CANFOR PULP INCOME FUND

CANFOR PULP LIMITED PARTNERSHIP

Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

MANAGEMENT'S RESPONSIBILITY

The information and representations in the financial statements and Management's Discussion and Analysis (MD&A) are the responsibility of Management and have been approved by the Board of Directors of Canfor Pulp Holding Inc. the general partner of Canfor Pulp Limited Partnership and by the Trustees of Canfor Pulp Income Fund. Management prepared the consolidated financial statements in accordance with accounting principles generally accepted in Canada and, where necessary, they reflect Management's best estimates and judgments at this time. It is reasonably possible that circumstances arise which cause actual results to differ. Management does not believe it is likely that any differences will be material. The financial information presented throughout this report is consistent with that contained in the consolidated financial statements.

Management is responsible for designing and maintaining adequate systems of internal controls over financial reporting, including policies and procedures to provide reasonable assurances as to the reliability of the financial records and the safeguarding of the assets, for both the Fund and the Partnership. The Partnership's chief executive officer and chief financial officer have evaluated the effectiveness of these disclosure controls and procedures for the year ended December 31, 2009, and have concluded that they are operating effectively.

Canadian Forest Products Ltd. (Canfor)'s Internal Audit Department performs independent reviews of the accounting records and related procedures. The Internal Audit Department reports its findings and recommendations both to Management and the Audit Committee.

The Board of Directors and the Trustees are responsible for ensuring that Management fulfills its responsibilities for financial reporting and are ultimately responsible for reviewing and approving the financial statements and Management's Discussion and Analysis. The Board and Trustees carry out these activities primarily through the Audit Committee.

The Audit Committee is comprised of Directors and Trustees who are not employees of the Partnership. The Committee meets periodically throughout the year with Management, external auditors and internal auditors to review their respective responsibilities, results of the reviews of internal accounting controls, policies and procedures, and financial reporting matters. The external auditors meet separately with the Audit Committee.

The consolidated financial statements and Management's Discussion and Analysis have been reviewed by the Audit Committee, which recommended their approval by the Board of Directors and the Trustees. The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, whose reports follow.

(signed) Paul Richards

Paul Richards
President and CEO
Canfor Pulp Holding Inc.

(signed) Terry Hodgins

Terry Hodgins
Chief Financial Officer and Secretary
Canfor Pulp Holding Inc.

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Chartered Accountants
PricewaterhouseCoopers Place
250 Howe Street, Suite 700
Vancouver, British Columbia
Canada V6C 3S7
Telephone +1 604 806 7000
Facsimile +1 604 806 7806

February 5, 2010

Audit Opinion

To the Unitholders of
Canfor Pulp Income Fund

We have audited the consolidated balance sheets of Canfor Pulp Income Fund (the “Fund”) as at December 31, 2009 and December 31, 2008, and the consolidated statements of income, comprehensive income and accumulated earnings and distributions and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Fund’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. 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 Fund as at December 31, 2009 and December 31, 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, BC

Canfor Pulp Income Fund
Consolidated Statements of Income, Comprehensive Income and Accumulated Earnings and Distributions

(thousands of dollars, except unit and per unit amounts)		**Year ended December 31, 2009**		Year ended December 31, 2008
Income				
Equity income in Canfor Pulp Limited Partnership	**$**	**6,644**	$	23,280
Net income before future income taxes		**6,644**		23,280
Future income taxes (recovery) (note 7)		**(2,422)**		3,076
Net income		**9,066**		20,204
Distributions declared (note 5)		**(9,229)**		(48,271)
Distributions in excess of earnings	**$**	**(163)**	$	(28,067)
Weighted average number of Fund units		**35,493,505**		35,493,514
Net income per Fund unit, basic and diluted	**$**	**0.26**	$	0.57
Net income for the year	**$**	**9,066**	$	20,204
Equity interest in other comprehensive loss of Canfor Pulp Limited Partnership		**(45)**		(193)
Comprehensive income	**$**	**9,021**	$	20,011
Accumulated earnings and distributions				
Balance, beginning of year – distributions in excess of earnings	**$**	**(72,863)**	$	**(44,796)**
Distributions in excess of earnings – current year		**(163)**		**(28,067)**
Balance, end of year – accumulated distributions in excess of earnings	**$**	**(73,026)**	$	**(72,863)**

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

Canfor Pulp Income Fund
Consolidated Statements of Cash Flows

(thousands of dollars)		**Year ended December 31, 2009**		Year ended December 31, 2008
Cash generated from (used in)				
Operating activities				
Net income	**$**	**9,066**	$	20,204
Items not affecting cash:				
Equity income in Canfor Pulp Limited Partnership		**(6,644)**		(23,280)
Future income taxes (recovery)		**(2,422)**		3,076
Distributions received from Canfor Pulp Limited Partnership		**7,809**		51,111
		7,809		51,111
Financing activities				
Distributions paid to unitholders	**$**	**(7,809)**	$	(51,111)
Beginning, change and ending balance in cash and cash equivalents	**$**	**-**	$	-

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

Canfor Pulp Income Fund
Consolidated Balance Sheets

(thousands of dollars)		As at December 31, 2009		As at December 31, 2008
ASSETS				
Current assets				
Distributions receivable from Canfor Pulp Limited Partnership (notes 5, 6)	**$**	**2,839**	$	1,420
Total current assets		**2,839**		1,420
Equity investment in Canfor Pulp Limited Partnership (note 4)		**263,644**		266,274
	$	**266,483**	$	267,694
LIABILITIES				
Current liabilities				
Distributions payable (note 5)	**$**	**2,839**	$	1,420
Total current liabilities		**2,839**		1,420
Future income taxes (note 7)		**37,287**		39,709
		40,126		41,129
UNITHOLDERS' EQUITY				
Unitholders' equity – 35,493,505 Fund units outstanding		**299,351**		299,351
Accumulated earnings and distributions		**(73,026)**		(72,863)
Accumulated other comprehensive income (note 8)		**32**		77
Total Unitholders' Equity		**226,357**		226,565
	$	**266,483**	$	267,694

Description of the Fund and basis of presentation of financial statements (note 1).

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

Approved by the Trustees

(signed) Stan Bracken-Horrocks

Stan Bracken-Horrocks
Trustee

(signed) Charles Jago

Charles Jago
Trustee

Canfor Pulp Income Fund

Notes to the Consolidated Financial Statements as at December 31, 2009

1. Description of the Fund and Basis of Presentation of Financial Statements

Canfor Pulp Income Fund (the Fund) is an unincorporated open-ended trust established under the laws of Ontario on April 21, 2006, pursuant to the Fund Declaration. The principal head office of the Fund is located at 1700 West 75th Avenue, Vancouver, B.C., Canada. The Fund has been established to acquire and hold, through a wholly owned trust, the Canfor Pulp Trust (the Trust), investments in the Limited Partnership Units of the Canfor Pulp Limited Partnership (the Partnership), and such other investments as the Trustees of the Fund may determine. The general partner of the Partnership is Canfor Pulp Holding Inc. (the General Partner) and each partner holds an ownership interest in the General Partner equal to its Partnership interest.

These consolidated financial statements include the accounts of the Fund and the Trust.

Each unitholder participates pro-rata in any distributions from the Fund.

The Fund is entirely dependent on distributions from the Partnership to make its own distributions.

2. Significant Accounting Policies

Principles of Consolidation

These consolidated financial statements include the accounts of the Fund and the Trust, its wholly-owned holding trust. All significant inter-company transactions have been eliminated.

