. The second unit will be repaired in the summer of 2009 once the necessary cables have been obtained. Hydro's estimated share of the cost of the repair to the cables in the amount of $6.6 million is covered by an insurance policy with a $1.3 million deductible. As at December 31, 2008, Hydro's share of expenses totaling $1.5 million have been incurred in relation to this repair and insurance proceeds of $0.2 million have been accrued. Churchill Falls will accrue the expenses and related insurance proceeds as incurred.

Hydro's 65.8% share of the total impact of the fire on net income for the year ended December 31, 2008 including lost revenue is estimated to be as follows:

(millions of dollars)	**2008**
Lost revenue - guaranteed winter availability	(8.4)
Lost revenue - power sales	(2.1)
Repair costs (net of insurance proceeds)	(1.3)
Net decrease in rental and other costs	0.8
Total impact on net income	(11.0)

22. COMPARATIVE FIGURES

Certain of the 2007 comparative figures have been reclassified to conform with the 2008 financial statement presentation.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

Deloitte.

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Auditors' Report

To the Lieutenant-Governor in Council
Province of Newfoundland and Labrador

We have audited the consolidated balance sheet of Newfoundland and Labrador Hydro (the "Company") as at December 31, 2009 and the consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by The Hydro Corporation Act, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Deloitte & Touche LLP

Chartered Accountants
March 9, 2010

BOARD OF DIRECTORS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

CATHY BENNETT
Owner/Operator
Bennett Restaurants Ltd.

TOM CLIFT
Associate Dean, Academic Programs
Memorial University - Faculty of Business

KEN MARSHALL
President
Rogers Cable - Atlantic Region

GERRY SHORTALL
Chartered Accountant
Corporate Director

OFFICERS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

MARK BRADBURY
Corporate Treasurer
Nalcor Energy

GILBERT BENNETT
Vice President
Lower Churchill Project

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary
Nalcor Energy

JIM HAYNES
Vice President Regulated Operations
Newfoundland and Labrador Hydro

PETER HICKMAN
Assistant Corporate Secretary
Nalcor Energy

ANDY MACNEILL
Vice President
Churchill Falls

JOHN MALLAM
Vice President Engineering Services
Newfoundland and Labrador Hydro

GERARD MCDONALD
Vice President Human Resources and
Organizational Effectiveness
Nalcor Energy

GLENN H. MITCHELL
Corporate Controller
Nalcor Energy

DERRICK STURGE
Vice President Finance and Chief Financial Officer
Nalcor Energy

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Canada A1B 4K7

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2009**	2008
ASSETS		
Current assets		
Cash and cash equivalents	**12.7**	-
Short-term investments	**37.4**	14.6
Accounts receivable	**85.6**	76.6
Current portion of regulatory assets (Note 4)	**4.8**	5.0
Fuel and supplies	**59.5**	52.7
Prepaid expenses	**2.2**	1.6
	202.2	150.5
Property, plant and equipment (Notes 3 and 19 (f))	**1,703.1**	1,702.4
Long-term receivables (Note 5)	**24.7**	26.7
Sinking funds (Notes 8 and 14)	**179.6**	163.9
Regulatory assets (Note 4)	**69.3**	74.6
Derivative instruments	**7.0**	-
Reserve fund (Note 18 (c))	**34.8**	23.4
	2,220.7	2,141.5
LIABILITIES		
Current liabilities		
Bank indebtedness (Note 8)	**-**	1.6
Accounts payable and accrued liabilities	**62.4**	55.1
Accrued interest	**28.7**	28.7
Current portion of long-term debt (Note 8)	**37.5**	9.1
Current portion of regulatory liabilities (Note 4)	**89.8**	22.3
Deferred capital contribution (Note 19 (g))	**0.2**	2.2
Promissory notes (Note 8)	**-**	163.0
Due to related parties (Notes 14 and 19)	**20.9**	2.9
	239.5	284.9
Long-term debt (Notes 8 and 14)	**1,141.6**	1,175.7
Regulatory liabilities (Note 4)	**32.8**	31.5
Employee future benefits (Notes 10 and 19 (f))	**52.4**	49.9
Long-term payable (Note 9)	**4.3**	0.7
Long-term related party note payable	**23.9**	-
	1,494.5	1,542.7
SHAREHOLDER'S EQUITY		
Share capital (Note 11)	**22.5**	22.5
Contributed capital (Notes 11 and 19 (f))	**211.8**	111.8
	234.3	134.3
Accumulated other comprehensive income (Notes 13 and 14)	**22.0**	16.5
Retained earnings (Note 19 (f))	**469.9**	448.0
	491.0	464.5
	726.2	598.8
	2,220.7	2,141.5

Commitments and contingencies (Note 18)
Subsequent events (Note 22)
See accompanying notes

On behalf of the Board:

John Ottenheimer
Director

Gerald Shortall
Director

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

Year ended December 31 (millions of dollars)	**2009**	2008
Revenue		
Energy sales	**561.6**	563.3
Other	**4.5**	5.6
	566.1	568.9
Expenses		
Operations and administration	**159.1**	141.8
Fuels	**155.2**	164.8
Interest (Note 15)	**83.8**	78.8
Amortization	**54.5**	53.0
Power purchased	**47.1**	41.0
Write-down of investment (Note 6)	**-**	2.7
	499.7	482.1
Net income	**66.4**	86.8
Retained earnings, beginning of year	**448.0**	521.8
Equity transfer (Note 19 (f))	**-**	(160.6)
Dividends	**44.5**	-
Retained earnings, end of year	**469.9**	448.0

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended December 31 (millions of dollars)	**2009**	2008
Net income	**66.4**	86.8
Other comprehensive income		
Change in fair value of sinking fund and reserve fund investments	**(0.7)**	(3.0)
Unrealized gain on derivatives designated as cash flow hedges	**6.2**	-
Comprehensive income	**71.9**	83.8

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31 (millions of dollars)	**2009**	2008
Cash provided by (used in)		
Operating activities		
Net income	**66.4**	86.8
Adjustments for items not involving cash		
Amortization	**54.5**	53.0
Accretion of long-term debt	**0.4**	0.5
Loss on disposal of property, plant and equipment	**1.3**	2.5
Unrealized gain on derivative assets	**(0.8)**	-
Write-down of investments	**-**	2.7
	121.8	145.5
Changes in non-cash operating working capital balances (Note 16)	**115.2**	31.7
	237.0	177.2
Financing activities		
(Decrease) increase in promissory notes	**(163.0)**	156.0
Repayment of long-term debt	**(0.9)**	(207.5)
Dividends paid to Nalcor Energy	**(44.5)**	-
Advance to Nalcor Energy (Note 19(f))	**-**	(3.0)
(Decrease) increase in deferred capital contribution	**(2.0)**	2.2
Contributed capital	**100.0**	-
	(110.4)	(52.3)
Investing activities		
Additions to property, plant and equipment	**(57.8)**	(90.1)
Increase in sinking funds	**(22.0)**	(20.8)
Increase in short-term investments	**(22.8)**	(3.1)
Increase in reserve fund	**(11.0)**	(11.3)
Proceeds on disposal of property, plant and equipment	**1.3**	0.7
	(112.3)	(124.6)
Net increase in cash	**14.3**	0.3
Cash position, beginning of year	**(1.6)**	(1.9)
Cash position, end of year	**12.7**	(1.6)
Cash position is represented by		
Bank indebtedness	**(4.3)**	(5.5)
Cash equivalents	**17.0**	3.9
	12.7	(1.6)
Supplementary disclosure of cash flow information		
Income taxes paid	**0.2**	0.2
Interest income received	**0.4**	0.9
Interest paid	**92.8**	101.6

See accompanying notes

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Newfoundland and Labrador Hydro (Hydro), a Nalcor Energy company, is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (Province) as a Crown corporation and its principal activity is the development, generation and sale of electricity.

Hydro holds interests in the following subsidiaries and jointly controlled companies:

Churchill Falls (Labrador) Corporation Limited (Churchill Falls) is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts (MW) (Churchill Falls Project).

Twin Falls Power Corporation (Twin Falls) is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Gull Island Power Corporation (GIPCo) is incorporated under the laws of Canada. Its objective was to develop the hydroelectric potential at Gull Island on the lower Churchill River in Labrador, and construct a direct current transmission system from Labrador to the island of Newfoundland. Lower Churchill Development Corporation (LCDC) is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River (lower Churchill Development). Both GIPCo and LCDC are inactive.

Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

Principles of Consolidation

The Consolidated Financial Statements include the financial statements of Hydro and its subsidiary companies, GIPCo, (100% owned) and LCDC, (51% owned). Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec on the Board of Directors of Churchill Falls. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has adopted the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

A portion of Hydro’s shareholding in Churchill Falls was deposited in a voting trust pursuant to an agreement with Hydro-Québec, in relation to Churchill Falls' General Mortgage Bonds. Effective February 25, 2008, the bonds were retired, removing the requirement for the shares to be held in trust.

Churchill Falls holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives Churchill Falls joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

Use of Estimates

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Preparation of these Consolidated Financial Statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, environmental and asset retirement obligations, amortization,

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Use of Estimates (cont'd.)
property, plant, and equipment and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities (PUB), and these differences could be material.

Rates and Regulations (Excluding Sales by Subsidiaries)
Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service (COS) methodology. The allowed rate of return on rate base is 7.4% (2008 - 7.4%). Hydro applies certain accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the financial statements are more fully disclosed in Note 4.

Cash and Cash Equivalents and Short-term Investments
Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and bankers' acceptances. Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. The short-term investments bear interest rates of 0.26% to 1.57% (2008 – 1.58% to 3.60%) per annum. Cash and cash equivalents are measured at fair value and short-term investments are measured at amortized cost.

Fuel and Supplies
Fuel and supplies inventories are recorded at the lower of average cost or net realizable value.

Property, Plant and Equipment
Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, are recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligation cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation will be recognized at that time.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment, or the fair value of assets contributed. Contributions are treated as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Hydro
Construction in progress includes the costs incurred in preliminary feasibility studies, engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to the weighted average cost of capital.

Gains or losses on the disposal of property, plant and equipment are recognized in income as incurred.

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on distribution system and other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dykes, tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt (kV). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators and conductors.

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

Churchill Falls
Churchill Falls uses the group amortization method for certain property, plant and equipment, other than the generation plant, transmission and terminals and service facilities.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Churchill Falls (cont'd.)
Amortization is calculated on a straight-line basis over the following estimated useful lives:

Hydroelectric generation plant	67 years
Transmission and terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Losses on other than normal retirements are charged to operations in the year incurred as adjustments to amortization expense.

Impairment of Long-lived Assets
Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

Revenue Recognition
Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB. Sales to Hydro-Québec and certain major industrial customers are at rates under the terms of applicable contracts.

A power contract with Hydro-Québec (Power Contract), dated May 12, 1969, provides for the sale of substantially all the energy from the Churchill Falls Project until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The rate is predetermined in the Power Contract and decreases from the existing rate of 2.5426 mills per kilowatt hour (kWh) to 2.0 mills per kWh upon renewal in 2016.

Churchill Falls receives revenues from Hydro-Québec, under a guaranteed winter availability contract (GWAC) through 2041. The GWAC provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base (AEB), as defined in the Power Contract, are tracked over a four-year period and then either recovered from or refunded to Hydro-Québec over the subsequent four-year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2008 - 7%).

Foreign Currency Translation
Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income.

(c) Foreign exchange gains and losses are included in income except for unrealized gains and losses related to First Mortgage Bonds which were recoverable under the Power Contract.

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Employee Future Benefits

Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group, which is approximately 13 years.

Financial Instruments and Hedging Activities

Financial Instruments

Financial assets and financial liabilities are recognized on the balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held-for-trading
Short-term investments	Available-for-sale
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held-to-maturity
Sinking funds - other investments	Available for sale
Reserve fund	Available for sale
Long-term receivable	Loans and receivables
Bank indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities
Promissory notes	Other liabilities
Long-term debt	Other liabilities
Due to related parties	Other liabilities

Each of these financial instruments is measured at amortized cost, except for the reserve fund, sinking fund – other investments, cash and cash equivalents and short-term investments which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities

Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Financial Instruments and Hedging Activities (cont'd.)

Derivative Instruments and Hedging Activities (cont'd.)
Hydro has designated forward foreign exchange contracts as cash flow hedges (Note 14). In a cash flow hedge relationship, the portion of gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income (OCI), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income.

Hydro had no fair value hedges in place at December 31, 2009 or 2008.

2. CHANGES IN ACCOUNTING POLICIES

New Accounting Policies

Effective January 1, 2009, Hydro adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA):

Goodwill and Intangible Assets
Section 3064, Goodwill and Intangible Assets establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides more comprehensive guidance particularly with respect to internally developed intangible assets. This new standard did not have any impact on Hydro's financial results or disclosures.

Financial Instruments
EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities issued by the Emerging Issues Committee. This abstract requires that an entity's own credit risk (for financial liabilities) and the credit risk of the counterparty (for financial assets) should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not have a material impact on Hydro's Consolidated Financial Statements.

Hydro also adopted the changes made by the CICA to Section 3862, Financial instruments – Disclosures whereby an entity shall classify and disclose fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. The required disclosures are included in Note 14.

2. CHANGES IN ACCOUNTING POLICIES (cont'd.)

Future Accounting Changes

International Financial Reporting Standards (IFRS)
In October 2009, the Accounting Standards Board (AcSB) issued a third and final Omnibus Exposure Draft confirming that publically accountable enterprises in Canada will be required to apply IFRS in full and without modification, for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. Accordingly, starting in 2011, Hydro will present its financial statements in accordance with IFRS, and will be required to present restated comparative information for its year-ended December 31, 2010 balances, and will also restate its opening balance sheet as at January 1, 2010.

Hydro is continuing to assess the financial reporting impacts of the adoption of IFRS, however, the impact of these differences on Hydro's future financial position and results of operations are not reasonably estimable or determinable at this time. Hydro does anticipate a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the level of disclosure required as well as any system changes that may be necessary to compile and process the information.

The International Accounting Standards Board (IASB) project schedule had indicated that a final standard on rate-regulated activities would be released in the second quarter of 2010. Commentary received on the Exposure Draft, and the resulting activities now planned by the IASB, creates uncertainty as to if and when a final standard will be released. If a final standard is released, it may not be until late 2011. Accordingly, Hydro is unable to conclude on the impact, if any, of differences that will apply to accounting for rate-regulated activities under IFRS versus Canadian GAAP.

