EXHIBIT R-5

kpmg

Consolidated Financial Statements of

BOWATER PULP AND PAPER CANADA INC.

Years ended December 31, 2001 and 2000

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Chartered Accountants

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AUDITORS' REPORT

To the Shareholders of
Bowater Pulp and Paper Canada Inc.

We have audited the consolidated balance sheets of Bowater Pulp and Paper Canada Inc. as at December 31, 2001 and 2000 and the consolidated statements of operations, deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) KPMG LLP

Chartered Accountants

Montréal, Canada

January 14, 2002 except as to note 20
which is as of May 16, 2002

BOWATER PULP AND PAPER CANADA INC.

Consolidated Financial Statements

Years ended December 31, 2001 and 2000

Financial Statements

BOWATER PULP AND PAPER CANADA INC.

Consolidated Balance Sheets

December 31, 2001 and 2000
(in millions of dollars)

	2001	2000
Assets		
Current assets:		
Marketable securities	$ 2.7	$ –
Short-term investment (note 7)	16.0	–
Accounts receivable:		
Trade	101.0	71.1
Other	46.7	34.3
Affiliates	208.0	187.5
Advances to affiliates	49.9	14.5
Inventories (note 8)	191.5	78.4
Prepaid expenses	8.6	2.2
	624.4	388.0
Future income taxes (note 6)	22.9	31.0
Advances to affiliates (note 9)	603.7	75.2
Capital assets (note 10)	1,874.2	1,242.1
Other assets (note 11)	88.7	67.2
Goodwill	38.5	0.6
	$ 3,252.4	$ 1,804.1

	2001	2000
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness	$ 39.5	$ 41.1
Accounts payable and accrued charges	221.8	142.3
Income and other taxes payable	14.6	8.4
Advances from the ultimate parent company	–	3.3
Dividends payable	–	0.4
Current portion of long-term debt (note 13)	114.5	164.0
	390.4	359.5
Future income taxes (note 6)	228.1	163.0
Advances from affiliates (note 12)	1,407.1	83.1
Long-term debt, net of current portion (note 13)	587.8	655.8
Other liabilities	98.7	56.8
Non-controlling interest	36.8	33.3
	2,748.9	1,351.5
Shareholders' equity:		
Capital stock (note 14)	959.1	959.1
Paid-in surplus	565.5	502.4
Deficit	(1,021.1)	(1,008.9)
	503.5	452.6
Commitments and contingencies (note 17)		
Subsequent events (note 20)		
	$ 3,252.4	$ 1,804.1

See accompanying notes to consolidated financial statements.

BOWATER PULP AND PAPER CANADA INC.

Consolidated Statements of Operations

Years ended December 31, 2001 and 2000
(in millions of dollars)

	2001	2000
Net sales (note 15)	$ 1,392.9	$ 1,346.1
Cost of sales	1,049.3	912.3
Depreciation of capital assets	117.2	98.8
Selling and administrative expenses	90.8	59.5
	1,257.3	1,070.6
Operating income	135.6	275.5
Interest expense, net (note 3)	(87.0)	(81.0)
Loss on early repayment of long-term debt (note 4)	–	(1.5)
Other expenses (note 5)	(38.2)	(20.6)
Earnings before income taxes and non-controlling interest	10.4	172.4
Income taxes (note 6)	17.4	57.8
(Loss) earnings before non-controlling interest	(7.0)	114.6
Non-controlling interest	(3.5)	0.5
Net (loss) earnings applicable to common shares	$ (10.5)	$ 115.1

See accompanying notes to consolidated financial statements.

BOWATER PULP AND PAPER CANADA INC.

Consolidated Statements of Deficit

Years ended December 31, 2001 and 2000
(in millions of dollars)

	2001	2000
Deficit, beginning of year:		
As previously reported	$ (1,008.9)	$ (1,071.8)
Prior year's restatement (net of income taxes of $9.7) (note 1 (b))	–	(50.4)
As restated	(1,008.9)	(1,122.2)
Net (loss) earnings	(10.5)	115.1
Dividends declared	(1.7)	(1.8)
Deficit, end of year	$ (1,021.1)	$ (1,008.9)

See accompanying notes to consolidated financial statements.