Investment in Canfor Pulp Limited Partnership

The Fund accounts for its investment in the Partnership using the equity method. Under the equity method the Fund records its pro-rata share of the Partnership's income as an increase in investment. Any distributions declared by the Partnership and accruing to the Fund reduce the carrying value of the Fund's investment in the Partnership.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. It is reasonably possible that circumstances may arise that cause actual results to differ from management estimates; however, management does not believe it is likely that such differences will materially affect the Fund's financial position. Significant areas requiring the use of management estimates are the valuation of the Fund's investment in the Partnership relative to its market value and the determination of future income tax.

Net Income per Fund Unit

Basic net income per Fund unit is based on the weighted average number of Fund units outstanding during the year. At December 31, 2009 and December 31, 2008 the Partnership had 35,776,483 Class B Exchangeable Limited Partnership Units outstanding which can be exchanged for Fund Units at the option of the holder Canadian Forest Products Ltd. (Canfor). Any issuance of new Fund units as a result of such an exchange would be accompanied by a corresponding increase in the Fund's investment in the Partnership through the acquisition of Class B Exchangeable Limited Partnership Units. As a result, this potential conversion would not result in any dilution of the Fund's net income per unit.

Income Taxes

The Fund is a unit trust for income tax purposes. As such, the Fund only has current taxes on any taxable income not allocated to the unitholders. For the years ended December 31, 2009 and December 31, 2008, all taxable income of the Fund was allocated to the unitholders. Income tax obligations relating to distributions from the Fund are the obligations of the unitholders.

Future Income Taxes

Future income tax assets and liabilities are determined based on the difference between the tax basis of the Fund's and Partnership's assets and liabilities and the respective amounts reported in the financial statements. Future tax assets or liabilities are calculated using the substantively enacted tax rates for the periods in which the differences are expected to be settled. Future tax assets are recognized to the extent that they are considered more likely than not to be realized.

3. Changes in Accounting Policies

Financial Instrument Disclosures

In June 2009, the CICA amended Handbook Section 3862, Financial Instruments – Disclosures, to enhance disclosures about fair value measurements and the liquidity risk of financial instruments. These amendments are intended to provide further detail on the relative reliability of the data or inputs used to measure the fair value of the entities' financial instruments. Specifically, financial instruments recognized at fair value on the Consolidated Balance Sheet must be classified in one of the following three fair value hierarchy levels:

- Level 1 – measurement based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – measurement based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability;
- Level 3 – measurement based on inputs that are not observable (supported by little or no market activity) for the asset or liability.

The Fund has incorporated this amendment into these audited consolidated financial statements.

4. Equity Investment in Canfor Pulp Limited Partnership

The Fund's equity investment in the Partnership is as follows:

(thousands of dollars)	**Year ended December 31, 2009**	Year ended December 31, 2008
Balance, beginning of year	**266,274**	291,458
Equity income of the Partnership	**6,644**	23,280
Equity interest in other comprehensive loss of the Partnership	**(45)**	(193)
Distributions from the Partnership	**(9,229)**	(48,271)
Balance, end of year	**263,644**	266,274

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5. Distributions

The Fund declared distributions during the twelve months of 2009 as follows:

(thousands of dollars, except per unit amounts)

Record Date	Payable Date	Amount per Fund Unit $	Amount $
January 30, 2009	February 13, 2009	0.04	1,420
February 27, 2009	March 13, 2009	0.01	355
March 31, 2009	April 15, 2009	0.01	355
April 30, 2009	May 15, 2009	0.01	355
May 29, 2009	June 15, 2009	0.01	355
June 30, 2009	July 15, 2009	0.01	355
July 31, 2009	August 14, 2009	0.01	355
August 31, 2009	September 15, 2009	0.01	355
September 30, 2009	October 15, 2009	0.01	355
October 30, 2009	November 13, 2009	0.01	355
November 30, 2009	December 15, 2009	0.05	1,775
December 31, 2009	January 15, 2010	0.08	2,839
		0.26	9,229

The Fund's monthly distributions are based on the Partnership's monthly distributions.

Monthly cash distributions from the Partnership are based on the Partnership's cash flow and are not directly equal to the Fund's pro-rata share of the Partnership's income under the equity method.

6. Related Party Transactions

All accounting, treasury, legal and administrative functions for the Fund are performed on its behalf, without charge, by the Partnership pursuant to a support agreement. Distributions earned from the Partnership for the year ended December 31, 2009 were $9.2 million of which $6.4 million was received, with the balance of $2.8 million receivable on December 31, 2009. For the year ended December 31, 2008 distributions earned were $48.3 million of which $46.9 million was received, with the balance of $1.4 million receivable on December 31, 2008.

7. Future Income Taxes

The following table reconciles the income tax expense calculated using statutory tax rates to the actual income tax expense (recovery).

(thousands of dollars)	**Year ended December 31, 2009**	Year ended December 31, 2008
Expected income tax expense at statutory tax rate of nil (2008 – nil)	**-**	-
Future income taxes (recovery) on temporary differences	**(2,422)**	3,076
	(2,422)	3,076

The temporary differences based on the Fund's 49.8% ownership of the Partnership are as follows:

(thousands of dollars)	**December 31, 2009**	December 31, 2008
Future income tax liability:		
Equity investment in the Partnership	**42,347**	44,453
Expected reversal of temporary differences prior to 2011	**(5,060)**	(4,744)
	37,287	39,709

In 2009 a future income tax recovery of $3.7 million was recorded as a result of a change in legislation impacting future taxation rates for Specified Investment Flow Through Trusts.

Based on a current estimate of the income tax liability at the beginning of 2011, the Fund has recorded a future income tax liability and corresponding non-cash future tax charge to net income. This non-cash charge relates to the Fund's 49.8% ownership in the Partnership and is based on temporary differences between the accounting and tax basis of the Partnership's assets and liabilities expected to reverse after January 1, 2011.

8. Accumulated Other Comprehensive Income

(thousands of dollars)	**Year ended December 31, 2009**	Year ended December 31, 2008
Balance, beginning of year	**77**	270
Other comprehensive loss	**(45)**	(193)
Balance, end of year	**32**	77

9. Capital Disclosures

The Fund's capital is comprised of unitholders' equity and accumulated earnings and distributions. The Fund's only source of liquidity is distributions received from the Partnership. The Fund's objective when managing capital is to make its own distributions to unitholders based on the distributions received from the Partnership.

(thousands of dollars)	**December 31, 2009**	December 31, 2008
Unitholders' equity [1]	**226,325**	226,488

Note [1]: Excludes accumulated other comprehensive income.

The Fund has no external capital requirements or covenants.

10. Financial Instruments

The Fund's financial instruments consist of distributions receivable from the Partnership and distributions payable to unitholders. Distributions receivable are classified as loans and receivables, and are measured at amortized cost. Distributions payable are classified as other liabilities and are measured at amortized cost. The carrying values of these financial instruments approximate their fair values due to the relatively short period to maturity of these instruments.

Financial instruments recognized at fair value on the Consolidated Balance Sheet must be classified in one of the following three fair value hierarchy levels:

- Level 1 – measurement based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – measurement based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability;
- Level 3 – measurement based on inputs that are not observable (supported by little or no market activity) for the asset or liability.

The Fund is not required to disclose fair value hierarchy levels for distributions receivable from the Partnership and distributions payable to unitholders, as the fair values of these financial instruments approximate the carrying value due to their short–term nature.

The Fund is exposed to certain risks related to the nature of its investment in the Partnership and the structure of the Fund, as well as the underlying risks related to the business of the Partnership. The Fund relies on the objectives, policies and processes of the Partnership for managing these risks.

11. Segmented Information

The Fund operates in one industry segment, namely investing in pulp and paper producing assets in one geographic region, Canada.