3. PROPERTY, PLANT AND EQUIPMENT

(millions of dollars)	Plant and Equipment in Service	Contributions in aid of Construction	Accumulated Amortization	Construction in Progress	Net Book Value
			2009		
Generation plant					
Hydroelectric	**1,397.5**	**22.9**	**352.3**	**1.1**	**1,023.4**
Thermal	**255.8**	**0.8**	**196.0**	**0.2**	**59.2**
Diesel	**64.6**	**5.9**	**33.5**	**2.8**	**28.0**
Transmission and distribution	**820.8**	**67.7**	**263.3**	**2.2**	**492.0**
Service facilities and other	**284.7**	**23.5**	**166.1**	**5.4**	**100.5**
	2,823.4	**120.8**	**1,011.2**	**11.7**	**1,703.1**
(millions of dollars)			**2008**		
Generation plant					
Hydroelectric	1,407.3	20.5	351.6	1.5	1,036.7
Thermal	247.5	0.8	190.6	1.9	58.0
Diesel	62.1	6.0	31.7	0.8	25.2
Transmission and distribution	794.5	60.2	248.2	4.2	490.3
Service facilities and other	282.7	32.4	162.2	4.1	92.2
	2,794.1	119.9	984.3	12.5	1,702.4

At the end of 2008, pursuant to an asset transfer agreement (the Transfer Agreement) between Hydro and Nalcor Energy (Nalcor), Hydro's parent company, $157.2 million of property, plant and equipment was transferred from Hydro to Nalcor for consideration equal to net book value (Note 19(f)).

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION

(millions of dollars)	**2009**	2008	**Remaining Recovery Settlement Period (years)**
Regulatory assets			
Foreign exchange losses	**68.9**	71.1	32.0
Deferred regulatory costs	**-**	0.2	-
Deferred major extraordinary repairs	**4.9**	7.6	2.8
Deferred study costs	**0.1**	0.2	2.0
Deferred wind power costs	**-**	0.5	-
Deferred energy conservation costs	**0.2**	-	N/A
Total regulatory assets	**74.1**	79.6	
Less: current portion	**4.8**	5.0	
	69.3	74.6	
Regulatory liabilities			
Rate stabilization plan	**122.0**	53.2	N/A
Deferred purchased power savings	**0.6**	0.6	17.5
Total regulatory liabilities	**122.6**	53.8	
Less: current portion	**89.8**	22.3	
	32.8	31.5	

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

Rate Stabilization Plan and Related Long-term Receivable

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Pursuant to Order No. P.U. 7 (2002-2003) and Order No. P.U. 40 (2003), RSP balances which accumulated prior to December 31, 2003, were converted to a long-term receivable bearing interest at the weighted average cost of capital to be recovered over a four-year period, which commenced in 2004. The recovery period for industrial customers ended on December 31, 2007 and for the utility customers on June 30, 2008. Any remaining balances were transferred to the current plan. Any subsequent balances accumulating in the RSP, including financing charges, are to be recovered in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2009, $42.3 million was recognized (2008 - $9.1 million) in the RSP and $18.3 million (2008 - $14.9 million) was recovered through rates and included in energy sales, with the corresponding cost amortized in fuels expenses.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods. Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.2 million annually, is included in interest expense (Note 15).

Deferred Regulatory Costs

Pursuant to Order No. P.U. 8 (2007), the PUB approved the deferral and amortization of external costs associated with Hydro's 2006 General Rate Application in the amount of $0.6 million. These costs are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include these costs in operating costs in the year incurred. In 2009, $0.2 million (2008 - $0.2 million) of amortization was recognized in operations and administration expense.

Deferred Major Extraordinary Repairs

In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $500,000, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station (HTGS). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In 2007, $2.0 million of expenses related to a turbine failure were deferred as a major extraordinary repair. This amount, net of insurance proceeds, was expensed in 2008. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2009, $2.7 million (2008 - $2.7 million) of amortization was recognized in operations and administration expense.

Deferred Study Costs

Pursuant to Order No. P.U. 14 (2004), the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the cost of these studies in operating costs in the year incurred. In 2009 there were no additions (2008 – nil) and $0.1 million (2008 - $0.2 million) of amortization was recognized in operating and administration expense.

Deferred Wind Power Costs

Pursuant to Order No. P.U. 20 (2008), the PUB agreed to allow Hydro to defer $0.5 million in costs associated with connecting the wind farms at St. Lawrence and Fermeuse to the Island Interconnected Grid through Newfoundland Power's transmission system and, accordingly, these costs have been recognized as a regulatory asset. These costs were expensed in 2009. In the absence of rate regulation, Canadian GAAP would require that Hydro include these costs in operating costs in the year incurred.

4. FINANCIAL STATEMENT EFFECTS OF RATE REGULATION (cont'd.)

Deferred Energy Conservation Costs
Pursuant to Order No. P.U. 8 (2007), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors and , accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2009, $0.2 million (2008 – nil) was deferred.

Deferred Purchased Power Savings
In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer the benefits of a reduced initial purchased power rate, to be amortized over a 30-year period. These savings in the amount of $0.6 million (2008 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

Property, Plant and Equipment
The PUB permits an allowance for funds used during construction (AFUDC), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2009, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.2%, the amount capitalized higher and interest expense lower by $0.1 million than that which would have been permitted in the absence of rate regulation. In 2008, Hydro's AFUDC of 7.6% was higher than its cost of debt of 7.3%, the amount capitalized higher and interest expense lower by $0.4 million than that which would have been permitted in the absence of rate regulation (Note 15).

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method. During 2005, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2004. Based on the results of this study, management currently estimates that accumulated amortization is approximately $170.0-$180.0 million lower than it would otherwise be and annual amortization expense is $10.0-$11.0 million lower, primarily due to the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets. A more recent study indicated that the amounts could be significantly higher. An update to this study is to be completed in 2010.

5. LONG-TERM RECEIVABLES

Long-term receivables consist of two refundable deposits in the amount of $23.9 million (2008 - $25.4 million) associated with an application for transmission service into Québec, bearing interest at one year Guaranteed Income Certificate (GIC) rates. The remaining portion of $0.8 million (2008 – $1.3 million) is a long-term receivable from Hydro-Québec, bearing interest at 7.0%.

6. INVESTMENTS

(millions of dollars)	**2009**	2008
Lower Churchill Development Corporation Limited	**-**	-

6. INVESTMENTS (cont'd.)

LCDC was incorporated in 1978 pursuant to the provisions of an agreement (Principal Agreement), between the Province and the Government of Canada. The Province and the Government of Canada own equity interests of 51% and 49% of LCDC, respectively. The Principal Agreement provides that future issues of Class A common shares shall preserve, as closely as possible, this ratio of beneficial ownership. Hydro is the designate for the Province's shareholding in LCDC.

Pursuant to the provisions of the Principal Agreement, the Province agreed to enter into an Option Agreement, dated November 24, 1978, with LCDC in respect of the GIPCo assets and the hydroelectric development rights to the lower Churchill River, (the Water Rights). In consideration of the option granted from the Province, LCDC issued 520 Class A common shares to Hydro valued at $5.2 million.

The option provided that, upon agreement to continue with the Project, LCDC would have acquired the GIPCo assets for $94.8 million ($100.0 million less the amount of $5.2 million representing the shares issued pursuant to the signing of the Option Agreement). A 10% convertible demand debenture in the amount of $94.8 million would have been issued as consideration for the GIPCo assets, and LCDC would have acquired the Water Rights from the Province with the consideration having been the issue of 3,000 Class B common shares without nominal or par value.

On November 20, 2008, LCDC was advised by the Province that it would not be extending the Option Agreement. As a consequence, LCDC's option expired on November 24, 2008, which had the effect of terminating the Option Agreement. Hydro's share of the option in the amount of $2.7 million was expensed as an asset write-down in 2008 and the liability to the Government of Canada for non-controlling interest in the amount of $2.5 million was eliminated.

Hydro holds 1,540 Class A common shares of LCDC which have a stated value of $10,000 each. 520 shares were acquired in 1979 pursuant to signing of the Option Agreement and 510 shares were acquired in each of the years 1980 and 1981, by way of capital contributions from the Province.

7. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Hydro's proportionate share of Churchill Falls' assets and liabilities at December 31, 2009, and its proportionate interest in Churchill Falls' operations for the year then ended.

(millions of dollars)	**2009**	2008
Current assets	**45.7**	35.1
Long-term assets	**374.5**	372.8
Current liabilities	**38.8**	10.2
Long-term liabilities	**12.7**	38.0
Revenues	**57.4**	65.4
Expenses	**50.9**	51.6
Net income	**6.5**	13.8
Cash provided by (used in)		
Operating activities	**14.6**	31.1
Financing activities	**0.9**	(15.7)
Investing activities	**(17.4)**	(18.7)

Income tax expense in the amount of $0.2 million (2008 - $0.2 million) related to a jointly controlled subsidiary, Twin Falls has been included in expenses.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. LONG-TERM DEBT

(millions of dollars)	**2009**			2008		
	Hydro	**Churchill Falls**	**Total**	Hydro	Churchill Falls	Total
Long-term debt	**1,149.8**	**29.3**	**1,179.1**	1,154.7	30.1	1,184.8
Less current portion	**8.2**	**29.3**	**37.5**	8.3	0.8	9.1
	1,141.6	**-**	**1,141.6**	1,146.4	29.3	1,175.7

Details of long-term debt are as follows:

Hydro

Series	**Face Value**	**Coupon Rate %**	**Year of Issue**	**Year of Maturity**		
(millions of dollars)					**2009**	2008
V *	125.0	10.50	1989	2014	**124.5**	124.5
X *	150.0	10.25	1992	2017	**149.2**	149.1
Y *	300.0	8.40	1996	2026	**293.1**	292.9
AB *	300.0	6.65	2001	2031	**306.8**	306.9
AD *	125.0	5.70	2003	2033	**123.6**	123.5
AE	225.0	4.30	2006	2016	**223.7**	223.5
Total debentures	1,225.0				**1,220.9**	1,220.4
Less sinking fund investments in own debentures					**71.1**	65.9
					1,149.8	1,154.5
Other					**-**	0.2
					1,149.8	1,154.7
Less: payments due within one year					**8.2**	8.3
					1,141.6	1,146.4

* Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2014 to 2033. Hydro debentures, which management intends to hold to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are as per bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 4.50% to 9.86% (2008 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. During 2008 and 2009, the guarantee fee was waived by the Province.

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2009 there were no promissory notes outstanding (2008 – $163.0 million).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end there were no amounts drawn on the facility (2008 – nil). Advances may take the form of a Prime Rate advance or the issuance of a Bankers' Acceptance (BA) with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year-end, Hydro had two letters of credit outstanding (Note 18(g)) reducing the availability of the credit facility by $7.5 million. In February 2010, Hydro issued 22 additional letters of credit, see Note 21.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. LONG-TERM DEBT (cont'd.)

Hydro (cont'd.)
Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	2010	2011	2012	2013	2014
Sinking fund requirements	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	-	-	-	-	125.0
	8.2	8.2	8.2	8.2	133.2

Churchill Falls

(millions of dollars)	**2009**	2008
Bank of Nova Scotia Credit Agreement		
4.4% due December 15, 2010		
Outstanding	**29.3**	30.1
Due within one year	**29.3**	0.8
Total long-term debt	**-**	29.3

Refinancing
On February 25, 2008 Churchill Falls completed a refinancing of the General Mortgage Bonds. The General Mortgage Bonds, bearing an interest rate of 7.5% (6.0% net of subsidies) were retired and replaced with a 4.4% fixed rate credit agreement with The Bank of Nova Scotia. Principal repayment terms of the new credit agreement are the same as those required by the General Mortgage Bonds which provided for semi-annual payments in an amount equal to 1.0% of the aggregate principal amount outstanding on January 1 preceding each payment date with a final principal payment due in 2010.

Repayment of Long-term Debt
Long-term debt repayments over the next five years are as follows:

(millions of dollars)	2010	2011	2012	2013	2014
	29.3	-	-	-	-

Dividend Restriction
Under the terms of the long-term debt instruments, Churchill Falls may pay cash dividends only out of earnings, as defined, accumulated from September 1, 1976. A shareholders' agreement signed in June 1999 places additional restrictions on dividends based on cash flow.

Operating Credit Facility
Churchill Falls maintains a $10.0 million Canadian unsecured operating credit facility with its banker. Advances may take the form of a Prime Rate advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA Fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. At year-end, Churchill Falls had a letter of credit outstanding (Note 18(g)) reducing the availability of the credit facility by $0.7 million.

9. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec as at December 31, 2009 represents the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of $4.3 million (2008 – $0.7 million) is long-term. The final amount will be determined on August 31, 2012 and will be paid/collected monthly beginning September 2012 and ending August 2016.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. EMPLOYEE FUTURE BENEFITS

Pension Plan
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.6 million (2008 - $4.6 million) are expensed as incurred.

Other Benefits
Additionally, Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2009, cash payments to beneficiaries for its unfunded other employee future benefits was $2.7 million (2008 - $3.0 million). An actuarial valuation was performed December 31, 2009.

(millions of dollars)	**2009**	2008
Accrued benefit obligation		
Balance at beginning of year	**51.1**	68.6
Transfer to Nalcor Energy	**(0.5)**	(1.4)
Current service cost	**1.4**	2.1
Interest cost	**3.8**	3.7
Actuarial loss (gain)	**16.5**	(18.9)
Benefits paid	**(2.7)**	(3.0)
Balance at end of year	**69.6**	51.1
Plan deficit	**69.6**	51.1
Unamortized actuarial loss	**(17.0)**	(0.5)
Unamortized past service cost	**(0.2)**	(0.2)
Transfer to Nalcor Energy	**-**	(0.5)
Accrued benefit liability at end of year	**52.4**	49.9

(millions of dollars)	**2009**	2008
Components of benefit cost		
Current service cost	**1.4**	2.1
Interest cost	**3.8**	3.7
Actuarial loss (gain)	**16.5**	(18.9)
	21.7	(13.1)
Difference between actual actuarial (gain) loss and amount recognized	**(16.5)**	20.0
Benefit expense	**5.2**	6.9

The significant actuarial assumptions used in measuring the accrued benefit obligations and benefit expense are as follows:

	2009	2008
Discount rate – benefit cost	**7.5%**	5.5%
Discount rate – accrued benefit obligations	**6.5%**	7.5%
Rate of compensation increase	**3.5%**	3.5%

Assumed healthcare trend rates:

	2009	2008
Initial healthcare expense trend rate	**7.5%**	7.0%
Cost trend decline to	**5.0%**	5.0%
Year that rate reaches the rate it is assumed to remain at	**2014**	2011

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

A 1% change in assumed healthcare trend rates would have had the following effects:

Increase	**2009**	2008
Current service and interest cost	**0.8**	1.2
Accrued benefits obligation	**10.7**	6.9

Decrease	**2009**	2008
Current service and interest cost	**(0.6)**	(0.8)
Accrued benefits obligation	**(8.4)**	(5.5)

11. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	**2009**	2008
Common shares of par value $1 each		
Authorized 25,000,000 shares;		
Issued and outstanding 22,503,942 shares	**22.5**	22.5

Contributed Capital

(millions of dollars)	**2009**	2008
Total contributed capital	**211.8**	111.8

During 2009, Nalcor contributed capital of $100.0 million (2008 – nil).

