

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Financial Statements
December 31, 2010
(expressed in Canadian dollars)

March 14, 2011

Independent Auditor's Report

**To the Trustee of
Hydro-Québec Trust for Management of Nuclear Fuel Waste**

We have audited the accompanying financial statements of Hydro-Québec Trust for Management of Nuclear Fuel Waste (the "Trust"), which comprise the statement of net assets as at December 31, 2010 and the statements of operations and changes in net assets for the year then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Trust as at December 31, 2010 and the results of its operations and the changes in its net assets for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP¹

¹ Chartered accountant auditor permit No. 8663

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Statements of Net Assets

As at December 31

(expressed in Canadian dollars)

| | Note | 2010 | 2009 |
|------------------------------|------|-------------------|-------------------|
| Assets | | | |
| Cash | | 75,733 | 98,288 |
| Investments | 4 | 69,499,588 | 59,585,898 |
| | | <hr/> | <hr/> |
| | | 69,575,321 | 59,684,186 |
| Liabilities | | | |
| Legal and other fees payable | | 12,782 | 10,112 |
| | | <hr/> | <hr/> |
| Net Assets | | <u>69,562,539</u> | <u>59,674,074</u> |

The accompanying notes are an integral part of these financial statements.

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Statements of Operations

For the years ended December 31

(expressed in Canadian dollars)

| | 2010 | 2009 |
|--------------------------|------------------|----------------|
| Investment income | | |
| Interest | 3,220,403 | 894,024 |
| Expenses | | |
| Legal and other fees | <u>35,453</u> | <u>13,239</u> |
| Net income | <u>3,184,950</u> | <u>880,785</u> |

The accompanying notes are an integral part of these financial statements.

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Statements of Changes in Net Assets

For the years ended December 31

(expressed in Canadian dollars)

| | Note | 2010 | 2009 |
|---------------------------------------|------|-------------------|-------------------|
| Net assets – Beginning of year | | 59,674,074 | 50,296,978 |
| Net income | | 3,184,950 | 880,785 |
| Contributions | 6 | 6,703,515 | 8,496,311 |
| Net assets – End of year | | <u>69,562,539</u> | <u>59,674,074</u> |

The accompanying notes are an integral part of these financial statements.

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Notes to Financial Statements

Years ended December 31, 2010 and 2009

(expressed in Canadian dollars)

1 Description of the Trust

The Act respecting the long-term management of nuclear fuel waste (the “Nuclear Fuel Waste Act” or “NFWA”) came into effect on November 15, 2002. As required under the NFWA, Canadian nuclear energy companies established by incorporation the Nuclear Waste Management Organization (“NWMO”), whose purpose was to propose to the Government of Canada approaches to the long-term management of nuclear fuel waste.

The NFWA also required nuclear energy companies to set up a trust fund with a financial institution to finance the costs involved in the long-term management of their nuclear fuel waste. As a result, Hydro-Québec established the Hydro-Québec Trust for Management of Nuclear Fuel Waste (the “Trust”). The Trustee is RBC Dexia Investor Services Trust. The Province of Quebec and Hydro-Québec are the beneficiaries of the Trust.

In November 2005, the NWMO submitted its study to the Government of Canada and recommended a formula which was adopted in June 2007.

In October 2007, the NWMO members adopted the agreement providing a formula for financing the costs inherent in the long-term management of members’ nuclear fuel waste. This formula, approved by Natural Resources Canada in April 2009, will be used to determine each member’s share in keeping with the number of its irradiated nuclear fuel bundles produced as of a given date. It also takes into account the date on which each member plans to ship the fuel bundles to the future national waste disposal site.

In order to fulfill its financial responsibilities, Hydro-Québec made an initial deposit of \$20 million in the Trust within 10 days after the legislation came into effect and has made the appropriate contributions in accordance with the legislation. In accordance with the long-term nuclear waste management strategy and the formula finalized by the Government of Canada for financing the costs involved, Hydro-Québec deposited \$6.7 million in 2010 (\$8.5 million in 2009).

The sums deposited in the Trust can only be used to finance the implementation of the approach prescribed by the Government of Canada.

2 Summary of significant accounting policies

Basis of presentation

The financial statements of the Trust were prepared by the Trustee in accordance with Canadian generally accepted accounting principles.

Investment income

Interest earned from long-term investments represents the accretion of the zero-coupon bonds, calculated using the effective interest rate method, while interest earned on short-term investments is recognized as interest income also using the effective interest rate method.

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Notes to Financial Statements

Years ended December 31, 2010 and 2009

(expressed in Canadian dollars)

Financial instruments

Financial instruments, on initial recognition, must be measured at their fair value. Their valuation during subsequent periods and the accounting of fluctuations in their fair value, if necessary, depend on the category in which they are classified: held for trading, held-to-maturity investments, loans and receivables, available for sale or other financial liabilities.