PricewaterhouseCoopers LLP
Chartered Accountants
PricewaterhouseCoopers Place
250 Howe Street, Suite 700
Vancouver, British Columbia
Canada V6C 3S7
Telephone +1 604 806 7000
Facsimile +1 604 806 7806

February 5, 2010

Audit Opinion

To the Partners of
Canfor Pulp Limited Partnership

We have audited the consolidated balance sheets of Canfor Pulp Limited Partnership (the "Partnership") as at December 31, 2009 and December 31, 2008, and the consolidated statements of income, comprehensive income and Partners' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. 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 Partnership as at December 31, 2009 and December 31, 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, BC

Canfor Pulp Limited Partnership
Consolidated Statements of Income, Comprehensive Income and Partners' Equity

(millions of dollars, except units and per unit amounts)	**Year ended December 31, 2009**	Year ended December 31, 2008
Revenue		
Sales	**$ 813.5**	$ 825.5
Business interruption insurance (note 19)	**3.2**	19.1
	816.7	844.6
Costs and expenses		
Manufacturing and product costs	**611.2**	595.8
Freight and other distribution costs	**121.1**	108.8
Amortization	**49.4**	47.6
Selling and administration costs	**23.0**	24.6
Settlement of asset retirement obligation (note 8)	**-**	(0.9)
	804.7	775.9
Operating income	**12.0**	68.7
Interest expense, net	**(10.1)**	(8.1)
Foreign exchange gain (loss) on long-term debt	**19.6**	(26.0)
Loss on derivative financial instruments (note 14)	**(1.5)**	(8.9)
Foreign exchange gain (loss) on working capital	**(6.7)**	13.1
Net property damage insurance gain	**0.2**	8.2
Other expense	**(0.1)**	(0.2)
	1.4	(21.9)
Net income	**13.4**	46.8
Other comprehensive income		
Adjustment for derivatives (note 17)	**(0.1)**	(0.4)
Comprehensive income	**$ 13.3**	$ 46.4
Net income per Partnership unit (note 13)		
Basic and diluted	**$ 0.19**	$ 0.66
Weighted average Partnership units outstanding	**71,270,025**	71,270,025
Partners' Equity		
Balance, beginning of year	**$ 534.4**	$ 584.9
Net income	**13.4**	46.8
Distributions declared to partners (note 16)	**(18.6)**	(96.9)
Other comprehensive loss (note 17)	**(0.1)**	(0.4)
Balance, end of year	**$ 529.1**	$ 534.4

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

Canfor Pulp Limited Partnership
Consolidated Statements of Cash Flows

(millions of dollars)		**Year ended December 31, 2009**		Year ended December 31, 2008
Cash and cash equivalents generated from (used in)				
Operating activities				
Net income	**$**	**13.4**	$	46.8
Items not affecting cash:				
Amortization		**49.4**		47.6
Foreign exchange loss (gain) on long-term debt		**(19.6)**		26.0
Reduction (increase) in value of derivative instruments		**(2.1)**		1.1
Employee future benefits		**5.2**		8.4
Loss on disposal of fixed assets		**0.2**		1.2
Settlement of asset retirement obligation		**-**		(0.9)
Change in deferred maintenance provision		**5.9**		9.2
Net property damage insurance gain		**(0.2)**		(8.2)
Other		**0.4**		0.6
Asset retirement obligation expenditures		**-**		(1.4)
Salary pension plan contribution		**(2.5)**		(2.1)
Long-term deferred maintenance expenditure		**(10.5)**		(8.7)
Other deferred expenditure		**(0.2)**		-
Cash flow from operations before working capital changes		**39.4**		119.6
Decrease (increase) in non-cash working capital (note 15)		**31.8**		(14.4)
		71.2		105.2
Financing activities				
Distributions paid to partners		**(15.7)**		(102.7)
Operating loan (repayment) draw (note 9)		**(25.2)**		25.2
		(40.9)		(77.5)
Investing activities				
Property, plant and equipment, net (note 15)		**(17.3)**		(39.4)
Insurance proceeds (note 19)		**0.1**		9.5
		(17.2)		(29.9)
Increase (decrease) in cash and cash equivalents		**13.1**		(2.2)
Cash and cash equivalents, beginning of year		**0.4**		2.6
Cash and cash equivalents, end of year	**$**	**13.5**	$	0.4

Supplementary cash flow information (note 15).

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

Canfor Pulp Limited Partnership
Consolidated Balance Sheets

(millions of dollars)	**As at December 31, 2009**	As at December 31, 2008
ASSETS		
Current assets		
Cash and cash equivalents	**$ 13.5**	$ 0.4
Accounts receivable (notes 12, 19)		
Trade	**110.5**	77.0
Insurance	**-**	7.4
Other	**8.6**	7.5
Inventories (note 4)	**135.4**	176.7
Prepaid expenses and other assets	**18.4**	16.5
Total current assets	**286.4**	285.5
Property, plant and equipment (note 5)	**534.1**	570.2
Other long-term assets (note 6)	**17.1**	13.2
	$ 837.6	$ 868.9
LIABILITIES		
Current liabilities		
Operating loan (note 9)	**-**	25.2
Accounts payable and accrued liabilities (note 12)	**134.5**	121.6
Distributions payable (note 16)	**5.7**	2.8
Total current liabilities	**140.2**	149.6
Long-term debt (note 9)	**115.1**	134.7
Long-term liabilities (note 10)	**53.2**	50.2
	$ 308.5	$ 334.5
PARTNERS' EQUITY – 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Limited Partnership Units (note 1)	**529.1**	534.4
	$ 837.6	$ 868.9

Commitments and contingencies (note 18).

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

Approved on behalf of Canfor Pulp Limited Partnership by
its General Partner, Canfor Pulp Holding Inc.

(signed) Stan Bracken-Horrocks	*(signed) Paul Richards*
Stan Bracken-Horrocks	Paul Richards
Director	Director

Canfor Pulp Limited Partnership

Notes to the Consolidated Financial Statements as at December 31, 2009 and 2008

1. Business Description and Basis of Presentation of Financial Statements

Canfor Pulp Limited Partnership (the Partnership) is a limited partnership formed on April 21, 2006, under the laws of Manitoba, to acquire and carry on the NBSK pulp and paper business of Canadian Forest Products Ltd. a subsidiary of Canfor Corporation (collectively Canfor). The business consists of two NBSK pulp mills and one NBSK pulp and paper mill located in Prince George, British Columbia and a marketing group based in Vancouver, British Columbia (the Pulp Business).

At December 31, 2009, Canfor owns 50.2% and Canfor Pulp Income Fund (the Fund) indirectly owns 49.8% of the issued and outstanding units of the Partnership.

The general partner of the Partnership is Canfor Pulp Holding Inc. (the General Partner), which holds an interest of 0.001% of the Partnership.

These audited consolidated financial statements are those of the Partnership and do not include the assets, liabilities, revenues and expenses of its partners. The Partnership, other than its incorporated subsidiaries, is not subject to income taxes as its income is allocated for tax purposes to its partners. Accordingly, no recognition has been made for income taxes related to Partnership income in these financial statements. The tax attributes of the Partnership's net assets flow directly to the partners.

Certain comparative figures have been reclassified to conform to current year presentation.

Economic Dependence

The Partnership depends on Canfor to provide approximately 63% (2008 – 64%) of its fibre supply as well as to provide certain key business and administrative services as described in note 12. As a result of these relationships the Partnership considers its operations to be dependent on its ongoing relationship with Canfor.