12. CAPITAL MANAGEMENT

Hydro

Hydro's primary objectives when managing capital are to minimize Hydro's cost of capital within the confines of established risk parameters, and to safeguard Hydro's ability to continue as a going concern. Hydro requires access to capital due to the capital intensive nature of the business which is required to ensure the continued delivery of safe and reliable service to its customers .

The capital managed by Hydro is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes (EBIT) coverage of interest. Adjustments to the capital structure are accomplished through adjustments to the amount of dividends paid to the Shareholder, cash infusion via contributed equity and new debt issuance or debt issuance with differing characteristics. Hydro's goal is to achieve a capital structure and cash flow to support debt.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. CAPITAL MANAGEMENT (cont'd.)

Hydro (cont'd.)
A summary of the capital structure is outlined below:

(millions of dollars)	**2009**		2008	
Debt				
Bank Indebtedness	-		1.6	
Long-term debt	**1,141.6**		1,175.7	
Current portion of long-term debt	**37.5**		9.1	
Promissory notes	**-**		163.0	
Sinking funds	**(179.6)**		(163.9)	
	999.5	**57.9%**	1,185.5	66.4%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**211.8**		111.8	
Accumulated other comprehensive income	**22.0**		16.5	
Retained earnings	**469.9**		448.0	
	726.2	**42.1%**	598.8	33.6%
Total debt and equity	**1,725.7**	**100.0%**	1,784.3	100.0%

Churchill Falls
Churchill Falls' objective when managing capital is to maintain its ability to continue as a going concern. Churchill Falls' requirements for capital in the future are expected to increase, coincident with the aging of the plant and related infrastructure. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing the level of dividend payments is a key aspect of ensuring the availability of funding to maintain the plant and infrastructure.

At present, the capital position of Churchill Falls is weighted heavily toward equity capital (share capital and retained earnings). The only remaining long-term debt at the end of the year consisted of a loan from the Bank of Nova Scotia, the balance of which comprised less than 10% of Churchill Falls' capital structure. This loan carries the same terms of repayment as the former General Mortgage Bonds and will mature in December of 2010, with any remaining principal due at that time. Churchill Falls has the right to prepay under certain conditions and has already taken advantage of the opportunity to do so. On March 19, 2008, Churchill Falls exercised its prepayment rights under the Credit Agreement to prepay $10.0 million in principal effective March 25, 2008. The corporate strategy is to ensure that funding is in place to extinguish the entire debt by the end of 2010 without re-financing. The capital structure is adjusted through the amount of dividends paid to shareholders.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in the fair value of sinking fund and reserve fund investments comprise the items in other comprehensive income.

(millions of dollars)	**2009**	2008
Balance, beginning of year	**16.5**	19.5
Change in fair value of sinking fund investments	**(1.1)**	(3.6)
Change in fair value of reserve fund investments	**0.4**	0.6
Unrealized gains on derivatives designated as cash flow hedges	**6.2**	-
Balance, end of year	**22.0**	16.5

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The estimated fair values of financial instruments as at December 31 are based on relevant market prices and information available at the time. The fair value of long-term debt is estimated based on the quoted market price for the same or similar debt instruments. The fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions. As a significant number of Hydro's assets and liabilities, including fuels and supplies and property, plant and equipment, do not meet the definition of financial instruments, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	**2009**		2008	
Financial liabilities				
Long-term debt including amount due within one year	**1,179.1**	**1,471.0**	1,184.8	1,484.8

Establishing Fair Value

The fair value of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities and due to related parties approximates their carrying values due to their short-term maturity.

The fair value of long-term debt, long-term receivables, and long-term payables are determined using the present value of future cash flows under current financing agreements, based on Hydro's current estimated borrowing rate for loans with similar terms and conditions.

Fair Value Hierarchy

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

Financial instruments included in Level 1 are cash and cash equivalents and short-term investments. Financial instruments included in Level 2 are the derivative instruments, the reserve fund and sinking funds – other investments. There are no financial instruments in Level 3.

Risk Management

Exposure to credit risk, liquidity risk and market risk arises in the normal course of Hydro's business.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

<u>Hydro</u>

(a) Credit Risk
Hydro is exposed to credit risk in the event of non performance by counterparties to its financial instruments. The majority of Hydro's receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers.

Hydro manages its investment credit risk exposure by restricting its investments to high quality securities such as Canada Treasury Bills, Bankers' Acceptances drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks.

(b) Liquidity Risk
Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Hydro manages this risk by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cashflows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and a $50.0 million operating credit facility. Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues.

(c) Market Risk
Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. During 2009, the Board of Directors of Nalcor, approved a formal financial risk management policy that outlined the risks associated with the operations of Nalcor and its subsidiaries and approaches and guidelines to be followed in the management of those risks. This policy will be reviewed by the Board annually or more frequently if there is a material change to Nalcor's financial risks and outlines a formal approval process for various hedging instruments used. The Audit Committee will provide oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates
Interest rate risk is managed within the corporate financing strategy where floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management are the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Exposure to changes in interest rates exists on interest expense related to the short-term debt portfolio and interest income related to the sinking fund investment portfolios. Hydro estimates that a change of 100 basis points from the actual average yield on the short-term debt portfolio in 2009 would have resulted in a change in interest expense of $0.5 million (2008 – $1.3 million). Similarly, a change of 100 basis points from the actual average yield on the sinking fund investment portfolio in 2009 would have resulted in a change in interest income of $2.3 million (2008 – $2.0 million) and a change in other comprehensive income of $16.6 million (2008 - $16.1 million). Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Hydro (cont'd)

(c) Market Risk (cont'd.)

Foreign Currency and Commodity Exposure
Fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Hydro's primary exposure to both foreign exchange and commodity price risk arise from its purchases of No. 6 fuel for consumption at the HTGS and certain electricity sales both of which are denominated in US dollars.

During 2009, Hydro had total purchases of No. 6 fuel of $87.5 million (2008 - $103.9 million) denominated in US dollars. Hydro's exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in actual fuel prices and exchange rates, as compared to that approved in Hydro's most recent cost of service study used to set rates, are captured in the RSP and are either refunded to or collected from customers through automatic rate adjustments. Hydro also employs the periodic use of forward currency contracts to avoid exposure to exchange rates on a particular day can be avoided.

During 2009, total electricity sales denominated in US dollars were $42.5 million. Hydro mitigates this risk through the use of forward contracts. During 2009, Hydro entered into a series of 24 monthly foreign currency forward contracts, the last of which matures April 2011, in the amount of $87.8 million US dollars at an average exchange rate of 1.17 to hedge 75% of Hydro's forecasted US dollars sales. The nominal contract value range from $2.4 million to $6.0 million. During the year, eight of the contracts were settled with the effective portion of the gain reported as energy sales and the ineffective portion as other income. The fair value of the 16 contracts outstanding as at December 31, 2009 is $7.0 million. These contracts have been designated as part of a hedging relationship.

Effect of Hedge Accounting on Financial Statements

(millions of dollars)	**Net Gains Included in Net Income**	**Unrealized Gains Included in OCI**
Ineffective portion	0.5	-
Effective portion	2.4	6.2

Churchill Falls

(a) Liquidity Risk
Churchill Falls is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. Churchill Falls manages this risk by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within its operations and by continuously monitoring cash flows. Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations and the $10.0 million unsecured credit facility. Long-term liquidity risk is managed by maintenance of the reserve fund in accordance with the June 1999 shareholders' agreement and dividend management policy to meet long-term liquidity requirements associated with debt retirement and the company's capital expenditure program.

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Churchill Falls (cont'd)

(b) Market Risk

Market risk refers primarily to the risk of loss resulting from changes in interest rates, foreign exchange rates and commodity prices.

Interest Rates

Interest rate risk is mitigated on Churchill Falls' long-term debt by virtue of a fixed interest rate to maturity. Exposure to changes in interest rates exists on investment income related to the short-term and reserve fund investment portfolios. Churchill Falls estimates that a change of 100 basis points from the actual average yield earned on the short-term investment portfolio in 2009 would have resulted in a change in interest income of $0.1 million (2008 – $0.2 million). Similarly, a change of 100 basis points from the actual average yield earned on the reserve fund investment portfolio in 2009 would have resulted in a change in interest income of $0.3 million (2008 – $0.2 million) and a change in other comprehensive income of $0.8 million (2008 - $0.5 million). Interest rate risk is managed within the corporate financing strategy where floating rate debt exposures and interest rate scenarios are forecast and evaluated.

Foreign Currency Exposure

The fair value or future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rate between a foreign currency and the Canadian dollar. Churchill Falls is exposed to foreign exchange risk when it enters into transactions to procure goods and services denominated in a foreign currency however this exposure to foreign exchange rate fluctuations is immaterial.

Commodity

Churchill Falls does not hold any financial instrument whose value would vary due to changes in a commodity price.

15. INTEREST EXPENSE

(millions of dollars)	**2009**	2008
Gross Interest		
Long-term debt	**92.0**	96.0
Promissory notes	**0.6**	4.2
	92.6	100.2
Accretion of long-term debt	**0.4**	0.5
Amortization of foreign exchange losses	**2.2**	2.2
Other	**7.0**	2.8
	102.2	105.7
Less		
Recovered from Hydro-Québec	**-**	0.1
Interest capitalized during construction	**0.8**	9.6
Interest earned	**17.6**	17.2
Net interest expense	**83.8**	78.8

With the refinancing of the General Mortgage Bonds in February 2008, Churchill Falls is required to share with Hydro-Québec any benefits it receives resulting from the respective change in interest rates. Prior to the refinancing, Churchill Falls recovered the difference between interest calculated at the rates prescribed in the Power Contract and interest paid on its long-term debt.

NEWFOUNDLAND AND LABRADOR HYDRO
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15. INTEREST EXPENSE (cont'd.)

Also, Churchill Falls can request Hydro and Hydro-Québec to make advances, against the issue of Subordinated Debt Obligations, to service its debt and to cover expenses if funds are not otherwise available. If such requests fail to attract sufficient advances, Churchill Falls can require Hydro-Québec to make additional advances, against the issue of units of Subordinate Debentures and shares of common stock, to service its debt and to cover its expenses that remain unfunded.

16. CHANGES IN NON-CASH OPERATING WORKING CAPITAL BALANCES

(millions of dollars)	**2009**	2008
Accounts receivable	**(9.0)**	3.6
Fuel and supplies	**(6.8)**	17.0
Prepaid expenses	**(0.6)**	(0.4)
Accounts payable and accrued liabilities	**7.3**	(20.8)
Regulatory assets	**5.5**	18.9
Regulatory liabilities	**68.8**	14.8
Accrued interest	**-**	(2.0)
Employee future benefits	**2.5**	3.0
Long-term receivables	**2.0**	(2.9)
Long-term payable	**3.6**	0.7
Due to related parties	**18.0**	(0.2)
Long-term related party note payable	**23.9**	-
	115.2	31.7

17. SEGMENT INFORMATION

Hydro operates in four business segments. Hydro Regulated encompasses sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. Nalcor's energy marketing activities include the sale of electricity to markets outside the Province. Other encompasses other non-regulated activities. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 1.

Segments

(millions of dollars)	**Hydro Regulated**	**Energy Marketing**	**Churchill Falls**	**Other**	**Inter-Segment**	**Total**
			2009			
Revenue						
Energy sales	**443.8**	**54.7**	**61.0**	**6.0**	**(3.9)**	**561.6**
Other	**2.2**	**0.7**	**0.3**	**-**	**1.3**	**4.5**
	446.0	**55.4**	**61.3**	**6.0**	**(2.6)**	**566.1**
Expenses						
Operations and administration	**100.9**	**17.2**	**37.7**	**3.3**	**-**	**159.1**
Fuels	**155.2**	**-**	**-**	**-**	**-**	**155.2**
Power purchased	**46.8**	**4.2**	**-**	**-**	**(3.9)**	**47.1**
Amortization	**41.7**	**-**	**12.8**	**-**	**-**	**54.5**
Interest	**83.5**	**-**	**0.4**	**(0.1)**	**-**	**83.8**
	428.1	**21.4**	**50.9**	**3.2**	**(3.9)**	**499.7**
Net income from operations	**17.9**	**34.0**	**10.4**	**2.8**	**1.3**	**66.4**
Preferred dividends	**-**	**-**	**1.3**	**-**	**(1.3)**	**-**
Net income	**17.9**	**34.0**	**11.7**	**2.8**	**-**	**66.4**
Capital expenditures	**54.1**	**-**	**3.7**	**-**	**-**	**57.8**
Total assets	**1,766.0**	**10.2**	**420.5**	**24.8**	**(0.8)**	**2,220.7**

17. SEGMENT INFORMATION (cont'd.)

Segments (cont'd.)

(millions of dollars)	Hydro Regulated	Energy Marketing	Churchill Falls	Other	Inter-Segment	Total
			2008			
Revenue						
Energy sales	440.1	51.3	68.9	6.9	(3.9)	563.3
Other	2.2	-	0.3	-	3.1	5.6
	442.3	51.3	69.2	6.9	(0.8)	568.9
Expenses						
Operations and administration	99.1	-	38.8	3.9	-	141.8
Fuels	164.8	-	-	-	-	164.8
Power purchased	41.4	3.5	-	-	(3.9)	41.0
Amortization	40.4	-	12.6	-	-	53.0
Interest	87.6	-	0.1	(8.9)	-	78.8
Write-down of investments	-	-	-	2.7	-	2.7
	433.3	3.5	51.5	(2.3)	(3.9)	482.1
Net income from operations	9.0	47.8	17.7	9.2	3.1	86.8
Preferred dividends	-	-	3.1	-	(3.1)	-
Net income	9.0	47.8	20.8	9.2	-	86.8
Capital expenditures	45.6	-	4.3	40.2	-	90.1
Total assets	1,711.4	3.7	414.4	21.7	(9.7)	2,141.5

During 2009, sales to Hydro's three largest customers amounted to over 80% of total energy sales.

Geographic Information

Revenues by geographic area:

(millions of dollars)	**2009**	2008
Newfoundland and Labrador	**453.1**	447.3
Québec	**69.8**	121.6
Nova Scotia	**39.7**	-
New Brunswick	**3.5**	-
	566.1	568.9

All of Hydro's assets are located in the Province.

18. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of Twin Falls will revert to Churchill Falls, and Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

18. COMMITMENTS AND CONTINGENCIES (cont'd.)

(b) The results of an Environmental Site Assessment (ESA) conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but further monitoring be carried out. Further monitoring is recommended for 2010 and every five years thereafter.

(c) Pursuant to the terms of the 1999 shareholders' agreement, in 2007, Churchill Falls commenced the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested $17.0 million in each of 2007, 2008 and 2009. The remaining investments will be acquired during a 30-day period commencing on each of the following dates:

January 1, 2010	$8.0	million
January 1, 2011	$8.0	million
January 1, 2012	$8.0	million

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holdings consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 Canadian Chartered Banks.