Investments are classified as held-to-maturity investments and are accounted for at amortized cost using the effective interest rate method unless they become subject to a permanent decline in value, in which case they are reduced to their fair value. The fair value of the zero-coupon bonds is calculated based on quoted prices in active markets for identical assets.

Cash was classified as held for trading and accounted for at fair value. Legal and other fees payable are classified as other financial liabilities and accounted for at cost, which approximates fair value due to its short-term maturities.

Income taxes

The Trust is exempt from income tax in accordance with paragraph 149(1)(z.2) of Bill C-10, Income Tax Amendments Act. As a result, the Trust has not provided for any income taxes in these financial statements.

3 Changes in accounting policies

Recent changes

2009

Credit risk and fair value of financial assets and financial liabilities

The Trust adopted *Emerging Issues Committee Abstract 173* (“EIC-173”) of the Canadian Institute of Chartered Accountants (“CICA”) Handbook, “Credit Risk and Fair Value of Financial Assets and Financial Liabilities”. This Abstract stipulates that counterparties’ credit risk and an entity’s own credit risk should be taken into account when estimating the fair value of all financial assets and financial liabilities, including derivatives. The application of EIC-173 did not have an impact on the financial statements of the Trust, except for the disclosure of the fair value of the zero-coupon bonds.

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Notes to Financial Statements

Years ended December 31, 2010 and 2009

(expressed in Canadian dollars)

Financial instruments

Effective January 1, 2009, the Trust adopted the recent amendments to CICA Handbook Section 3862, “Financial Instruments – Disclosures”. Disclosures about fair value of financial instruments require the disclosure of the estimated fair value of financial instruments. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Amendments to CICA Handbook Section 3862 establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of fair value hierarchy are as follows:

- Level 1 Inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities that the investment manager has the ability to access at the measurement date.
- Level 2 Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, including inputs in markets that are not considered to be active.
- Level 3 Inputs that are unobservable. There is little if any market activity. Inputs into the determination of fair value require significant management judgment or estimation.

The Trust’s zero-coupon bonds are accounted at amortized cost using the effective interest method, and the disclosure of fair value of these bonds is based on Level 1 inputs.

4 Investments

| | 2010 | | 2009 | |
|---|-------------------|-------------------|-------------------|-------------------|
| | Amortized cost | Fair value | Amortized cost | Fair value |
| Zero-coupon bonds | | | | |
| Hydro-Québec, face value of \$27,000,000, effective interest rate of 4.22%, April 15, 2017 | 20,823,948 | 21,859,200 | 19,981,270 | 20,246,400 |
| Hydro-Québec, face value of \$49,200,000 (2009 – \$37,000,000), effective interest rate of 5.26% (2009 – 5.29%), April 15, 2022 | 27,594,589 | 30,506,952 | 19,624,484 | 20,705,000 |
| Hydro-Québec, face value of \$50,500,000, effective interest rate of 5.51%, April 15, 2027 | 21,081,051 | 23,975,885 | 19,980,144 | 20,067,210 |
| | <u>69,499,588</u> | <u>76,342,037</u> | <u>59,585,898</u> | <u>61,018,610</u> |

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Notes to Financial Statements

Years ended December 31, 2010 and 2009

(expressed in Canadian dollars)

5 Financial instruments

Investment objective

The objective of the Trust is to finance the costs involved in the long-term management of Hydro-Québec's nuclear fuel waste. In addition to bonds issued by public bodies, the Trust may invest in corporate bonds and notes, equities and derivatives.

Financial risk management

The Trust's financial instruments consist of zero-coupon bonds. The Trust is exposed to risks associated with its investment strategies and the markets in which it invests.

a) Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the fair values or cash flows of financial instruments.

The Trust had no interest rate risk exposure because it held investments in zero-coupon bonds accounted for at amortized cost. Changes in interest rates therefore had no impact on net income.

b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause financial loss to the other party. The Trust is exposed to credit risk mainly through its concentration of investments. As at December 31, 2010, the Trust limited its exposure to credit risk by investing in Hydro-Québec bonds, which is a related party. Hydro-Québec is a Government of Quebec Crown corporation.

Cash

The fair value of cash approximates its book value due to its short-term maturity.

Hydro-Québec Trust for Management of Nuclear Fuel Waste

Notes to Financial Statements

Years ended December 31, 2010 and 2009

(expressed in Canadian dollars)

6 Contributions

Contributions by Hydro-Québec were as follows:

| | |
|-----------------------------|-------------------|
| Initial contribution – 2002 | 20,000,000 |
| Annual contributions: | |
| 2003 | 4,000,000 |
| 2004 | 4,000,000 |
| 2005 | 4,000,000 |
| 2006 | 4,000,000 |
| 2007 | 4,000,000 |
| 2008 | 4,000,000 |
| 2009 | 8,496,311 |
| 2010 | <u>6,703,515</u> |
| | <u>59,199,826</u> |