2. Significant Accounting Policies

Principles of Consolidation

These audited consolidated financial statements include the accounts of the Partnership, its wholly owned subsidiaries and its 50% interests in Premium One Papers (a general partnership) and Canfor April Corporation (a joint venture). The 50% interests in the general partnership and joint venture are accounted for using proportionate consolidation. All significant inter-company transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. It is reasonably possible that circumstances may arise that cause actual results to differ from management estimates, however, management does not believe it is likely that such differences will materially affect the Partnership's financial position.

Significant areas requiring the use of management estimates are inventory valuations, amortization rates, employee benefit plan assumptions, asset retirement obligations, impairment of long-lived assets, provisions for insurance claims and environmental remediation.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with an original maturity date of 90 days or less.

Valuation of Inventories

Inventories of pulp and paper products, wood chips, and processing materials and supplies are valued at the lower of average cost and net realizable value.

Property, Plant and Equipment

The Partnership capitalizes the costs of major replacements, extensions, and improvements to plant and equipment.

Assets are amortized over the following estimated productive lives:

Buildings..	10 to 50 years
Pulp and paper machinery and equipment	20 years

Amortization of manufacturing assets is calculated on a straight-line basis. Assets under construction are not amortized.

Employee Future Benefits

The Partnership provides certain pension, health care benefits and pension bridge plans to eligible retired employees.

The Partnership accrues the costs and related obligations of the defined benefit salary pension plans, the pension bridge plan and other retirement benefit plans using the projected benefit actuarial method prorated on service and management's best estimates of salary escalation and other relevant factors. Actuarial gains and losses arise from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of the active employees, which is 10 years for the salary pension plan, 11 years for the pension bridge plan and 11 years for the other benefit plans. Pension plan assets are valued at fair value for purposes of calculating the expected return on plan assets. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. On January 1, 2000, the Pulp Business (Canfor) adopted the new recommendations of the Canadian Institute of Chartered Accountants relating to the accounting for pensions and other post-employment benefits using the prospective application method. The Partnership is amortizing the transitional obligation on a straight-line basis over 16 years, which was the average remaining service period of employees expected to receive benefits under the benefit plan as of January 1, 2000.

For hourly employees covered by industry union defined benefit pension plans, earnings are charged with the Partnership's contributions required under the collective agreements.

Revenue Recognition

Revenues are derived from the following major product lines: pulp, paper and sales commissions. Revenue is recognized from product sales when persuasive evidence of a sale exists, the sales price is fixed and determinable, goods have been delivered or title has transferred, and collectability is reasonably assured. Sales are reported net of discounts, allowances and vendor rebates. Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by the Partnership are reported as cost of sales.

Foreign Currency Translation

The majority of sales are denominated in foreign currencies. Foreign currencies are translated into Canadian dollars using the temporal method as follows: monetary assets and liabilities at period end exchange rates; and revenues and expenses at exchange rates prevailing at the time the transaction occurs. Exchange gains and losses are reflected in income as incurred.

Derivative Financial Instruments

The Partnership utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange and commodity price risk. For example, from time to time, it purchases foreign exchange forward sales contracts to hedge related foreign currency denominated accounts receivable balances and also enters into swap transactions to reduce its exposure to fluctuating natural gas prices. The Partnership records all derivatives at fair value and its policy is not to utilize derivative financial instruments for trading or speculative purposes.

Impairment of Long-lived Assets

Long-lived assets are reviewed for impairment when the occurrence of events or changes in circumstances indicate that the carrying value of the assets may not be recoverable, as measured by comparing their net book value to the estimated future cash flows generated over their estimated remaining useful lives. Impaired assets are recorded at fair value, determined principally using discounted future cash flows expected from their use and eventual disposition.

Income Taxes

The Partnership is not directly subject to federal or provincial income taxes. The taxable income or loss of the Partnership is required to be allocated to the Partnership's partners. Management is of the opinion that any income tax liability arising from the activities of the wholly owned subsidiaries will not be material.

Major Maintenance Costs

The Partnership has adopted the deferral method of accounting for major maintenance costs. Under this method an asset is recorded when expenditures for maintenance costs related to major maintenance are incurred. This asset is then amortized over the period to which the maintenance relates. The Partnership has presented the related unamortized expenditures in prepaid expense and other assets, and other long-term assets, as appropriate.

3. Changes in Accounting Policies

Financial Instrument Disclosures

In June 2009, the CICA amended Handbook Section 3862, Financial Instruments – Disclosures, to enhance disclosures about fair value measurements and the liquidity risk of financial instruments. These amendments are intended to provide further detail on the relative reliability of the data or inputs used to measure the fair value of the entities financial instruments. Specifically, financial instruments recognized at fair value on the Consolidated Balance Sheet must be classified in one of the following three fair value hierarchy levels:

- Level 1 – measurement based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – measurement based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability;
- Level 3 – measurement based on inputs that are not observable (supported by little or no market activity) for the asset or liability.

The Partnership has incorporated this amendment into these audited consolidated financial statements.

4. Inventories

(millions of dollars)	**December 31, 2009**	December 31, 2008
Pulp	**55.2**	86.7
Paper	**15.9**	20.6
Wood chips	**21.5**	23.3
Processing materials and supplies	**42.8**	46.1
	135.4	176.7

Paper finished goods inventory balances at December 31, 2009 are presented net of a write-down from cost to net realizable value totalling $0.1 million (2008 pulp and paper – $1.9 million).

5. Property, Plant and Equipment

(millions of dollars)	December 31, 2009 Cost	Accumulated amortization	Net
Land and improvements	**5.4**	**-**	**5.4**
Asset retirement - landfill	**2.3**	**0.8**	**1.5**
Buildings, machinery and equipment	**1,344.1**	**820.1**	**524.0**
Construction in progress	**3.2**	**-**	**3.2**
	1,355.0	**820.9**	**534.1**

(millions of dollars)	December 31, 2008 Cost	Accumulated amortization	Net
Land and improvements	5.4	-	5.4
Asset retirement - landfill	2.3	0.8	1.5
Buildings, machinery and equipment	1,332.6	771.7	560.9
Construction in progress	2.4	-	2.4
	1,342.7	772.5	570.2

6. Other Long-term Assets

(millions of dollars)	**December 31, 2009**	December 31, 2008
Pension benefit plan (note 7)	**11.3**	11.7
Maintenance shutdown costs	**5.4**	0.9
Other	**0.4**	0.6
	17.1	13.2

7. Employee Future Benefits

The Partnership, in participation with Canfor, has funded and unfunded defined benefit plans, as well as a defined contribution plan, that provide pension, other retirement and post-employment benefits to substantially all salaried employees and for its hourly employees covered under collective agreements. The defined benefit plans are based on years of service and final average salary. The post-employment benefit plans are non-contributory and include a range of health care and other benefits.

Total employee future benefit expenses were as follows:

(millions of dollars)	Year ended December 31 **2009**	2008
Pension plans	**5.0**	3.7
Other employee future benefit plans	**3.5**	6.0
Contributions to forest industry union plans	**6.5**	6.3
	15.0	16.0

Defined benefit plans

The measurement date for the determination of accrued benefit obligations and the fair value of plan assets for the employee future benefit plans is September 30, 2009. The most recent actuarial valuation for funding purposes for the Canfor salaried employees' pension plans in which the Partnership's employees participate was on December 31,

2006. The most recent actuarial valuations for the other post retirement benefit plan and the Pension Bridge Plan were on September 30, 2007 and December 31, 2006, respectively.

The next actuarial valuation for funding purposes for the registered salaried employee defined benefit pension plan is currently in progress and scheduled to be completed in 2010 with an effective date of December 31, 2009. Changes in the fair value of plan assets and actuarial assumptions, as appropriate to reflect prevailing financial market conditions at that time, including assumed rate of return on plan assets, discount rates and other variables, will be reflected in the December 31, 2009 valuation and will determine funding requirements for 2010 and subsequent years.