A summary of Hydro's 65.8% share of the reserve fund is as follows:

(millions of dollars)	**2009**	2008
Opening balance	**23.4**	11.2
Contribution	**11.2**	11.2
Total contribution to reserve fund	**34.6**	22.4
Net interest earned	**(0.2)**	0.4
Mark-to-market adjustment	**0.4**	0.6
Fair value of reserve fund	**34.8**	23.4

(d) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2008 - $0.2 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.9 million (2008 - $22.2 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate effect of such an action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(e) Outstanding commitments for capital projects total approximately $13.3 million (2008 - $7.1 million).

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18. COMMITMENTS AND CONTINGENCIES (cont'd.)

(f) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

Estimated payments due in each of the next five years are as follows:

(millions of dollars)	2010	2011	2012	2013	2014
Power purchases	27.0	27.6	28.5	29.5	30.2

On December 16, 2008, the Province introduced legislation cancelling two power purchase agreements related to hydro facilities.

(g) Hydro has issued two irrevocable letters of credit, one in the amount of $7.2 million to the New Brunswick System Operator as credit support related to an application for point to point transmission service. The second letter of credit has been issued to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement. Churchill Falls has issued an irrevocable letter of credit, in the amount of $0.7 million to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes, granted by the Department of Environment and Conservation.

(h) Effective March 31, 2009, Hydro's five-year power sales agreement to sell energy to Hydro-Québec expired. Effective April 1, 2009, Hydro has entered into a power sales agreement with a third party with respect to the energy previously sold to Hydro-Québec. To facilitate market access, Hydro has entered into a five-year transmission service agreement with Hydro-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

Pursuant to Hydro's five-year transmission service agreement with Hydro-Québec TransÉnergie, the transmission rental payments for the next five years are as follows:

2010	$ 19.2 million
2011	$ 19.2 million
2012	$ 19.2 million
2013	$ 19.2 million
2014	$ 4.8 million

(i) Hydro has received funding in the amount of $2.5 million from the Atlantic Canada Opportunities Agency in relation to a wind-hydrogen-diesel research development project in the community of Ramea; this funding is repayable by annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2009, there have been no commercial implementations.

19. RELATED PARTY TRANSACTIONS

The Province, Nalcor, Churchill Falls, Nalcor Energy – Oil and Gas, Nalcor Energy – Bull Arm Fabrication, LCDC and GIPCo are related parties of Hydro. In addition, the PUB is related to Hydro by virtue of its status as an agency of the Province. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $5.9 million (2008 - $6.0 million) of the power produced by Churchill Falls and Hydro's 65.8% share is eliminated upon consolidation.

(b) For the year ended December 31, 2009, approximately $1.9 million (2008 - $1.8 million) of operating costs were recovered from Churchill Falls for engineering, technical, management and administrative services. Hydro's 65.8% share is eliminated upon consolidation.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2009, Hydro incurred $0.6 million in costs related to the PUB (2008 - $0.6 million) of which $0.1 million (2008 - $0.1 million) was included in accrued liabilities.

(d) As at December 31, 2009 Hydro has a payable to Nalcor of $20.8 million (2008- $2.9 million) and a payable to Churchill Falls of $0.1 million (2008 – nil). This payable consists of various intercompany operating costs.

(e) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually. As at December 31, 2009 $2.4 million (2008 - $3.3 million) was payable.

(f) During 2008, certain assets and liabilities and their related debt and equity were transferred from Hydro to Nalcor Energy. Details of the transactions are noted below:

(millions of dollars)	2008
Property, plant and equipment	157.2
Contributed capital	(2.2)
Employee future benefits	(0.5)
Retained earnings from non-regulated activity in Hydro	(160.6)
Total	(6.1)

(g) During 2009, Nalcor advanced $1.1 million (2008 - $4.5 million) as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. Hydro also received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2009, the full amount of $0.2 million has been recorded as a deferred capital contribution.

(h) During 2009, Hydro received $0.4 million (2008 - $0.4 million) as a rate subsidy for rural isolated customers from the Province and $1.6 million (2008 - $1.5 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.1 million (2008 - $0.1 million) recorded as accounts receivable at year-end.

20. SIGNIFICANT OCCURRENCES

On November 3, 2008, a fire occurred in a cable shaft at Churchill Falls causing extensive damage to two sets of high-voltage cables in two units of the cable shaft. This resulted in lost GWAC revenue and power sales of approximately $7.7 million and $2.5 million in 2009 and $8.4 million and $2.1 million in 2008.

Hydro's share of total repair costs of $5.3 million as of December 31, 2009 were covered by insurance with the exception of a $1.3 million deductible. Repair work was completed on the first unit in February 2009 and the second unit in October 2009.

21. WATER MANAGEMENT AGREEMENT

In June 2007, the Province passed an amendment to the Electrical Power Control Act, 1994 ("EPCA"). The amendment requires parties, that utilize a common water resource in the province for power production, enter into a water management agreement. If the parties cannot reach an agreement, the Board of Commissioners of Public Utilities ("PUB") has the authority to impose an agreement on the parties. Churchill Falls shares the Churchill River with a Nalcor proposed hydroelectrical generation development, downstream from Churchill Falls. The amendment provides that any resulting water management agreement will not adversely affect existing power contracts.

A tentative agreement reached between management of Nalcor and Churchill Falls was not approved by the Churchill Falls Board of Directors. As a result, on November 10, 2009 Nalcor applied to the PUB to establish the terms of the agreement.

22. SUBSEQUENT EVENTS

(a) In January 2010, Hydro entered into 28 swap contracts to hedge the commodity price risk on electricity sales in the amount of $24.7 million.

(b) On February 23, 2010, Churchill Falls filed a motion against Hydro-Quebec in the Quebec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The outcome of this motion is not determinable at this time.

On February 3, 2010, the Province established a trust with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses incurred in relation to this matter.

(c) In February 2010, Hydro issued 22 letters of credit, for transmission bookings, reducing the availability of its credit facility by $11.5 million.

(d) On March 9, 2010, the PUB issued a board order establishing the water management agreement proposed by Nalcor in November 2009.

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010

BOARD OF DIRECTORS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

CATHY BENNETT
Owner/Operator
Bennett Restaurants Ltd.

TOM CLIFT
Associate Dean, Academic Programs
Memorial University - Faculty of Business

KEN MARSHALL
President
Rogers Cable - Atlantic Region

GERALD SHORTALL
Chartered Accountant
Corporate Director

HEAD OFFICE
Newfoundland and Labrador Hydro
Hydro Place. 500 Columbus Drive
P.O. Box 12400. St. John's, NL
Canada A1B 4K7

OFFICERS

JOHN OTTENHEIMER Q.C. (Chair)
Corporate Director

ED MARTIN
President and Chief Executive Officer
Nalcor Energy

GILBERT BENNETT
Vice President
Lower Churchill Project

WAYNE CHAMBERLAIN
General Counsel and Corporate Secretary
Nalcor Energy

JIM HAYNES
Vice President Regulated Operations
Newfoundland and Labrador Hydro

ANDY MACNEILL
Vice President
Churchill Falls

JOHN MACISAAC
Vice President Project Execution and Technical Services
Newfoundland and Labrador Hydro

GERARD MCDONALD
Vice President Human Resources and
Organizational Effectiveness
Nalcor Energy

DERRICK STURGE
Vice President Finance and Chief Financial Officer
Nalcor Energy

PETER HICKMAN
Assistant Corporate Secretary
Nalcor Energy

MARK BRADBURY
Corporate Treasurer and Chief Risk Officer
Nalcor Energy

S. KENT LEGGE
Corporate Controller
Nalcor Energy

Deloitte.

Deloitte & Touche LLP
10 Factory Lane
Fort William Building
St. John's NL A1C 6H5
Canada

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Independent Auditors' Report

To the Lieutenant-Governor in Council, Province of Newfoundland and Labrador.

We have audited the accompanying consolidated financial statements of Newfoundland and Labrador Hydro, which comprise the consolidated balance sheet as at December 31, 2010, and the consolidated statements of income and retained earnings, comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Newfoundland and Labrador Hydro as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants
April 1, 2011

NEWFOUNDLAND AND LABRADOR HYDRO

CONSOLIDATED BALANCE SHEET

As at December 31 (millions of dollars)	**2010**	2009
ASSETS		
Current assets		
Cash and cash equivalents	**52.7**	12.7
Short-term investments	**11.9**	37.3
Accounts receivable	**81.3**	86.2
Current portion of regulatory assets (Note 4)	**3.8**	4.8
Inventory	**62.9**	59.5
Prepaid expenses	**3.1**	2.2
Derivative assets	**2.0**	5.7
	217.7	208.4
Property, plant and equipment (Note 3)	**1,722.3**	1,703.1
Sinking funds	**208.4**	179.6
Regulatory assets (Note 4)	**65.9**	69.3
Long-term receivables (Note 5)	**25.7**	24.7
Derivative assets	**-**	1.3
Reserve fund (Note 18(c))	**39.3**	34.8
	2,279.3	2,221.2
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**123.2**	83.9
Accrued interest	**28.7**	28.7
Current portion of long-term debt (Note 7)	**8.2**	37.5
Current portion of regulatory liabilities (Note 4)	**118.9**	89.8
Deferred capital contribution	**0.1**	0.2
Derivative liabilities	**0.3**	-
	279.4	240.1
Long-term debt (Note 7)	**1,136.7**	1,141.6
Regulatory liabilities (Note 4)	**40.9**	32.8
Asset retirement obligations (Note 9)	**11.4**	-
Employee future benefits (Note 10)	**57.7**	52.4
Long-term payable (Note 8)	**4.6**	4.3
Long-term related party note payable (Note 19)	**25.3**	23.9
	1,556.0	1,495.1
SHAREHOLDER'S EQUITY		
Share capital (Note 11)	**22.5**	22.5
Contributed capital (Notes 2 and 11)	**116.0**	115.4
	138.5	137.9
Accumulated other comprehensive income (Note 12)	**27.3**	22.0
Retained earnings	**557.5**	566.2
	584.8	588.2
	723.3	726.1
Commitments and contingencies (Note 18)		
Subsequent event (Note 21)		
	2,279.3	2,221.2

See accompanying notes

On behalf of the Board:

ED MARTIN

GERRY SHORTALL

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

For the year ended December 31 (millions of dollars)	**2010**	2009
Revenue		
Energy sales	**572.2**	561.6
Interest and finance income (Note 15)	**17.8**	17.8
Other revenue	**6.1**	3.8
	596.1	583.2
Expenses		
Fuels	**140.4**	155.2
Power purchased	**44.4**	47.1
Operations and administration	**163.6**	158.5
Interest and finance charges (Note 15)	**105.0**	102.2
Amortization	**56.4**	54.5
Other gains and losses	**2.6**	(0.7)
	512.4	516.8
Net income	**83.7**	66.4
Retained earnings, beginning of year (Note 2)	**566.2**	544.3
Dividends	**92.4**	44.5
Retained earnings, end of year	**557.5**	566.2

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (millions of dollars)	**2010**	2009
Net income	**83.7**	66.4
Other comprehensive income		
Change in fair value of available for sale financial instruments	**20.6**	9.8
Change in fair value of derivatives designated as cash flow hedges	**1.1**	9.2
Amounts recognized in net income	**(16.4)**	(13.5)
Comprehensive income	**89.0**	71.9

See accompanying notes

NEWFOUNDLAND AND LABRADOR HYDRO
CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (millions of dollars)	**2010**	2009
Cash provided by (used in)		
Operating activities		
Net income	**83.7**	66.4
Adjusted for items not involving a cash flow		
Amortization	**56.4**	54.5
Accretion of long-term debt	**0.4**	0.4
Loss on disposal of property, plant and equipment	**0.7**	1.3
Unrealized loss (gain) on derivative instruments	**0.3**	(0.8)
	141.5	121.8
Changes in non-cash working capital balances (Note 16)	**86.8**	85.7
	228.3	207.5
Financing activities		
Decrease in promissory notes	**-**	(163.0)
Long-term debt retired	**(29.3)**	(0.9)
Dividends paid to Nalcor	**(92.4)**	(44.5)
Contributed capital	**0.6**	100.0
(Increase) decrease in long-term receivables	**(1.0)**	2.0
Increase in long-term payable	**0.3**	3.6
Increase in long-term related party note payable	**1.4**	23.9
Decrease in deferred capital contribution	**(0.1)**	(2.0)
	(120.5)	(80.9)
Investing activities		
Additions to property, plant and equipment	**(65.4)**	(57.8)
Increase in sinking fund	**(23.4)**	(22.0)
Decrease (increase) in short-term investments	**25.4**	(22.8)
Increase in reserve fund	**(4.9)**	(11.0)
Proceeds on disposal of property, plant and equipment	**0.5**	1.3
	(67.8)	(112.3)
Net increase in cash	**40.0**	14.3
Cash position, beginning of year	**12.7**	(1.6)
Cash position, end of year	**52.7**	12.7
Cash position is represented by		
Cash (bank indebtedness)	**52.5**	(4.3)
Cash equivalents	**0.2**	17.0
	52.7	12.7

Supplementary cash flow information (Note 16)

See accompanying notes

1. DESCRIPTION OF BUSINESS

Newfoundland and Labrador Hydro ("Hydro"), is incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador ("Province") as a Crown corporation and its principal activity is the development, generation and sale of electricity.

Hydro holds interests in the following subsidiaries and jointly controlled companies:

Churchill Falls (Labrador) Corporation Limited ("Churchill Falls") is incorporated under the laws of Canada and owns and operates a hydroelectric generating plant and related transmission facilities situated in Labrador which has a rated capacity of 5,428 megawatts ("MW").

Twin Falls Power Corporation ("Twin Falls") is incorporated under the laws of Canada and has developed a 225 MW hydroelectric generating plant on the Unknown River in Labrador. The plant has been inoperative since 1974.

Lower Churchill Development Corporation ("LCDC") is incorporated under the laws of Newfoundland and Labrador and was established with the objective of developing all or part of the hydroelectric potential of the lower Churchill River. LCDC is inactive.

Hydro and its subsidiary and jointly controlled companies, other than Twin Falls, are exempt from paying income taxes under Section 149 (1) (d) of the Income Tax Act.

2. SIGNIFICANT ACCOUNTING POLICIES

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

Gull Island Power Corporation ("GIPCo") was transferred to Nalcor Energy ("Nalcor"), Hydro's parent company, effective December 2009. The carrying value of Hydro's investment in GIPCo was nil and was transferred to Nalcor at cost. As it was a related party transaction, the transfer has been accounted for using the continuity of interests method and the comparative figures, specifically beginning retained earnings and contributed capital, have been restated to reflect the transfer as GIPCo is no longer a subsidiary of Hydro.

Principles of Consolidation
The Consolidated Financial Statements include the financial statements of Hydro and its subsidiary, LCDC (51% owned). Intercompany transactions and balances have been eliminated upon consolidation.

Effective June 18, 1999, Hydro, Churchill Falls and Hydro-Québec entered into a shareholders' agreement which provided, among other matters, that certain of the strategic operating, financing and investing policies of Churchill Falls be subject to approval jointly by representatives of Hydro and Hydro-Québec on the Board of Directors of Churchill Falls. Although Hydro retains its 65.8% ownership interest, the agreement changed the nature of the relationship between Hydro and Hydro-Québec, with respect to Churchill Falls, from that of majority and minority shareholders, respectively, to that of joint venturers. Accordingly, Hydro has applied the proportionate consolidation method of accounting for its interest in Churchill Falls subsequent to the effective date of the shareholders' agreement.