Information about the Partnership's defined benefit plans, including its identified participation in the Canfor salaried employee pension plans and other post-employment benefit plans and the Pension Bridge Plan, are as follows:

Defined Benefit Plan Assets

(millions of dollars)	**2009** Pension Benefit Plans	**2009** Other Benefit Plans	2008 Pension Benefit Plans	2008 Other Benefit Plans
Fair market value of plan assets				
Beginning of year	**$ 51.0**	**$ -**	$ 58.1	$ -
Actual return on plan assets	**0.1**	**-**	(8.7)	-
Employer contributions	**3.0**	**1.0**	2.6	0.8
Employee contributions	**0.3**	**-**	0.3	-
Benefit payments	**(1.7)**	**(1.0)**	(1.3)	(0.8)
End of year	**$ 52.7**	**$ -**	$ 51.0	$ -

	Percentage of Plan Assets **2009**	Percentage of Plan Assets 2008
Plan assets consist of the following:		
Equity securities	**58%**	61%
Debt securities	**41%**	38%
Other	**1%**	1%
	100%	100%

Defined Benefit Plan Obligations

(millions of dollars)	**2009** Pension Benefit Plans	**2009** Other Benefit Plans	2008 Pension Benefit Plans	2008 Other Benefit Plans
Accrued benefit obligation				
Beginning of year	**$ 60.5**	**$ 37.1**	$ 65.1	$ 56.8
Current service cost	**2.9**	**0.7**	3.8	1.3
Interest cost	**4.0**	**2.5**	3.7	3.2
Employee contributions	**0.3**	**-**	0.3	-
Benefit payments	**(1.7)**	**(1.0)**	(1.3)	(0.8)
Plan amendments	**-**	**-**	1.0	-
Actuarial loss (gain)	**2.4**	**5.0**	(12.1)	(23.4)
End of year	**$ 68.4**	**$ 44.3**	$ 60.5	$ 37.1

Reconciliation of the Funded Status of the Defined Benefit Plans to the Amounts Recorded in the Financial Statements

(millions of dollars)	**2009** Pension Benefit Plans	**2009** Other Benefit Plans	2008 Pension Benefit Plans	2008 Other Benefit Plans
Fair market value of plan assets	**$ 52.7**	**$ -**	$ 51.0	$ -
Accrued benefit obligation	**68.4**	**44.3**	60.5	37.1
Funded status of plans – deficit	**(15.7)**	**(44.3)**	(9.5)	(37.1)
Employer contributions after measurement date	**0.8**	**0.3**	0.8	0.2
Unamortized transitional obligation (asset)	**(0.8)**	**4.7**	(0.8)	5.5
Unamortized past service costs	**2.2**	**-**	2.4	-
Unamortized net actuarial loss (gain)	**18.2**	**(3.9)**	12.9	(9.4)
Accrued benefit asset (liability)	**$ 4.7**	**$ (43.2)**	$ 5.8	$ (40.8)
The accrued benefit asset (liability) is included in the Partnership's balance sheet as follows:				
Other long-term assets (note 6)	**$ 11.3**	**$ -**	$ 11.7	$ -
Accounts payable and accrued liabilties	**(0.8)**	**-**	-	-
Long-term liabilities (note 10)	**(5.8)**	**(43.2)**	(5.9)	(40.8)
	$ 4.7	**$ (43.2)**	$ 5.8	$ (40.8)

Included in the above pension and other retirement benefit provisions and fair value of plan assets at year-end are the following amounts in respect of plans that are not fully funded:

(millions of dollars)	**2009** Pension Benefit Plans	**2009** Other Benefit Plans	2008 Pension Benefit Plans	2008 Other Benefit Plans
Fair market value of plan assets	**$ 52.7**	**$ -**	$ 0.3	$ -
Accrued benefit obligation	**(68.4)**	**(43.2)**	(10.7)	(40.8)
Funded status - plan deficit	**$ (15.7)**	**$ (43.2)**	$ (10.4)	$ (40.8)

Included in the $15.7 million pension plan deficit noted above, is $11.3 million relating to the Pension Bridge Plan and other pension plans, for which no funding obligation is required (2008 – $10.4 million).

The expense for the Partnership sponsored defined benefit plans are as follows:

(millions of dollars)	**2009** Incurred in Year	**2009** Matching Adjustments[1]	**2009** Recognized in Year	2008 Incurred in Year	2008 Matching Adjustments[1]	2008 Recognized in Year
Defined Benefit Pension Plans						
Current service cost, net of employee contributions	**$ 2.9**	**$ -**	**$ 2.9**	$ 3.8	$ -	$ 3.8
Interest cost	**4.0**	**-**	**4.0**	3.7	-	3.7
Return on plan assets	**(0.1)**	**(3.8)**	**(3.9)**	8.7	(13.1)	(4.4)
Actuarial loss (gain)	**2.4**	**(1.4)**	**1.0**	(12.1)	12.6	0.5
Plan amendments	**-**	**0.2**	**0.2**	1.0	(0.9)	0.1
Amortization of transitional obligation	**-**	**(0.1)**	**(0.1)**	-	(0.1)	(0.1)
	$ 9.2	**$ (5.1)**	**$ 4.1**	$ 5.1	$ (1.5)	$ 3.6
Other Benefit Plans						
Current service cost, net of employee contributions	**$ 0.7**	**$ -**	**$ 0.7**	$ 1.2	$ -	$ 1.2
Interest cost	**2.5**	**-**	**2.5**	3.2	-	3.2
Actuarial loss (gain)	**5.0**	**(5.6)**	**(0.6)**	(23.4)	24.2	0.8
Amortization of transitional obligation	**-**	**0.8**	**0.8**	-	0.8	0.8
	$ 8.2	**$ (4.8)**	**$ 3.4**	$ (19.0)	$ 25.0	$ 6.0

[1] Accounting adjustments to allocate costs to different periods so as to recognize the long-term nature of employee future benefits.

Significant Assumptions

The actuarial assumptions used in measuring the Partnership's defined benefit plan provisions are as follows:

(weighted average assumptions)	**2009** Pension Benefit Plans	**2009** Other Benefit Plans	2008 Pension Benefit Plans	2008 Other Benefit Plans
Accrued benefit obligation as of December 31:				
Discount rate	**6.25%**	**6.75%**	6.60 %	6.70 %
Rate of compensation increase	**3.0%**	**n/a**	3.0 %	n/a
Benefit costs for year ended December 31:				
Discount rate	**6.60%**	**6.7%**	5.60 %	5.50 %
Expected long-term rate of return on plan assets	**7.5%**	**n/a**	7.5 %	n/a
Rate of compensation increase	**3.0%**	**n/a**	3.0 %	n/a

Assumed health care cost trend rates (weighted average assumptions)	**2009**	2008
Initial health care cost trend rate	**7.40%**	5.67%
Ultimate health care trend rate	**4.10%**	4.22%
Year ultimate rate is reached	**2029**	2014

Sensitivity analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the other benefit plans. A one percentage point change in assumed health care cost trend rates would have the following effects for 2009:

	1% Increase	1% Decrease
Accrued benefit obligation	**$ 8.3**	**$ (6.7)**
Total of service and interest cost	**0.7**	**(0.5)**

8. Asset Retirement Obligations

(millions of dollars)	**December 31, 2009**	December 31, 2008
Balance beginning of year	**2.8**	11.3
Accretion expense	**0.2**	0.4
Current expenditures	**-**	(1.2)
Gain on settlement	**-**	(0.9)
Change in estimate	**-**	(6.8)
Balance end of year	**3.0**	2.8

The Partnership's asset retirement obligations represent estimated undiscounted future payments of $40.6 million to remediate the landfills at the end of their useful lives. Payments relating to landfill closure costs are expected to occur at periods ranging from 32 to 40 years which have been discounted at 5.8% and 6.3%, respectively. The estimated fair value is $3.0 million and the amount is included in long-term liabilities.

The Partnership has certain assets that have indeterminate useful lives and, therefore, there is an indeterminate settlement date for the related asset retirement obligation. As a result, no asset retirement obligations were recorded for these assets. These assets include, for example, wastewater and effluent ponds that will have to be drained once the related operating facility is closed and storage sites for which removal of chemicals and other related materials will be required once the related operating facility is closed. Once the useful life of these assets becomes determinable and an estimate of fair value can be made, an asset retirement obligation will be recorded.

9. Credit Facilities and Long-term Debt

At December 31, 2009 the Partnership has outstanding long-term debt of $115.1 million (2008 – $134.7 million, US$110.0 million for both 2009 and 2008) in the form of unsecured US dollar private placement notes (the Notes). The Notes bear interest at 6.41% and are repayable in full on their maturity date of November 30, 2013.

On September 30, 2009 the Partnership completed a new $40 million bank credit facility with a maturity date of November 30, 2011, of which $0.5 million was utilized at December 31, 2009 for a standby letter of credit issued for general business purposes. In addition, the Partnership has arranged a separate facility with a maturity date of November 30, 2011, to cover the $16.0 million standby letter of credit issued to BC Hydro under the Energy Purchase Agreement. The general terms and conditions of the new financing are similar to the previous bank credit facility, with interest and other costs at prevailing market rates. The leverage ratio and interest coverage ratio remain consistent with the financial covenants under the long-term Note agreement, which agreement was unchanged and not affected by the new bank financing. The effective interest rate on the bank credit facility for the year ended December 31, 2009 was 2.9%.

The Notes and bank credit agreements each contain similar financial covenants including a maximum allowable debt:EBITDA leverage ratio and minimum required EBITDA:interest coverage ratio. The Partnership remained in compliance with all covenants at December 31, 2009 and throughout the year.

The fair value of long-term debt at December 31, 2009 was $120.9 million (US$115.6 million).

10. Long-term Liabilities

(millions of dollars)	**December 31, 2009**	December 31, 2008
Accrued pension obligations (note 7)	**5.8**	5.9
Post employment benefits (note 7)	**43.2**	40.8
Derivative financial instruments (note 14)	**1.2**	0.7
Asset retirement obligations (note 8)	**3.0**	2.8
	53.2	50.2

11. Capital Disclosures

The Partnership's objectives when managing capital are to safeguard its assets and maintain a globally competitive cost structure, continue as a going concern and provide returns to its partners in the form of distributions and capital appreciation. In addition, the Partnership works with relevant stakeholders to ensure the safety of its operations and employees, and to remain in compliance with all environmental regulations.

The Partnership's capital is comprised of net debt and Partners' equity:

(millions of dollars)	**December 31, 2009**	December 31, 2008
Total debt	**115.1**	159.9
Cash and cash equivalents	**(13.5)**	(0.4)
Net debt	**101.6**	159.5
Total Partners' equity[1]	**529.1**	534.3
	630.7	693.8

Note: [1] Excludes accumulated other comprehensive income – note 17.

Management determines the level of cash distributions based on the level of cash flow from operations before changes in non-cash working capital and long-term deferred maintenance, less actual capital expenditures. During the year distributions are based on estimates of full year cash flow and capital spending; thus distributions may be adjusted as these estimates change. It is expected that normal seasonal fluctuations in non-cash working capital will be funded from cash resources or the revolving short-term credit facility, and thus will not significantly affect the level of distributions.

The Partnership believes its objectives for managing capital in the current economic environment are still appropriate.

The Partnership's long-term debt and short-term credit facility agreements contain leverage and interest ratio covenants, as described in note 9.

12. Related Party Transactions

The Partnership purchased wood chips and hog fuel from Canfor sawmills in the amount of $119.4 million in 2009 (2008 — $144.5 million). The Partnership also purchased wood chips from Lakeland Mills Ltd. and Winton Global Lumber Ltd., in which Canfor owns a one-third interest. Purchases from these entities in 2009 were $3.9 million (2008 — $6.0 million). The Partnership sold wood chips to Howe Sound Pulp and Paper Limited Partnership (HSLP), a partnership 50% owned by Canfor, in the amount of $0.1 million (2008 – $0.7 million). Purchased wood chips and hog fuel were included in manufacturing and product costs.

Effective July 1, 2006, the Partnership entered into a services agreement under which Canfor provides certain business and administrative services to the Partnership. Total value of the services provided in 2009 was $3.0 million (2008 — $3.3 million), which were included in manufacturing and product costs and selling and administration costs.

Effective July 1, 2006, the Partnership entered into an incidental services agreement with Canfor, under which the Partnership provides certain business and administrative services to Canfor. Total value of the services provided in

2009 was $1.7 million (2008 — $1.8 million), which were included in manufacturing and product costs and selling and administration costs.

The Partnership markets bleached chemi-thermo mechanical pulp production from Canfor's Taylor Pulp Mill (Taylor) for which it earned commissions totalling $1.9 million in 2009 (2008 — $2.0 million), included in sales. The Partnership also purchased chemi-thermo mechanical pulp from Taylor for resale totalling $1.7 million in 2009 (2008 — $3.5 million). The Partnership sold NBSK pulp to Taylor for packaging use totalling $2.3 million in 2009 (2008 — $2.2 million). In respect of the products marketed and services provided for Taylor, the Partnership held balances of $24.4 million in accounts receivable - trade (2008 — $9.9 million) and $24.5 million in accounts payable (2008 — $12.2 million) to Canfor at December 31, 2009.

The Partnership markets the NBSK pulp produced by Howe Sound Pulp and Paper Limited Partnership (HSLP), a partnership 50% owned by Canfor, for which it earned commissions totalling $2.4 million in 2009 (2008 — $2.6 million), included in sales. In respect of the products marketed and service provided for HSLP, the Partnership held balances of $16.5 million in accounts receivable - trade (2008 — $16.9) and $17.6 million in accounts payable (2008 — $20.4) to HSLP at December 31, 2009.

Under the agreements for the marketing of production from HSLP and Canfor's Taylor Pulp Mill, the Partnership assumes the customer credit risk. Accordingly, the Partnership records on its balance sheet the accounts receivable from the customer and the accounts payable to HSLP and Canfor for sales made under those agreements.

At December 31, 2009, a total of $16.3 million (2008 — $15.2 million) was outstanding as accounts payable to Canfor in respect of purchases of wood chips, hog fuel, services and amounts paid on behalf of the Partnership. At December 31, 2009 a total of $0.4 million (2008 — $0.2 million) was payable to Lakeland Mills Ltd. for wood chips.

During 2009, the Partnership declared distributions totalling $18.6 million to its limited partners. Distributions to Canfor were $9.4 million, of which $6.5 million was paid, with the balance of $2.9 million payable on December 31, 2009. Distributions to the Fund were $9.2 million, of which $6.4 million was paid, with the balance of $2.8 million payable on December 31, 2009. For the year ended December 31, 2008, the Partnership declared distributions totalling $96.9 million to its limited partners. Distributions to Canfor were $48.6 million, of which $47.2 million was paid, with the balance of $1.4 million payable on December 31, 2008. Distributions to the Fund were $48.3 million, of which $46.9 million was paid, with the balance of $1.4 million payable on December 31, 2008.

These transactions occurred 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.