Churchill Falls holds 33.33% of the equity share capital of Twin Falls and is a party with other shareholders in a participation agreement which gives Churchill Falls joint control of Twin Falls. This investment is accounted for by the proportionate consolidation method.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Use of Estimates

Preparation of these Consolidated Financial Statements requires the use of estimates and assumptions that affect the amounts reported and disclosed in these statements and related notes. Key areas where management has made complex or subjective judgements include the fair value and recoverability of assets, the reported amounts of revenue and expenses, litigation, environmental and asset retirement obligations, amortization, property, plant, and equipment and other employee future benefits. Actual results may differ from these estimates, including changes as a result of future decisions made by the Newfoundland and Labrador Board of Commissioners of Public Utilities ("PUB"), and these differences could be material.

Rates and Regulations (Excluding Sales by Subsidiaries)

Hydro's revenues from its electrical sales to most customers within the Province are subject to rate regulation by the PUB. Hydro's borrowing and capital expenditure programs are also subject to review and approval by the PUB. Rates are set through periodic general rate applications utilizing a cost of service ("COS") methodology. The allowed rate of return on rate base is 7.4% (2009 - 7.4%). Hydro applies certain accounting policies that differ from enterprises that do not operate in a rate regulated environment. Generally these policies result in the deferral and amortization of costs or credits which will be recovered or refunded in future rates. In the absence of rate regulation these amounts would be included in the determination of net income in the year the amounts are incurred. The effects of rate regulation on the Consolidated Financial Statements are more fully disclosed in Note 4.

Cash and Cash Equivalents and Short-term Investments

Cash and cash equivalents and short-term investments consist primarily of Canadian treasury bills and Banker's Acceptances ("BA"). Those with original maturities at date of purchase of three months or less are classified as cash equivalents whereas those with original maturities beyond three months and less than twelve months are classified as short-term investments. The short-term investments bear interest rates of 0.85% to 1.35% (2009 – 0.26% to 1.57%) per annum. Cash and cash equivalents and short-term investments are measured at fair value.

Inventory

Inventory is recorded at the lower of average cost and net realizable value.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost, which comprises materials, labour, contracted services, other costs directly related to construction and an allocation of certain overhead costs. Expenditures for additions and betterments are capitalized and normal expenditures for maintenance and repairs are charged to operations. The cost of property, plant and equipment under construction is transferred to property, plant and equipment in service when construction is completed and facilities are commissioned, at which point amortization commences.

Contributions in aid of construction are funds received from customers and governments toward the incurred cost of property, plant and equipment, or the fair value of assets contributed. Contributions are recorded as a reduction to property, plant and equipment and the net property, plant and equipment is amortized.

<u>Hydro</u>

Construction in progress includes the costs incurred in engineering and construction of new generation, transmission and distribution facilities. Interest is charged to construction in progress at rates equivalent to Hydro's weighted average cost of capital.

Gains and losses on the disposal of property, plant and equipment are recognized in income as incurred.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Amortization is calculated on hydroelectric generating plant and on transmission plant in service on the sinking fund method using interest factors ranging from 5.25% to 15.79%. Amortization on distribution system and other plant in service is calculated on the straight-line method. These methods are designed to fully amortize the cost of the facilities, after deducting contributions in aid of construction, over their estimated service lives.

Estimated service lives of the major assets are as follows:

Generation plant	
Hydroelectric	50, 75 and 100 years
Thermal	25 and 30 years
Diesel	20 years
Transmission	
Lines	40 and 50 years
Switching stations	40 years
Distribution system	30 years
Other	3 to 50 years

Hydroelectric generation plant includes the powerhouse, turbines, governors and generators, as well as water conveying and control structures, including dams, dykes, tailrace, penstock and intake structures. Thermal generation plant is comprised of the powerhouse, turbines and generators, boilers, oil storage tanks, stacks and auxiliary systems. Diesel generation plant includes the buildings, engines, generators, switchgear, fuel storage and transfer systems, dykes and liners and cooling systems.

Transmission lines include the support structures, foundations and insulators associated with lines at voltages of 230, 138 and 69 kilovolt ("kV"). Switching stations assets are used to step up voltages of electricity from generating to transmission and to step down voltages for distribution.

Distribution system assets include poles, transformers, insulators and conductors.

Other assets include telecontrol, computer software, buildings, vehicles, furniture, tools and equipment.

<u>Churchill Falls</u>
Amortization is calculated on a straight-line basis over the following estimated useful lives:

Hydroelectric generation plant	67 years
Transmission and terminals	67 years
Service facilities	67 years
Other	5 to 100 years

Gains and losses on disposal of property, plant and equipment are recognized in income as incurred.

Impairment of Long-Lived Assets

Hydro reviews the carrying value of its property, plant and equipment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss corresponding to the amount by which the carrying value exceeds fair value is recognized, if applicable.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Asset Retirement Obligations
The fair value of the future expenditures required to settle legal obligations associated with the retirement of property, plant and equipment, is recognized to the extent that they are reasonably estimable. Asset retirement obligations are recorded as a liability at fair value, with a corresponding increase to property, plant and equipment. Accretion of asset retirement obligations is included in net income through Amortization. Differences between the recorded asset retirement obligation and the actual retirement costs incurred are recorded as a gain or loss in the settlement period.

Employee Future Benefits
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions are expensed as incurred.

Hydro provides group life insurance and health care benefits on a cost-shared basis to retired employees, in addition to a severance payment upon retirement. The expected cost of providing these other employee future benefits is accounted for on an accrual basis and has been actuarially determined using the projected benefit method prorated on service and management's best estimate of salary escalation, retirement ages of employees and expected health care costs. The excess of net cumulative actuarial gains and losses over 10% of the accrued benefit obligation is amortized over the expected average remaining service life of the employee group.

Revenue Recognition
Revenue is recognized on the accrual basis, as power deliveries are made, and includes an estimate of the value of electricity consumed by customers in the year, but billed subsequent to year-end. Sales within the Province are primarily at rates approved by the PUB, whereas export sales and sales to certain major industrial customers are either at rates under the terms of the applicable contracts, or at market rates.

A power contract with Hydro-Québec ("Power Contract"), dated May 12, 1969, provides for the sale of a significant amount of the energy from the Churchill Falls until 2041. The Power Contract has a 40-year term to 2016 which then renews for a further term of 25 years. The rate is predetermined in the Power Contract and decreases from the existing rate of 2.5426 mills per kilowatt hour ("kWh") to 2.0 mills per kWh upon renewal in 2016.

Churchill Falls receives revenues from Hydro-Québec, under a guaranteed winter availability contract ("GWAC") through 2041. The GWAC provides for the sale of 682 MW of guaranteed seasonal availability to Hydro-Québec during the months of November through March in each of the remaining years until the end of the Power Contract.

The value of differences between energy delivered and the Annual Energy Base ("AEB"), as defined in the Power Contract, is tracked over a four-year period and then either recovered from or refunded to Hydro-Québec over the subsequent four-year period, unless the balance is less than $1.0 million in which case it is recovered or refunded immediately. These long-term receivables or long-term payables are subject to interest at 7% per annum (2009 - 7%).

Foreign Currency Translation
Foreign currency transactions are translated into their Canadian dollar equivalent as follows:

(a) At the transaction date, each asset, liability, revenue or expense is translated using exchange rates in effect at that date.

(b) At the date of settlement and at each balance sheet date, monetary assets and liabilities are adjusted to reflect exchange rates in effect at that date. Any resulting gain or loss is reflected in income, except gains or losses on purchases of fuel which are included in the cost of fuel inventory.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Financial Instruments and Hedging Activities

Financial Instruments

Financial assets and financial liabilities are recognized on the balance sheet when Hydro becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Hydro has classified each of its financial instruments into the following categories: financial assets and liabilities held for trading; loans and receivables; financial assets held to maturity; financial assets available for sale; and other financial liabilities.

Hydro has classified its financial instruments as follows:

Cash and cash equivalents	Held for trading
Short-term investments	Available for sale
Accounts receivable	Loans and receivables
Sinking funds - investments in same Hydro issue	Held to maturity
Sinking funds - other investments	Available for sale
Reserve fund	Available for sale
Derivative assets	Held for trading
Long-term receivables	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Accrued interest	Other liabilities
Long-term debt	Other liabilities
Derivative liabilities	Held for trading
Long-term payable	Other liabilities
Long-term related party note payable	Other liabilities

Each of these financial instruments is measured at amortized cost, except for cash and cash equivalents and short-term investments, reserve fund, sinking fund – other investments, derivative assets and derivative liabilities which are measured at fair value.

Transaction costs related to financial assets and financial liabilities are included as part of the cost of the instrument, with the exception of cash and cash equivalents and short-term investments which are expensed as incurred through interest and finance charges, based upon the pricing obtained during the quotation process. Discounts and premiums on financial instruments are amortized to income over the life of the instrument.

Derivative Instruments and Hedging Activities

Derivative instruments are utilized by Hydro to manage market risk. Hydro's policy is not to utilize derivative instruments for speculative purposes. Hydro may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between price movements in the derivative instruments and the hedged items. Hydro formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

Hydro has designated foreign exchange forward contracts as cash flow hedges (Note 14). In a cash flow hedge relationship, the portion of gains or losses on the hedging item that is determined to be an effective hedge is recognized in Other Comprehensive Income ("OCI"), while the ineffective portion is recorded in net income. The amounts recognized in OCI are reclassified in net income when the hedged item affects net income.

Hydro had no fair value hedges in place at December 31, 2010 or 2009.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Future Accounting Changes

In October 2009, the Accounting Standards Board (AcSB) issued a third and final Omnibus Exposure Draft confirming that publically accountable enterprises in Canada will be required to apply International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), in full and without modification, for interim and annual financial statements beginning on or after January 1, 2011. As a result of recent changes to Part 1 of the Canadian Institute of Chartered Accountants (CICA) Handbook – Accounting, by the AcSB, certain rate-regulated entities can defer the adoption of IFRS by one year to January 1, 2012. Hydro meets the AcSB's criteria for the deferral and has chosen to adopt IFRS effective January 1, 2012.

Hydro is continuing to assess the financial reporting impacts of the adoption of IFRS; however, the impact of IFRS will depend on the IFRS standards in effect at the time of conversion on January 1, 2012 and the accounting elections made.

The IASB has deferred its work on rate-regulated activities accounting project and has not provided interim guidance for the recognition and measurement of regulatory assets and liabilities. Accordingly, Hydro continues to assess existing IFRS guidance to determine the impact of differences that will apply to accounting for rate-regulated activities upon adoption of IFRS on January 1, 2012.

3. PROPERTY, PLANT AND EQUIPMENT

	Property Plant and Equipment In Service	Contributions In Aid of Construction	Accumulated Amortization	Construction In Progress	Net Book Value
(millions of dollars)			**2010**		
Generation plant					
Hydroelectric	**1,417.1**	**22.9**	**379.0**	**3.3**	**1,018.5**
Thermal	**273.8**	**0.8**	**201.6**	**3.2**	**74.6**
Diesel	**68.0**	**5.8**	**35.3**	**2.2**	**29.1**
Transmission and distribution	**838.2**	**67.9**	**280.4**	**10.8**	**500.7**
Other	**297.8**	**24.0**	**178.2**	**3.8**	**99.4**
	2,894.9	**121.4**	**1,074.5**	**23.3**	**1,722.3**
(millions of dollars)			2009		
Generation plant					
Hydroelectric	1,410.8	22.9	365.6	1.1	1,023.4
Thermal	255.8	0.8	196.0	0.2	59.2
Diesel	64.6	5.9	33.5	2.8	28.0
Transmission and distribution	820.8	67.7	263.3	2.2	492.0
Other	284.7	23.5	166.1	5.4	100.5
	2,836.7	120.8	1,024.5	11.7	1,703.1

4. REGULATORY ASSETS AND LIABILITIES

(millions of dollars)	**2010**	2009	**Remaining Recovery Settlement Period (Years)**
Regulatory assets			
Foreign exchange losses	**66.8**	68.9	31.0
Deferred major extraordinary repairs	**2.3**	4.9	1.8
Deferred study costs	**-**	0.1	1.0
Deferred energy conservation costs	**0.6**	0.2	n/a
Total regulatory assets	**69.7**	74.1	
Less current portion	**3.8**	4.8	
	65.9	69.3	
Regulatory liabilities			
Rate stabilization plan	**159.2**	122.0	n/a
Deferred purchased power savings	**0.6**	0.6	16.5
Total regulatory liabilities	**159.8**	122.6	
Less current portion	**118.9**	89.8	
	40.9	32.8	

Regulatory assets represent future revenues associated with certain costs, incurred in current or prior periods that are expected to be recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenues associated with amounts that are expected to be refunded to customers as a result of the rate-setting process. Amounts deferred as regulatory assets and liabilities are subject to PUB approval. The risks and uncertainties related to regulatory assets and liabilities are subject to periodic assessment. When Hydro considers that the value of these regulatory assets or liabilities is no longer likely to be recovered or repaid through future rate adjustments, the carrying amount is reflected in operations. The following is a description of each of the circumstances in which rate regulation affects the accounting for a transaction or event.

Rate Stabilization Plan

On January 1, 1986, Hydro, having received the approval of the PUB, implemented a rate stabilization plan (RSP) which primarily provides for the deferral of fuel expense variances resulting from changes in fuel prices, levels of precipitation and load. Adjustments required in retail rates to cover the amortization of the balance in the plan are implemented on July 1 of each year. Similar adjustments required in industrial rates are implemented on January 1 of each year.

Balances accumulating in the RSP, including financing charges, are to be recovered or refunded in the following year, with the exception of hydraulic variation, which will be recovered or refunded at a rate of twenty-five percent of the outstanding balance at year-end. Additionally, a fuel rider is calculated annually based on the forecast fuel price and is added to or subtracted from the rates that would otherwise be in effect.

Hydro recognizes the RSP balances as a regulatory asset or liability based on the expectation that rates will be adjusted annually to provide for the collection from, or refund to, customers in future periods. In the absence of rate regulation, Canadian GAAP would require that the cost of fuel be recognized as an operating expense in the period in which it was consumed. In 2010, $23.3 million was recognized (2009 - $42.3 million) in the RSP and $2.3 million (2009 - $18.3 million) was recovered through rates and included in energy sales, with the corresponding cost amortized in fuels expenses.

Deferred Foreign Exchange Losses

Hydro incurred foreign exchange losses related to the issuance of Swiss Franc and Japanese Yen denominated debt in 1975 and 1985, respectively, which were recognized when the debt was repaid in 1997. The PUB has accepted the inclusion of realized foreign exchange losses related to long-term debt in rates charged to customers in future periods.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

Deferred Foreign Exchange Losses (cont'd.)
Any such loss, net of any gain, is deferred to the time of the next rate hearing for inclusion in the new rates to be set at that time. Accordingly, these losses are recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the losses in operating costs, in each year that the related debt was outstanding, to reflect the exchange rates in effect on each reporting date.