13. Net Income per Partnership Unit

Basic net income per Partnership unit is based on the weighted average number of Limited Partnership units outstanding during the year. All outstanding Partnership units were issued on July 1, 2006, and there was no change in the number of outstanding Partnership units during the year.

14. Financial Instruments

Classification of Financial Instruments

The Partnership has classified its cash and cash equivalents as held-for-trading. Accounts receivable are classified as loans and receivables and are measured at amortized cost. Accounts payable and accrued liabilities, distributions payable, operating loan and long-term debt, including interest payable, are classified as other liabilities, all of which are measured at amortized cost. Derivative instruments are recorded in the balance sheet at fair value. The Partnership has no derivatives embedded in its financial or non-financial contracts that are not closely related to the host contract.

Financial Risk Management

The Partnership is exposed to a number of risks as a result of holding financial instruments. These risks include credit risk, liquidity risk and market risk.

Risk management is carried out by the risk management committee under a “Risk Management Controls Policy”. The policy sets out the responsibilities, reporting and counter party credit and communication requirements associated with all of the Partnership’s risk management activity. Responsibility for overall philosophy, direction and approval is that of the Board of Directors.

I. Credit risk:

Credit risk is the risk of financial loss to the Partnership if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Financial instruments that potentially subject the Partnership to credit risk include cash and cash equivalents, accounts receivable and derivatives.

In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The Partnership does not have holdings in asset-backed commercial paper. The cash and cash equivalents balance at December 31, 2009 was $13.5 million. The Partnership does not believe there is any significant credit risk associated with cash on deposit held in major Canadian and international financial institutions.

The Partnership utilizes a combination of credit insurance and self-insurance to manage the risk associated with trade receivables. Approximately 81% of the outstanding trade receivables are covered under credit insurance. In addition, the Partnership requires letters of credit on certain export trade receivables and periodically discounts these letters of credit without recourse. The Partnership recognizes the sale of the letters of credit on the settlement date, and accordingly reduces the related trade accounts receivable balance. At December 31, 2009, the Partnership had reduced the trade accounts receivable balance by $11.9 million due to discounting of letters of credit. The Partnership’s trade receivable balance at December 31, 2009 was $110.5 million. The Partnership believes that its approach to managing credit risk associated with the collection of outstanding trade accounts receivable is appropriate in the current credit market.

The Partnership does not believe that there is any significant counter party credit risk in respect of outstanding derivatives.

II. Liquidity risk:

Liquidity risk is the risk that the Partnership will be unable to meet its financial obligations as they fall due. The Partnership manages liquidity risk through management of its capital structure in conjunction with cash flow forecasting including anticipated investing and financing activities, and use of the bank credit facility to meet short-term working capital requirements.

The Partnership also reviews on an ongoing basis, the level of distributions, capital expenditures and timing of scheduled major maintenance outages and may adjust these amounts periodically to manage cash resources. In addition, the Partnership is utilizing discounting of letters of credit on outstanding trade receivables to manage liquidity risk. At December 31, 2009, the impact of discounting of letters of credit accelerated cash collection and reduced the trade accounts receivable balance by $11.9 million. The Partnership believes it will be able to meet all of its financial obligations as they become due.

At December 31, 2009, the Partnership’s accounts payable and accrued liabilities totalled $134.5 million, all of which fall due for payment within one year of the balance sheet date. The Partnership’s distributions payable at December 31, 2009 totalled $5.7 million, which fall due for payment on January 15, 2010.

III. Market risk:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates, foreign currency and commodity prices.

a. Interest rate risk:

The Partnership is exposed to interest rate risk through its financial assets and financial obligations bearing variable interest rates and through its off-balance sheet lease obligations.

The Partnership manages interest rate risk by maximizing the interest earned on excess funds while maintaining the liquidity necessary to meet day-to-day operating cash flow requirements and payment of monthly declared distributions to unitholders.

Fluctuations in market interest rates are not expected to have a material impact on the Partnership's results of operations due to the short-term nature of the respective financial assets and obligations and the fixed interest rate on long-term debt.

The Partnership currently does not use derivative instruments to reduce its exposure to interest rate risk.

b. Currency risk:

The Partnership is exposed to foreign exchange risk. The Partnership's products are sold globally with prices primarily denominated in US dollars or linked to prices quoted in US dollars with certain expenditures transacted in US dollars. In addition the Partnership holds financial assets and liabilities in US dollars. These primarily include US dollar bank accounts and investments, trade accounts receivable and long-term debt.

The Partnership enters into US dollar forward sales contracts to reduce exposure to fluctuations in US exchange rates on US dollar denominated accounts receivable and accounts payable balances.

c. Commodity price risk:

The Partnership's financial performance is dependent on the selling price of its products and the purchase price of raw material inputs. Consequently, the Partnership is exposed to changes in commodity prices for pulp and paper, as well as changes in fibre, freight, chemical and natural gas prices. The markets for pulp and paper are cyclical and are influenced by a variety of factors. These factors include periods of excess supply due to industry capacity additions, periods of decreased demand due to weak global economic activity, inventory destocking by customers and fluctuations in currency exchange rates. During periods of low prices, the Partnership is subject to reduced revenues and margins, which adversely impact profitability.

The Partnership may periodically use derivative instruments to mitigate commodity price risk. For the year ended December 31, 2009 the Partnership used derivative instruments to reduce exposure to natural gas prices.

In addition, the sensitivity of the Partnership's results to currency fluctuations and price changes for its principal products and input costs, when operating at full capacity, is estimated to be as follows:

(millions of dollars, unaudited)	Impact on annual Net income
Canadian dollar – US $0.01 change per Canadian dollar	$ 6
NBSK pulp – US $10 change per tonne	6
Natural gas cost - $1 change per gigajoule	4
Chip cost - $2 change per tonne	5

Fair Value Hierarchy

Financial instruments recognized at fair value on the Consolidated Balance Sheet must be classified in one of the following three fair value hierarchy levels:

- Level 1 – measurement based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;

- Level 2 – measurement based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability;
- Level 3 – measurement based on inputs that are not observable (supported by little or no market activity) for the asset or liability.

The following table sets forth the carrying value and the fair value of the Partnership's financial assets and liabilities. The table also identifies the levels per the fair value hierarchy where fair value is recognized in the balance sheet.

As at December 31, 2009

(millions of dollars)	Carrying Value	Fair Value	Fair Value Hierarchy Level
Financial assets:			
Cash and cash equivalents[1]	13.5	13.5	1
Accounts receivable[1]	118.0	118.0	2
Derivative assets[2]	1.1	1.1	2
Financial liabilities:			
Account payable and accrued liabilities[1]	132.2	132.2	2
Distributions payable[1]	5.7	5.7	2
Long-term debt[3]	115.1	120.9	N/A
Derivative liabilities[2]	3.5	3.5	2

[1] Fair value approximates carrying value due to the short term nature of these instruments.
[2] The fair value of derivative instruments is based on quoted market prices for comparable contracts and represent the amount the Partnership would have received from, or paid to, a counterparty to unwind the contract at the market rates in effect at the balance sheet dates and therefore derivative instruments are classified within Level 2 of the fair value hierarchy established by section 3862. Derivative assets are recorded in other accounts receivable and derivative liabilities are recorded in accounts payable and accrued liabilities and in long-term liabilities in the consolidated balance sheet.
[3] Recorded at amortized cost.

Derivative Instruments

Periodically, the Partnership uses derivative instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, pulp and natural gas prices.

For the year ended December 31, 2009 the Partnership recorded a net loss on derivative financial instruments of $1.5 million (2008 – $8.9 million) relating to settlement of maturing contracts during the year and the revaluation to market of outstanding contracts at the end of the year, for natural gas swaps and US dollar forward contracts.