Commencing in 2002, the PUB ordered Hydro's deferred realized foreign exchange losses be amortized over a forty-year period. This amortization, of $2.1 million (2009 - $2.2 million), is included in Interest and finance charges (Note 15).

Deferred Major Extraordinary Repairs
In its report dated April 13, 1992, the PUB recommended that Hydro adopt a policy of deferring and amortizing the costs of major extraordinary repairs in excess of $0.5 million, subject to PUB approval on a case-by-case basis. In 2005, Hydro started an asbestos abatement program at the Holyrood Thermal Generating Station ("HTGS"). This program was carried out over a three-year period. Pursuant to Order No. P.U. 2 (2005), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, the costs incurred in each year of the program were recognized as a regulatory asset to be amortized over the subsequent five-year period. In 2006, Hydro incurred $2.3 million in expenses to repair a boiler tube failure at the HTGS. Pursuant to Order No. P.U. 44 (2006), the PUB approved the deferral and amortization of these costs as a major extraordinary repair. Accordingly, these costs are being amortized over a five-year period. In the absence of rate regulation, Canadian GAAP would require that Hydro expense the cost of the asbestos abatement program and the boiler tube repairs in the year incurred. In 2010, $2.6 million (2009 - $2.7 million) of amortization was recognized in Operations and administration expense.

Deferred Study Costs
Pursuant to Order No. P.U. 14 (2004), the PUB directed Hydro to conduct an independent study of the treatment of Newfoundland Power's generation in Hydro's COS, and an independent marginal cost study, and to accumulate these costs in a deferral account to be dealt with at the next general rate application. Pursuant to Order No. P.U. 8 (2007), Hydro received approval for recovery of these costs over a three-year period commencing in 2007. Accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include the cost of these studies in operating costs in the year incurred. In 2010, $0.1 million (2009 - $0.1 million) was recognized in Operations and administration expense.

Deferred Energy Conservation Costs
Pursuant to Order No. P.U. 14 (2009), Hydro received approval to defer costs associated with an electrical conservation program for residential, industrial, and commercial sectors and , accordingly, these costs have been recognized as a regulatory asset. In the absence of rate regulation, Canadian GAAP would require that Hydro include this program as operating costs in the year incurred. In 2010, $0.4 million (2009 – $0.2 million) was deferred.

Deferred Purchased Power Savings
In 1997, Hydro interconnected communities in the area of L'Anse au Clair to Red Bay to the Hydro-Québec system. In its report dated July 12, 1996, the PUB recommended that Hydro defer and amortize the benefits of a reduced initial purchased power rate over a 30-year period. These savings in the amount of $0.6 million (2009 - $0.6 million) are recognized as a regulatory liability. In the absence of rate regulation, Canadian GAAP would require that Hydro include the actual cost of purchased power in operating costs in the year incurred.

Property, Plant and Equipment
The PUB permits an allowance for funds used during construction ("AFUDC"), based on Hydro's weighted average cost of capital, to be included in the cost of capital assets and amortized over future periods as part of the total cost of the related asset. In 2010, Hydro's AFUDC of 7.6% (2009 - 7.6%) is higher than its cost of debt of 7.2% (2009 – 7.2%) and the amount capitalized is higher and interest expense is lower by $0.1 million (2009 - $0.1 million) than that which would be permitted under Canadian GAAP in the absence of rate regulation.

4. REGULATORY ASSETS AND LIABILITIES (cont'd.)

Property, Plant and Equipment (cont'd.)

Hydro amortizes its hydroelectric generating assets and transmission assets using the sinking fund method, as approved by the PUB. In the absence of rate regulation, these assets would likely be amortized using the straight-line method. During 2010, Hydro engaged an independent consultant to conduct an amortization study. The scope of this study included a review of Hydro's amortization methods as well as a statistical analysis of service life estimates and calculation of appropriate amortization rates and annual and accrued amortization balances as at December 31, 2009. Based on the results of this study, management currently estimates that switching from the use of sinking fund rather than straight-line amortization for hydroelectric and transmission assets, as well as changing from unit based amortization to a group based method on a remaining life basis would result in an immaterial change in the annual amortization expense.

5. LONG-TERM RECEIVABLES

Included in long-term receivables are two refundable deposits in the amount of $24.1 million (2009 - $23.9 million), associated with an application for transmission service into Québec, bearing interest at one-year Guaranteed Income Certificate ("GIC") rates, a $0.1 million (2009 – nil) deposit associated with an application for transmission service in New Brunswick, bearing interest at the Prime Rate, and two refundable deposits in the amount of $1.2 million (2009 – nil) associated with an application for transmission service into Nova Scotia, bearing interest at the Prime Rate less 1%. The remaining portion of $0.3 million (2009 – $0.8 million) is the 2004-2008 AEB receivable from Hydro-Québec bearing interest at 7.0%.

6. JOINT VENTURE

The following amounts included in the Consolidated Financial Statements represent Hydro's proportionate share of Churchill Falls' assets and liabilities at December 31, 2010, and its proportionate interest in Churchill Falls' operations for the year then ended.

(millions of dollars)	**2010**	2009
Current assets	**39.2**	45.7
Long-term assets	**375.8**	374.5
Current liabilities	**15.6**	38.8
Long-term liabilities	**14.0**	12.7
Revenues	**74.1**	58.8
Expenses	**50.8**	48.4
Net income	**23.3**	10.4
Cash provided by (used in)	**48.3**	15.3
Operating activities	**(27.9)**	3.5
Financing activities	**(0.4)**	(17.4)
Investing activities		

Income tax expense in the amount of $0.2 million (2009 - $0.2 million) related to a jointly controlled subsidiary, Twin Falls has been included in expenses.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. LONG-TERM DEBT

	2010			2009		
(millions of dollars)	**Hydro**	**Churchill Falls**	**Total**	Hydro	Churchill Falls	Total
Long-term debt	**1,144.9**	**-**	**1,144.9**	1,149.8	29.3	1,179.1
Less current portion	**8.2**	**-**	**8.2**	8.2	29.3	37.5
	1,136.7	**-**	**1,136.7**	1,141.6	-	1,141.6

Details of long-term debt are as follows:

Hydro

(millions of dollars)	**Face Value**	**Coupon Rate%**	**Year of Issue**	**Year of Maturity**	**2010**	2009
V *	125.0	10.50	1989	2014	**124.6**	124.5
X *	150.0	10.25	1992	2017	**149.3**	149.2
Y *	300.0	8.40	1996	2026	**293.3**	293.1
AB *	300.0	6.65	2001	2031	**306.7**	306.8
AD *	125.0	5.70	2003	2033	**123.6**	123.6
AE	225.0	4.30	2006	2016	**223.8**	223.7
Total debentures	1,225.0				**1,221.3**	1,220.9
Less: sinking fund investments in own debentures					**76.4**	71.1
					1,144.9	1,149.8
Less: payments due within one year					**8.2**	8.2
					1,136.7	1,141.6

* Sinking funds have been established for these issues.

Sinking fund investments consist of bonds, debentures, promissory notes and coupons issued by, or guaranteed by, the Government of Canada or any province of Canada, and have maturity dates ranging from 2013 to 2033. Hydro debentures, which are intended to be held to maturity, are deducted from long-term debt while all other sinking fund investments are shown separately on the balance sheet as assets. Annual contributions to the various sinking funds are in accordance with the bond indenture terms, and are structured to ensure the availability of adequate funds at the time of expected bond redemption. Effective yields range from 3.86% to 9.86% (2009 - 4.50% to 9.86%).

Promissory notes, debentures and long-term loans are unsecured and unconditionally guaranteed as to principal and interest and, where applicable, sinking fund payments, by the Province. The Province charges Hydro a guarantee fee of one percent annually on the total debt (net of sinking funds) guaranteed by the Province, outstanding as of the preceding December 31. For the years ended December 31, 2010 and 2009, the guarantee fee was waived by the Province.

Hydro uses promissory notes to fulfill its short-term funding requirements. As at December 31, 2010 there were no promissory notes outstanding (2009 – nil).

Hydro maintains a $50.0 million Canadian or US equivalent unsecured operating credit facility with its banker and at year-end there were no amounts drawn on the facility (2009 – nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility also provides coverage for overdrafts on Hydro's bank accounts, with interest calculated at the Prime Rate. At year-end, Hydro had 24 letters of credit outstanding (Note 18(g)) reducing the availability of the credit facility by $18.9 million (2009 - $7.5 million).

7. LONG-TERM DEBT (cont'd.)

Required repayments of long-term debt and sinking fund requirements over the next five years will be as follows:

(millions of dollars)	2011	2012	2013	2014	2015
Sinking fund requirement	8.2	8.2	8.2	8.2	8.2
Long-term debt repayment	-	-	-	125.0	-
	8.2	8.2	8.2	133.2	8.2

Churchill Falls

(millions of dollars)	**2010**	2009
Bank of Nova Scotia Credit Agreement		
4.4% due December 15, 2010		
Outstanding	**-**	29.3
Due within one year	**-**	29.3
Total long-term debt	**-**	-

On December 15, 2010, Churchill Falls repaid the Bank of Nova Scotia Credit Agreement in full.

Operating Credit Facility
Churchill Falls maintains a $10.0 million Canadian unsecured operating credit facility with its banker and at year-end, there were no amounts drawn on the facility (2009 - nil). Advances may take the form of a Prime Rate Advance or the issuance of a BA with interest calculated at the Prime Rate or prevailing Government BA fee. The facility provides coverage for overdrafts on Churchill Falls' bank accounts, with interest calculated at the Prime Rate. At year-end, Churchill Falls had two letters of credit outstanding (Note 18(g)) reducing the availability of the credit facility by $1.0 million (2009 - $1.0 million).

Churchill Falls had an additional letter of credit outstanding with another Schedule 1 Chartered Bank in the amount of $1.0 million (2009 - $1.0 million). This letter of credit did not reduce the availability of the credit facility at year end.

8. LONG-TERM PAYABLE

The long-term payable to Hydro-Québec as at December 31, 2010 represents the accumulation of differences between energy delivered monthly and the AEB energy billed monthly, which will be tracked during the four-year period from September 1, 2008 to August 31, 2012. Currently, the full amount of $4.6 million (2009 – $4.3 million) is long-term. The final amount will be determined on August 31, 2012 and will be paid or collected monthly beginning September 2012 and ending August 2016.

9. ASSET RETIREMENT OBLIGATIONS

During the year ended December 31, 2010, Hydro recognized a liability associated with the retirement of portions of the HTGS. The reconciliation of the beginning and ending carrying amount of asset retirement obligations is as follows:

(millions of dollars)	**2010**	2009
Asset retirement obligations, beginning of year	**-**	-
Liabilities incurred	**11.4**	-
Liabilities settled	**-**	-
Accretion	**-**	-
Asset retirement obligations, end of year	**11.4**	-

The total undiscounted estimated cash flows required to settle the obligations at December 31, 2010 is $20.5 million (2009 – nil). Payments to settle the liability are expected to occur between 2021 and 2029. The fair value of the asset retirement obligations was determined using the present value of future cash flows discounted at the Hydro's credit-adjusted risk-free rate of 4.1%.

A significant number of Hydro's assets include generation plants, transmission assets and distribution systems. These assets can continue to run indefinitely with ongoing maintenance activities. As it is expected that Hydro's assets will be used for an indefinite period, no removal date can be determined and consequently, a reasonable estimate of the fair value of any related asset retirement obligations cannot be determined at this time. If it becomes possible to estimate the fair value of the cost of removing assets that Hydro is legally required to remove, an asset retirement obligation for those assets will be recognized at that time.

10. EMPLOYEE FUTURE BENEFITS

Pension Plan
Employees participate in the Province's Public Service Pension Plan, a multi-employer defined benefit plan. The employer's contributions of $4.9 million (2009 - $4.6 million) are expensed as incurred.

Other Benefits
Hydro provides group life insurance and healthcare benefits on a cost-shared basis to retired employees, and in certain cases, their surviving spouses, in addition to a severance payment upon retirement. In 2010, cash payments to beneficiaries for its unfunded other employee future benefits was $2.3 million (2009 - $2.7 million). An actuarial valuation was performed as at December 31, 2009 and extrapolated to December 31, 2010. The next actuarial valuation will be performed as at December 31, 2012.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

(millions of dollars)	**2010**	2009
Accrued benefit obligation		
Balance at beginning of year	**69.6**	51.1
Transfer to Nalcor Energy	**-**	(0.5)
Current service cost	**2.2**	1.4
Interest cost	**4.6**	3.8
Actuarial loss	**9.2**	16.5
Benefits paid	**(2.3)**	(2.7)
Balance at end of year	**83.3**	69.6
Plan deficit	**83.3**	69.6
Unamortized actuarial loss	**(25.4)**	(17.0)
Unamortized past-service cost	**(0.2)**	(0.2)
Accrued benefit liability at end of year	**57.7**	52.4

(millions of dollars)	**2010**	2009
Component of benefit cost		
Current service cost	**2.2**	1.4
Interest cost	**4.6**	3.8
Actuarial loss	**9.2**	16.5
	16.0	21.7
Difference between actuarial loss and amount recognized	**(8.4)**	(16.5)
Benefit expense	**7.6**	5.2

The significant actuarial assumptions used in measuring the accrued benefit obligations and benefit expense are as follows:

	2010	2009
Discount rate – benefit cost	**6.50%**	7.50%
Discount rate – accrued benefit obligation	**5.75%**	6.50%
Rate of compensation increase	**3.50%**	3.50%

Assumed healthcare trend rates:

	2010	2009
Initial health care expense trend rate	**7.50%**	7.50%
Cost trend decline to	**5.00%**	5.00%
Year that rate reaches the rate it is assumed to remain at	**2016**	2016

10. EMPLOYEE FUTURE BENEFITS (cont'd.)

Other Benefits (cont'd.)

A 1% change in assumed health care trend rates would have had the following effects:

Increase	**2010**	2009
Current service and interest cost	**1.2**	0.8
Accrued benefit obligation	**14.2**	10.7

Decrease	**2010**	2009
Current service and interest cost	**(0.9)**	(0.6)
Accrued benefit obligation	**(11.1)**	(8.4)

11. SHAREHOLDER'S EQUITY

Share Capital

(millions of dollars)	**2010**	2009
Common shares of par value $1 each		
Authorized: 25,000,000		
Issued and outstanding 22,503,942	**22.5**	22.5

Contributed Capital

(millions of dollars)	**2010**	2009
Total contributed capital	**116.0**	115.4

On February 3, 2010, the Province established the Churchill Falls (Labrador) Corporation Trust ("the Trust") with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses incurred in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. During 2010 the Trust contributed capital of $0.6 million.

Under the continuity of interests method of accounting, the 2009 comparative has been restated to reflect the transfer of GIPCo to Nalcor, resulting in a decrease of $96.4 million in contributed capital.

There were no contributions by Nalcor during 2010 (2009 - $100.0 million).

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

(millions of dollars)	**2010**	2009
Balance, beginning of year	**22.0**	16.5
Change in fair value of available for sale financial instruments	**20.6**	9.8
Change in fair value of derivatives designated as cash flow hedges	**1.1**	9.2
Amount recognized in net income	**(16.4)**	(13.5)
Balance, end of year	**27.3**	22.0

13. CAPITAL MANAGEMENT

Hydro

Hydro's principal business requires ongoing access to capital in order to maintain the continued delivery of safe and reliable service to its customers. Therefore, Hydro's primary objective when managing capital is to ensure ready access to capital at a reasonable cost.

The capital managed by Hydro is comprised of debt (long-term debentures, promissory notes, bank credit facilities and bank indebtedness) and equity (share capital, contributed capital, accumulated other comprehensive income and retained earnings).

A summary of the capital structure is outlined below:

(millions of dollars)	**2010**		2009	
Debt				
Long-term debt	**1,136.7**		1,141.6	
Current portion of long-term debt	**8.2**		37.5	
Sinking funds	**(208.4)**		(179.6)	
	936.5	**56.4%**	999.5	57.9%
Equity				
Share capital	**22.5**		22.5	
Contributed capital	**116.0**		115.4	
Accumulated other comprehensive income	**27.3**		22.0	
Retained earnings	**557.5**		566.2	
	723.3	**43.6%**	726.1	42.1%
Total debt and equity	**1,659.8**	**100.0%**	1,725.6	100.0%

Hydro's approach to capital management encompasses various factors including monitoring the percentage of floating rate debt in the total debt portfolio, the weighted average term to maturity of its overall debt portfolio, its percentage of debt to debt plus equity and its earnings before interest and taxes ("EBIT") coverage of interest.

For the regulated portion of Hydro's operations a capital structure comprised of 75% debt and 25% common equity is maintained, a ratio which management believes to be optimal with respect to its cost of capital. This capital structure is maintained by a combination of dividend policy, contributed equity and debt issuance. The issuance of any new debt with a term greater than one year requires prior approval of Hydro's regulator, the PUB.

Per legislation, the total of the short-term loans issued by Hydro and outstanding at any time, shall not exceed a limit as fixed by the Lieutenant-Governor in Council. Short-term loans are those loans issued with a term not exceeding two years. The current limit is set at $300 million. The balance outstanding as at December 31, 2010 was Nil (2009 - Nil). Issuance of long-term and short-term debt by Hydro is further restricted by Bill C-24, an amendment to the Newfoundland and Labrador Hydro Act of 1975. The Bill effectively limits Hydro's total borrowings, which includes both long and short-term debt, to $1.6 billion at any point in time.

Churchill Falls

Churchill Falls' objective when managing capital is to maintain its ability to continue as a going concern. Churchill Falls' requirements for capital in the future are expected to increase, coincident with the aging of the plant and related infrastructure and the execution of the long-term asset management plan. The focus of the capital management policy is to provide flexibility to ensure cash continues to be available to satisfy capital requirements. Managing the level of dividend payments is a key aspect of ensuring the availability of funding to maintain the plant and infrastructure.

At present, the capital position of Churchill Falls is comprised entirely of equity capital (share capital, contributed capital and retained earnings). The capital structure is adjusted through the amount of dividends paid to shareholders.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The estimated fair values of financial instruments as at December 31, 2010 and 2009 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that Hydro might receive or incur in actual market transactions.

As a significant number of Hydro's assets and liabilities do not meet the definition of a financial instrument, the fair value estimates below do not reflect the fair value of Hydro as a whole.

	Carrying Value	**Fair Value**	Carrying Value	Fair Value
(millions of dollars)	**2010**		2009	
Financial assets				
Cash and cash equivalents	**52.7**	**52.7**	12.7	12.7
Short-term investments	**11.9**	**11.9**	37.3	37.3
Accounts receivable	**81.3**	**81.3**	86.2	86.2
Sinking funds – investments in same Hydro issue	**76.4**	**93.6**	71.1	85.2
Sinking funds – other investments	**208.4**	**208.4**	179.6	179.6
Long-term receivable (1)	**25.7**	**n/a**	24.7	n/a
Derivative assets (including current portion)	**2.0**	**2.0**	7.0	7.0
Reserve fund	**39.3**	**39.3**	34.8	34.8
Financial liabilities				
Accounts payable and accrued liabilities	**123.2**	**123.2**	83.9	83.9
Accrued interest	**28.7**	**28.7**	28.7	28.7
Long-term debt including amount due within one year (before sinking funds)	**1,221.3**	**1,589.7**	1,250.2	1,471.0
Derivative liabilities	**0.3**	**0.3**	-	-
Long-term payable	**4.6**	**4.7**	4.3	4.4
Long-term related party note payable (1)	**25.3**	**n/a**	23.9	n/a

The fair value of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities, accrued interest and due to related parties approximates their carrying values due to their short-term maturity.

(1) The fair value of the long-term receivable and long-term related party note payable is subject to uncertainty regarding the timing of future cash flows and as such, the fair value of the long-term receivable cannot be determined at December 31, 2010 and 2009.

Establishing Fair Value

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the nature of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Fair Value (cont'd.)

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

Establishing Fair Value (cont'd.)
The following table presents Hydro's fair value hierarchy for financial assets and liabilities as at December 31. There were no transfers between Level 1 and Level 2 during the year:

	Level 1	Level 2	Total
(millions of dollars)	**2010**		
Financial assets			
Cash and cash equivalents	**52.7**	**-**	**52.7**
Short-term investments	**11.9**	**-**	**11.9**
Accounts receivable	**81.3**	**-**	**81.3**
Sinking funds – investments in same Hydro issue	**-**	**93.6**	**93.6**
Sinking funds – other investments	**-**	**208.4**	**208.4**
Derivative assets	**-**	**2.0**	**2.0**
Reserve fund	**-**	**39.3**	**39.3**
Financial liabilities			
Accounts payable and accrued liabilities	**123.2**	**-**	**123.2**
Accrued interest	**28.7**	**-**	**28.7**
Long-term debt including amount due within one year (before sinking funds)	**-**	**1,589.7**	**1,589.7**
Derivative liabilities	**-**	**0.3**	**0.3**
Long-term payable	**-**	**4.7**	**4.7**
	2009		
Financial assets			
Cash and cash equivalents	12.7	-	12.7
Short-term investments	37.3	-	37.3
Accounts receivable	86.2	-	86.2
Sinking funds – investments in same Hydro issue	-	85.2	85.2
Sinking funds – other investments	-	179.6	179.6
Derivative assets	-	7.0	7.0
Reserve fund	-	34.8	34.8
Financial liabilities			
Accounts payable and accrued liabilities	83.9	-	83.9
Accrued interest	28.7	-	28.7
Long-term debt including amount due within one year	-	1,471.0	1,471.0
Derivative liabilities	-	-	-
Long-term payable	-	4.4	4.4

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Fair Value (cont'd.)

Establishing Fair Value (cont'd.)
There were no financial assets or liabilities valued using Level 3 of the fair value hierarchy as at December 31, 2010 and 2009.

Risk Management
Exposure to credit risk, liquidity risk and market risk arises in the normal course of Hydro's business.

Credit Risk
Hydro is exposed to credit risk in the event of non-performance by counterparties to its financial instruments. The majority of the receivables are from regulated utilities which minimizes credit risk. There is risk that Hydro will not be able to collect all of its remaining accounts receivable and amounts owing under its customer finance plans. These financial instruments which arise in the normal course of business do not represent a significant concentration of credit risk as amounts are owed by a large number of customers on normal credit terms. Hydro manages this credit risk primarily by executing its credit and collection policy including the requirement for security deposits from certain customers. As at December 31, 2010 security deposits of $0.1 million (2009 - $0.1 million) are included in accounts payable and accrued liabilities.

Hydro's three largest customers account for 80.3% (2009 –78.8%) of total energy sales and 69.0% (2009 – 69.6%) of accounts receivable. These customers are comprised of rate regulated organizations or organizations with an investment grade rating.

Hydro does not have any significant amounts that are past due and uncollectable for which a provision has not been recognized at December 31, 2010.

Hydro manages its investment credit risk exposure by restricting its investments to high-quality securities such as Canada Treasury Bills, BAs drawn on Schedule 1 Canadian Chartered Banks and Term Deposits issued by Schedule 1 Canadian Chartered Banks. Additionally, the investments held within the portfolios of Churchill Falls do not exceed 10% with any one institution with the exception of the Government of Canada.

Liquidity Risk
Hydro is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. This risk is managed by maintaining borrowing facilities sufficient to cover both anticipated and unexpected fluctuations within the operations and by continuously monitoring cash flows.

Short-term liquidity is provided through cash and cash equivalents on hand, funds from operations, a $300.0 million promissory note program and credit facilities.

Long-term liquidity risk is managed by the issuance of a portfolio of debentures with maturity dates ranging from 2014 to 2033. Sinking funds have been established for these issues with exception to Series AE.

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Liquidity Risk (cont'd.)
The following are the contractual maturities of Hydro's financial liabilities, including principal and interest, as at December 31, 2010:

(millions of dollars)	<1 Year	1-3 Years	3-5 years	> 5 Years	Total
Accounts payable and accrued liabilities	123.2	-	-	-	123.2
Accrued interest	28.7	-	-	-	28.7
Derivative liabilities	0.3	-	-	-	0.3
Long-term debt including amount due within one year	-	-	125.0	1,100.0	1,225.0
Long-term payable	-	1.5	2.3	0.8	4.6
Interest	61.8	181.3	161.5	752.4	1,157.0
	214.0	182.8	288.8	1,853.2	2,538.8

Market Risk
Market risk refers primarily to the risk of loss resulting from changes in interest rates, commodity prices and foreign exchange rates. Nalcor has a formal financial risk management policy that outlines the risks associated with the operations of Nalcor and its subsidiaries outlining approaches and guidelines to be followed in the management of those risks. This policy is reviewed by the Board annually or more frequently if there is a material change to Nalcor's financial risks. The Audit Committee provides oversight on behalf of the Board with the exception of any items that specifically require Board approval.

Interest Rates
Interest rate risk is managed within the corporate financing strategy whereby floating rate debt exposures and interest rate scenarios are forecast and evaluated. A diversified portfolio of fixed and floating rate debt is maintained and managed with a view to an acceptable risk profile. Key quantitative parameters for interest rate risk management includes the percentage of floating rate debt in the total debt portfolio, coupled with an examination of the weighted average term to maturity of the entire debt portfolio. By setting clear guidelines in respect to these quantitative parameters, Hydro attempts to minimize the likelihood of a material impact on net income resulting from an unexpected change in interest rates.

Hydro is exposed to interest rate risk related to the short-term debt portfolio, the sinking fund investment portfolios and reserve fund investment portfolios. Interest rate risk on the long-term debt portfolio is mitigated through the use of fixed rate debentures. The following table illustrates Hydro's exposure to a 100 basis point (1%) change in interest rates:

	Net Income		Other Comprehensive Income	
(millions of dollars)	1% decrease	1 % increase	1% decrease	1 % increase
Interest on short-term investments	(0.3)	0.3	-	-
Interest on sinking fund	-	-	29.3	(10.3)
Interest on reserve fund	(0.1)	0.1	1.1	(0.9)
	(0.4)	0.4	30.4	(11.2)

14. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd.)

Risk Management (cont'd.)

Market Risk (cont'd.)

Foreign Currency and Commodity Exposure
The fair value of future cash flows of a financial instrument will fluctuate due to changes in the exchange rate between the foreign currency and the Canadian dollar. Hydro's primary exposure to both foreign exchange and commodity price risk arises within Hydro from its purchases of No. 6 fuel for consumption at the HTGS and certain electricity sales both of which are denominated in USD.

During 2010, Hydro had total purchases of No. 6 fuel of $104.1 million (2009 - $87.5 million) denominated in USD. Exposure to both the foreign exchange and commodity price risk associated with these fuel purchases is mitigated through the operation of the RSP. The purpose of the RSP is to both reduce volatility in customer rates as well as mitigate potential net income volatility from fuel price and volume variations. All variances in fuel prices including exchange rates, as compared to that approved in Hydro's most recent cost of service study, are captured in the RSP and are either refunded to or collected from customers through rate adjustments. Hydro also employs the periodic use of forward currency contracts to manage exposure to exchange rates on a particular day.

During 2010, total electricity sales denominated in USD were $72.8 million (2009 - $41.8 million). Hydro mitigates this risk through the use of commodity swaps and foreign currency forward contracts.

During 2009, Hydro entered into a series of 24 monthly foreign exchange forward contracts, in the amount of $87.8 million USD at an average exchange rate of 1.17 to hedge 75% of Hydro's forecasted USD electricity sales, the last of which expires in April 2011. These contracts have been designated as part of a hedging relationship.

During 2010, Hydro entered into 28 commodity swap contracts totalling $24.7 million, the last of which expired in December 2010. These contracts swapped floating market rates for fixed rates which ranged from $26 USD/MWh to $50 USD/MWh. These contracts have not been designated as part of a hedging relationship. During 2010, 24 of these settled. The fair value of the four contracts outstanding as at December 31, 2010 is a liability of $0.3 million and $3.4 million in losses from these contracts is included in Other gains and losses.

Effect of Hedge Accounting on Financial Statements

	Net Gains Included in Net Income	**Unrealized Gains Included in OCI**	Net Gains Included in Net Income	Unrealized Gains Included in OCI
(millions of dollars)	**2010**		2009	
Ineffective portion	**0.2**	**-**	0.5	-
Effective portion	**5.9**	**1.3**	2.4	6.2

The ineffective portion of hedging gains and losses is included in net income through Other gains and losses.

NEWFOUNDLAND AND LABRADOR HYDRO
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15. INTEREST AND FINANCE INCOME /CHARGES

(millions of dollars)	**2010**	2009
Interest and finance income		
Interest on sinking fund	**15.2**	13.9
Interest on reserve fund	**1.4**	1.3
Other interest income	**1.2**	2.6
	17.8	17.8
Interest and finance charges		
Long-term debt	**91.7**	91.8
Interest on rate stabilization plan	**10.2**	7.0
Accretion of long-term debt	**0.4**	0.4
Amortization of deferred foreign exchange losses	**2.1**	2.2
Other	**1.8**	1.6
	106.2	103.0
Interest capitalized during construction	**(1.2)**	(0.8)
	105.0	102.2

16. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	**2010**	2009
Accounts receivable	**4.9**	(9.2)
Inventory	**(3.4)**	(6.8)
Prepaid expenses	**(0.9)**	(0.6)
Regulatory assets	**4.4**	5.5
Regulatory liabilities	**37.2**	68.8
Accounts payable and accrued liabilities	**39.3**	25.5
Employee future benefits	**5.3**	2.5
Changes to non-cash working capital balances	**86.8**	85.7
Income taxes paid	**0.2**	0.2
Interest received	**2.0**	2.1
Interest paid	**92.1**	92.9

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17. SEGMENT INFORMATION

Hydro operates in four business segments. Hydro Regulated encompass sales of electricity to customers within the Province. Churchill Falls operates a hydroelectric generating facility and sells electricity primarily to Hydro-Québec. Hydro's Energy Marketing activities include the sale of electricity to markets outside the Province. Other encompasses other non-regulated activities. The designation of segments has been based on a combination of regulatory status and management accountability. The segments' accounting policies are the same as those previously described in Note 2.