For the year ended December 31, 2009 the Partnership recorded losses of $7.6 million (2008 – gain of $0.5 million) relating to settlement of maturing natural gas swaps as a charge to non-operating income. At December 31, 2009 the Partnership had outstanding commodity swaps hedging future natural gas purchases of 1.7 million gigajoules extending to October, 2011. At December 31, 2009 the unrealized loss of $3.5 million (2008 – $3.2 million) on these outstanding commodity swaps is recorded as a liability in accounts payable and accrued liabilities and in long-term liabilities.

For the year ended December 31, 2009 the Partnership recorded a net gain of $4.0 million (2008 – losses of $7.8 million) on settlement of maturing US dollar forward contracts as a credit to non-operating income. At December 31, 2009 the Partnership had outstanding US dollar forward contracts of $77.8 million extending to March, 2010. At December 31, 2009 the unrealized gain of $1.1 million (2008 – loss of $1.3 million) on these outstanding US dollar forward contracts is recorded as an asset in other accounts receivable.

15. Supplementary Cash Flow Information

(millions of dollars)	Year ended December 31 **2009**	2008
Decrease (increase) in non-cash working capital		
Accounts receivable – trade and other	**(33.4)**	71.0
Insurance receivable	**7.3**	(7.5)
Inventories	**41.3**	(46.7)
Prepaid expenses and other assets	**(1.8)**	(0.9)
Accounts payable and accrued liabilities	**18.4**	(30.3)
	31.8	(14.4)
Capital expenditures		
Capital expenditures - cash	**17.3**	39.4
Less property damage insurance proceeds	**-**	(9.4)
Net capital expenditures - cash	**17.3**	30.0
Capital expenditures accruals – net	**(3.8)**	(4.7)
Change in asset retirement obligations – long-term	**-**	(6.8)
	13.5	18.5
Net interest paid	9.0	8.1

16. Distributions

The Partnership declared distributions in the twelve months of 2009 as follows:

(millions of dollars, except per unit amounts) Record Date	Payable Date	Amount per Partnership Unit $	Amount $
January 30, 2009	February 13, 2009	0.04	**2.9**
February 27, 2009	March 13, 2009	0.01	**0.7**
March 31, 2009	April 15, 2009	0.01	**0.7**
April 30, 2009	May 15, 2009	0.01	**0.7**
May 29, 2009	June 15, 2009	0.01	**0.7**
June 30, 2009	July 15, 2009	0.01	**0.7**
July 31, 2009	August 14, 2009	0.01	**0.8**
August 31, 2009	September 15, 2009	0.01	**0.7**
September 30, 2009	October 15, 2009	0.01	**0.7**
October 30, 2009	November 13, 2009	0.01	**0.7**
November 30, 2009	December 15, 2009	0.05	**3.6**
December 31, 2009	January 15, 2010	0.08	**5.7**
		0.26	**18.6**

17. Accumulated Other Comprehensive Income

(millions of dollars)	Year ended December 31, 2009	Year ended December 31, 2008
Balance, beginning of year	**0.1**	0.5
Adjustment for exchange translation	**(0.2)**	0.2
Adjustment for derivatives recoded in other comprehensive income (loss)	**0.1**	(0.6)
Balance, end of year	**-**	0.1

Since the inception of the Partnership, the total of the cumulative comprehensive income, less cumulative distributions is as follows:

(millions of dollars)	**December 31, 2009**
Cumulative comprehensive income	**276.7**
Cumulative distributions	**(335.1)**
	(58.4)
Partners' capital – at July 1, 2006	**587.5**
Partners' equity, end of year	**529.1**

18. Commitments and Contingencies

The Partnership has committed to the following operating leases for property, plant and equipment. As at December 31, 2009, the future minimum lease payments under these operating leases were as follows:

(millions of dollars)	
2010	2.3
2011	1.7
2012	0.8
Thereafter	1.0
Total minimum lease payments	5.8

The Partnership finalized an amending Energy agreement with BC Hydro effective September 15, 2009 which provides for the sale of power production that exceeds an amended commitment of the original cogeneration project at the Prince George Pulp and Paper Mill. The obligation to produce power for the remainder of the term of the agreement, extending to August 2020, is reduced to 338 GWh per year from 390 GWh effective September 15, 2009. Under the amended Cogeneration Agreement with BC Hydro, if the cogeneration project generates less than the amended commitment in any year and the shortfall cannot be made up by excess generation in prior years or excess generation in the subsequent year, the Partnership is required to pay BC Hydro an amount equal to the uncorrected shortfall as a ratio of the annual requirement. Under the agreement, the Partnership is required to post a standby letter of credit as security in annually decreasing amounts as minimum required amount of electricity is generated. As of December 31, 2009, the Partnership has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount $16.0 million has been issued to BC Hydro.

19. Prince George Pulp and Paper Mill Fire and Insurance

During 2009, the Partnership reached a final settlement with the insurers of the claim from the Prince George Pulp and Paper Mill fire in 2008. Total business interruption insurance accrued and received was $25.6 million, which is net of a 3-day equivalent deductible of $1.0 million. Total business interruption insurance recorded in 2009 was $3.5 million, with $3.2 million recorded as revenue and $0.3 million recorded as a credit to manufacturing and product costs.

Total property damage insurance accrued and received was $12.4 million, which is net of aggregate policy deductibles of $3.25 million. Total property damage insurance proceeds recorded as a non-operating gain in 2009 were $0.2 million.

Final payment received in 2009 was $11.0 million, of which $9.8 million related to final settlement of the business interruption insurance claim and $1.2 million for property damage, of which $0.1 million has been classified as an investing activity on the cash flow statement, with the balance of $1.1 million representing demolition costs.

20. Pulp and Paper Green Transformation Program

On October 9, 2009 the Canadian federal government announced the allocation of credits from the billion dollar Pulp and Paper Green Transformation Program (the Program). The Partnership has been allocated $122.2 million from the Program announced by the Canadian government on June 17, 2009. The Program is designed as a reimbursement of funds to be spent on qualifying energy and environmental capital projects. Credits may be used until the program end date of March 31, 2012. The Partnership has identified and will be submitting a number of projects for Program approval. These projects are expected to provide economic and environmental benefits to the Partnership's operations.

21. Segmented Information [a]

(millions of dollars)	Pulp	Paper	Unallocated Costs	Total
Year ended December 31, 2009				
Sales to external customers [b]	**690.0**	**122.5**	**1.0**	**813.5**
Sales of pulp to paper segment [c]	**63.7**	**(63.7)**	**-**	**-**
Operating income (loss)	**11.7**	**10.6**	**(10.3)**	**12.0**
Amortization	**45.9**	**3.3**	**0.2**	**49.4**
Capital expenditures, net	**13.2**	**0.1**	**0.2**	**13.5**
Identifiable assets	**739.3**	**64.4**	**33.9**	**837.6**
Year ended December 31, 2008				
Sales to external customers [b]	695.2	130.3	-	825.5
Sales of pulp to paper segment [c]	78.7	(78.7)	-	-
Operating income (loss)	72.5	9.4	(13.2)	68.7
Amortization	43.7	3.7	0.2	47.6
Capital expenditures, net	26.7	0.4	0.8	27.9
Identifiable assets	772.6	73.9	22.4	868.9

(a) Operations are presented by product lines. Operations are considered to be in one geographic area since all production facilities are in Canada. Substantially all sales are exported outside Canada, with sales to the United States representing 36% (2008 – 43%).

(b) Sales to the largest customer represented approximately 7% of pulp segment sales (2008 – 12%).

(c) Sales of slush pulp to the paper segment are accounted for at approximate market value. The sales are transacted as a cost transfer and are not reflected in Pulp sales.