Segments	Hydro Regulated	Churchill Falls	Energy Marketing	Other	Inter-segment	Total
(millions of dollars)			**2010**			
Revenue						
Energy sales	**417.1**	**76.0**	**77.5**	**5.5**	**(3.9)**	**572.2**
Interest and finance income	**16.1**	**1.7**	**-**	**-**	**-**	**17.8**
Other revenue	**2.3**	**0.3**	**-**	**-**	**3.5**	**6.1**
	435.5	**78.0**	**77.5**	**5.5**	**(0.4)**	**596.1**
Expenses						
Fuels	**140.3**	**-**	**-**	**0.1**	**-**	**140.4**
Power purchased	**44.2**	**-**	**4.1**	**-**	**(3.9)**	**44.4**
Operations and administration	**97.8**	**40.5**	**21.4**	**3.9**	**-**	**163.6**
Interest and finance charges	**102.9**	**1.6**	**0.5**	**-**	**-**	**105.0**
Amortization	**43.8**	**12.6**	**-**	**-**	**-**	**56.4**
Other gains and losses	**-**	**-**	**2.6**	**-**	**-**	**2.6**
	429.0	**54.7**	**28.6**	**4.0**	**(3.9)**	**512.4**
Net income from operations	**6.5**	**23.3**	**48.9**	**1.5**	**3.5**	**83.7**
Preferred dividends	**-**	**3.5**	**-**	**-**	**(3.5)**	**-**
Net income	**6.5**	**26.8**	**48.9**	**1.5**	**-**	**83.7**
Capital expenditures	**55.5**	**9.9**	**-**	**-**	**-**	**65.4**
Total assets	**1,831.5**	**417.0**	**7.4**	**25.4**	**(2.0)**	**2,279.3**

(millions of dollars)			2009			
Revenue						
Energy sales	443.8	61.0	54.7	6.0	(3.9)	561.6
Interest and finance income	16.4	1.4	-	-	-	17.8
Other revenue	2.2	0.3	-	-	1.3	3.8
	462.4	62.7	54.7	6.0	(2.6)	583.2
Expenses						
Fuels	155.2	-	-	-	-	155.2
Power purchased	46.8	-	4.2	-	(3.9)	47.1
Operations and administration	100.9	37.7	16.6	3.3	-	158.5
Interest and finance charges	99.9	1.8	0.6	(0.1)	-	102.2
Amortization	41.7	12.8	-	-	-	54.5
Other gains and losses	-	-	(0.7)	-	-	(0.7)
	444.5	52.3	20.7	3.2	(3.9)	516.8
Net income from operations	17.9	10.4	34.0	2.8	1.3	66.4
Preferred dividends	-	1.3	-	-	(1.3)	-
Net income	17.9	11.7	34.0	2.8	-	66.4
Capital expenditures	54.1	3.7	-	-	-	57.8
Total assets	1,766.0	421.1	10.2	24.7	(0.8)	2,221.2

NEWFOUNDLAND AND LABRADOR HYDRO
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. SEGMENT INFORMATION (cont'd.)

Geographic Information
Revenues by geographic area:

(millions of dollars)	**2010**	2009
Newfoundland and Labrador	**453.8**	473.9
Québec	**70.5**	69.2
Nova Scotia	**11.1**	36.6
New Brunswick	**60.7**	3.5
	596.1	583.2

All of Hydro's physical assets are located in the Province.

18. COMMITMENTS AND CONTINGENCIES

(a) Under the terms of a sublease with Twin Falls, expiring on December 31, 2014, Churchill Falls is required to deliver to Twin Falls, at an agreed price, horsepower equivalent to the installed horsepower of the Twin Falls plant and to maintain Twin Falls' plant and equipment. The costs associated with making the plant operational, if required, are not estimable at this time. In 2015, the physical assets of Twin Falls will revert to Churchill Falls, and Churchill Falls is required to make this horsepower available to Hydro at rates that are commercially reasonable pursuant to the 1999 shareholders' agreement.

(b) The results of an Environmental Site Assessment ("ESA") conducted at the Twin Falls Generating Station indicated higher than acceptable concentrations of contaminants in the soil and waters adjacent to the powerhouse. Further testing was conducted to determine the extent of contamination. The recommendations arising from this testing indicate that remediation is not required, but that monitoring be carried out every 5 years. Monitoring was performed throughout 2010 with no remediation required. Further monitoring will be performed in 2015.

(c) Pursuant to the terms of the 1999 shareholders' agreement Churchill Falls, in 2007, commenced the creation of a $75.0 million segregated reserve fund to contribute towards the funding of capital expenditures related to Churchill Falls' existing facilities and their replacement. Churchill Falls invested $17.0 million in each of 2007, 2008 and 2009 and $8.0 million in 2010. The remaining investments will be acquired during the 30-day period commencing on each of the following dates:

January 1, 2011	$8.0	million
January 1, 2012	$8.0	million

This fund must remain in place until the end of the shareholders' agreement in 2041. Any amounts removed to fund capital expenditures must be replaced. Reserve fund holdings consist of securities issued by the Government of Canada, various provinces of Canada and Schedule 1 Canadian Chartered Banks. Hydro's share of this commitment is 65.8%.

A summary of Hydro's 65.8% share of the reserve fund is as follows:

(millions of dollars)	**2010**	2009
Opening balance	**34.8**	23.4
Contribution	**5.3**	11.2
Net interest	**(0.4)**	(0.2)
Mark-to-market adjustment	**(0.4)**	0.4
Fair value of reserve fund	**39.3**	34.8

18. COMMITMENTS AND CONTINGENCIES

(d) Hydro has received claims instituted by various companies and individuals with respect to outages and other miscellaneous matters. Although such matters cannot be predicted with certainty, management currently considers Hydro's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for, to be $0.1 million (2009 - $0.1 million).

One of Hydro's industrial customers commenced legal proceedings in 1997, claiming approximately $21.8 million (2009 - $21.9 million) related to outages and plant shutdowns. Hydro is defending this claim. While the ultimate outcome of this action cannot be ascertained at this time, in the opinion of Hydro's management, following consultation with its legal counsel, no liability should be recognized.

(e) Outstanding commitments for capital projects total approximately $17.6 million (2009 - $13.3 million).

(f) Hydro has entered into a number of long-term power purchase agreements as follows:

Type	Rating	In-service Date	Term
Hydroelectric	175 kW	1988	Continual
Hydroelectric	3 MW	1995	25 years
Hydroelectric	4 MW	1998	25 years
Cogeneration	15 MW	2003	20 years
Wind	390 kW	2004	15 years
Wind	27 MW	2008	20 years
Wind	27 MW	2009	20 years

Estimated payments due in each of the next five years are as follows:

(millions of dollars)	2011	2012	2013	2014	2015
Power purchases	23.9	24.5	25.1	25.6	26.1

(g) Hydro has issued 23 irrevocable letters of credit to the New Brunswick System Operator totalling $18.6 million as credit support related to applications for point to point transmission services. In addition Hydro has issued one letter of credit to the Department of Fisheries and Oceans in the amount of $0.3 million as a performance guarantee in relation to the Fish Habitat Compensation Agreement. Churchill Falls has issued 3 irrevocable letters of credit, totalling $2.0 million to ensure satisfactory management of its waste management and compliance with a certificate of approval for the transportation of special hazardous wastes, granted by the Department of Environment and Conservation.

(h) Hydro entered into power sales agreements with third parties with respect to the energy previously sold to Hydro-Québec under a power sales agreement that expired on March 31, 2009. To facilitate market access, Hydro has entered into a five-year transmission service agreement with Hydro-Québec TransÉnergie to acquire access to 265 MW of transmission capacity from Labrador through Québec. Hydro has the right to renew its transmission service contract at the end of the contract term. If at that time there is a competing request for the same path, in order to renew the service agreement, Hydro must agree to accept a contract term that is at least equal to that competing request.

Pursuant to Hydro's five-year transmission service agreement with Hydro-Québec TransÉnergie, the transmission rental payments to contract maturity are as follows:

2011	$ 19.4 million
2012	$ 19.4 million
2013	$ 19.4 million
2014	$ 4.8 million

18. COMMITMENTS AND CONTINGENCIES (cont'd.)

(i) Hydro has received funding, in the amount of $3.0 million, from the Atlantic Canada Opportunities Agency in relation to a wind-hydrogen-diesel research development project in the community of Ramea. This funding is repayable in annual installments of $25,000 per commercial implementation of the resulting product. As at December 31, 2010 there have been no commercial implementations.

(j) On February 23, 2010, Churchill Falls filed a motion against Hydro-Quebec in the Quebec Superior Court. The motion is seeking a modification to the pricing terms of the 1969 Power Contract as of November 30, 2009. The trial is scheduled for the fall of 2013. The outcome of this motion is not determinable at this time.

19. RELATED PARTY TRANSACTIONS

Hydro enters into various transactions with its parents, subsidiaries and other affiliates. These transactions occur within the normal course of operations and are measured at the exchange amount, which is the amount of consideration agreed to by the related parties. Related parties with which Hydro transacts are as follows:

Related Party	Relationship
Nalcor Energy ("Nalcor")	Nalcor Energy is a 100% shareholder of Hydro.
The Province	The Province is a 100% shareholder of Nalcor.
Churchill Falls	Churchill Falls is a jointly controlled subsidiary of Hydro.
Twin Falls	Twin Falls is a jointly controlled subsidiary of Churchill Falls.
The Trust	Churchill Falls (Labrador) Corporation Trust was created by the Province with Churchill Falls as the beneficiary.
Nalcor Energy – Oil and Gas	Nalcor Energy – Oil and Gas is a wholly owned subsidiary of Nalcor.
Board of Commissioners of Public Utilities	The PUB is an agency of the Province.

Intercompany transactions and balances have been eliminated upon consolidation. The amounts included in the financial statements for related party transactions are as follows:

(millions of dollars)		**Nalcor**	**Other Affiliates**	**Total**
			2010	
Revenue	(g)	**-**	**2.0**	**2.0**
Expenses	(a)(b)(c)(e)	**20.2**	**4.8**	**25.0**
Accounts receivable	(g)(h)	**-**	**1.9**	**1.9**
Accounts payable and accrued liabilities	(c)(d)(e)	**40.9**	**3.8**	**44.7**
Deferred capital contribution	(f)	**-**	**0.1**	**0.1**
Long-term related party note payable	(i)	**25.3**	**-**	**25.3**
(millions of dollars)			2009	
Revenue	(g)	-	2.0	2.0
Expenses	(a)(b)(c)(e)	21.4	4.0	25.4
Accounts receivable	(g)(h)	-	0.7	0.7
Accounts payable and accrued liabilities	(c)(d)(e)	21.3	2.7	24.0
Deferred capital contribution	(f)	-	0.2	0.2
Long-term related party note payable	(i)	23.9	-	23.9

19. RELATED PARTY TRANSACTIONS (cont'd.)

(a) Hydro has entered into a long-term power contract with Churchill Falls for the purchase of $6.0 million (2009 - $5.9 million) of the power produced by Churchill Falls.

(b) For the year ended December 31, 2010, approximately $2.5 million (2009 - $1.2 million) of operating costs were recovered from Nalcor and $3.4 million (2009 - $2.7 million) from other affiliates for engineering, technical, management and administrative services. During 2010 Hydro incurred $2.7 million (2009 - $1.7 million) of operating costs from Nalcor for engineering, technical, management and administrative services.

(c) Hydro is required to contribute to the cost of operations of the PUB as well as pay for the cost of hearings into applications it makes. During 2010, Hydro incurred $0.6 million in costs related to the PUB (2009 - $0.6 million) of which $0.1 million (2009 - $0.1 million) was included in Accounts payable and accrued liabilities.

(d) As at December 31, 2010, Hydro has a payable to Nalcor of $40.9 million (2009- $21.3 million) and a receivable from other affiliates for $1.5 million (2009 – $0.6 million receivable and $0.2 payable). This payable/receivable consists of various intercompany operating costs and power purchases.

(e) Under the terms and conditions of the Churchill Falls (Labrador) Corporation (Lease) Act, 1961, Churchill Falls must pay rentals and royalties to the Province annually. As at December 31, 2010, $5.6 million (2009 - $3.7 million) was payable.

(f) During 2010, Nalcor advanced $2.3 million (2009 - $1.1 million) as a contribution in aid of construction related to the Ramea Wind-Hydrogen-Diesel Project. Hydro also received contributions in aid of construction from the Province related to wind feasibility studies. As at December 31, 2010, $0.1 million (2009 - $0.2 million) has been recorded as a Deferred capital contribution.

(g) During 2010, Hydro received $0.4 million (2009 - $0.4 million) as a rate subsidy for rural isolated customers from the Province and $1.6 million (2009 - $1.6 million) as an energy rebate to offset the cost of basic electricity consumption for Labrador rural isolated residential customers under the Northern Strategic Plan with $0.3 million (2009 - $0.1 million) recorded as Accounts receivable at year-end.

(h) On February 3, 2010, the Province established the Trust with Churchill Falls as the beneficiary. The purpose of this trust is to fund the external costs and expenses in relation to the motion filed by Churchill Falls seeking a modification to the pricing terms of the 1969 Power Contract. To date, $0.8 million has been received and $0.2 million has been accrued as due from the Trust.

(i) Hydro has a long-term related party note payable to Nalcor for $25.3 million (2009 – $23.9 million). The note is non-interest bearing and has no set terms of repayment.

20. WATER MANAGEMENT AGREEMENT

In June 2007, the Province passed an amendment to the Electrical Power Control Act, 1994 ("EPCA"). The amendment requires parties that utilize a common water resource in the province for power production, enter into a water management agreement. The amendment provides that any resulting water management agreement will not adversely affect existing power contracts. Churchill Falls shares the Churchill River with a Nalcor Energy proposed hydro-electric generation development downstream from Churchill Falls. On March 9, 2010, the PUB issued a Board Order establishing a water management agreement between the parties.

21. SUBSEQUENT EVENT

In January 2011, Hydro entered into nine forward contracts with a notional value of $35.7 million to hedge the foreign exchange risk on USD electricity sales. In February 2011, Hydro also entered into 20 swap contracts with a notional value of $27.8 million to hedge the commodity price risk on electricity sales.

22. COMPARATIVE FIGURES

The comparative figures have been reclassified to conform with the 2010 financial statement presentation including Interest and finance charges, Other gains and losses, Accounts receivable and Accounts payable and accrued liabilities.