BOWATER PULP AND PAPER CANADA INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2001 and 2000
(in millions of dollars)

		2001		2000
Cash flows from operating activities:				
Net (loss) earnings	$	(10.5)	$	115.1
Adjustments for:				
Depreciation of capital assets		117.2		98.8
Amortization of other assets and goodwill		0.7		0.6
Future income taxes		(3.8)		38.3
Non-controlling interest		3.5		(0.5)
Write-off of capital assets		5.7		–
Gain on disposal of capital assets		–		(3.9)
Gain from disposal of other assets		–		(3.1)
Unrealized exchange loss		32.1		25.7
Write-off of deferred start-up costs		–		6.8
Other		1.8		0.3
		146.7		278.1
Net change in non-cash operating working capital		(198.6)		(138.6)
		(51.9)		139.5
Cash flows (used in) from investing activities:				
Additions to capital assets		(89.9)		(188.2)
Increase in long-term investment		(11.6)		–
Increase in pension assets		(8.8)		(9.3)
Increase in marketable securities		(2.7)		–
Proceeds from sale of capital assets		0.8		10.5
Other		0.2		(1.1)
		(112.0)		(188.1)
Cash flows from financing activities:				
(Decrease) increase in bank indebtedness		(27.5)		16.0
Repayment of long-term debt		(164.9)		(46.8)
Advances from affiliates		356.3		74.2
		163.9		43.4
Net increase (decrease) in cash and cash equivalents		–		(5.2)
Cash and cash equivalents, beginning of year		–		5.2
Cash and cash equivalents, end of year	$	–	$	–
Other information related to cash flows:				
Cash paid during the year for:				
Interest	$	73.4	$	83.0
Income taxes		18.9		9.0

See accompanying notes to consolidated financial statements.

1. Significant accounting policies:

(a) Basis of presentation:

The consolidated financial statements include the accounts of Bowater Pulp and Paper Canada Inc. (the "Company") and its subsidiaries. As described more fully in note 2, the Company completed the acquisition of Bowater Canadian Forest Products Inc. on September 24, 2001. The results of Bowater Canadian Forest Products Inc.'s operations have been included in the consolidated financial statements since September 24, 2001.

These financial statements are expressed in Canadian dollars. All consolidated subsidiaries are wholly-owned except for Bowater Maritimes Inc., which is owned at 67%. The Company also has a 30% interest in an unconsolidated entity, Chaleur Sawmills Associates, which is accounted for using the equity method.

All significant intercompany transactions and balances have been eliminated.

(b) Foreign currency translation:

Monetary assets and liabilities are translated from foreign currencies into Canadian dollars at rates of exchange at the date of the balance sheet. Revenues and expenses are translated at average rates in effect during the month in which the transaction took place.

Gains and losses on forward and range forward contracts, which hedge anticipated future sales, are recorded in earnings in the same period the sale is recognized and are included in net sales.

During the year 2001, the Canadian Institute of Chartered Accountants ("CICA") adopted a modification to Handbook section 1650 - Foreign Currency Translation, which no longer permits the deferral and amortization of unrealized gains and losses on long-term foreign currency denominated assets and liabilities. The section which is mandatory after January 1, 2002 can be applied in anticipation. The Company adopted the amendments with retroactive effect to January 1, 2000.

The cumulative effect of this change in accounting for foreign currency translation of $50.4 million, net of income taxes of $9.7 million, is determined as of January 1, 2000 and is reported separately in the consolidated statement of deficit as a restatement of the opening balance of deficit for the year ended December 31, 2000.

(c) Inventories:

Inventories of finished products are valued at the lower of average cost and net realizable value. Inventories of raw materials, repair materials and other operating supplies are valued at average cost.

1. Significant accounting policies (continued):

(d) Capital assets:

Capital assets are stated at cost after the deduction of investment tax credits and government grants. The Company amortizes its capital assets over their estimated useful lives using the straight-line method for buildings and equipment. The pulp and paper mills, which are the Company's principal capital assets, are amortized over a period of 20 years. Accumulated amortization includes write-downs of buildings and equipment.

During the construction period, interest is capitalized on major improvements and expansions. No amortization is charged on major improvements or expansions until construction is completed.

(e) Other assets:

Financing costs incurred in issuing long-term debt are deferred and amortized over the term of the related obligation.

Long-term investments, except the long-term investment in a sawmill partnership which is accounted for using the equity method, are accounted for at cost. When there is a permanent loss in value of a long-term investment, the amount recorded is written down to recognize this loss in value in the statement of earnings.

(f) Goodwill:

Goodwill, representing the excess of cost over the fair value of the net assets acquired, is recorded at cost less accumulated amortization. Goodwill is amortized using the straight-line method over 30 years. The Company monitors its goodwill balances to determine whether any impairment of these assets has occurred.

(g) Environmental expenditures:

The Company expenses environmental costs related to existing conditions resulting from past or current operations and from which no current or future benefit is discernible. Expenditures that extend the life of the related property are capitalized. We determine our liability on a site-by-site basis and record a liability at the time it is probable and can be reasonably estimated.

1. Significant accounting policies (continued):

(h) Income taxes:

The Company accounts for income taxes using the asset and liability method. Under this method, future income tax assets and liabilities are determined based on the temporary differences between the accounting basis and the tax basis of assets and liabilities. These temporary differences are measured using the current tax rates and laws expected to apply when these differences reverse. Future tax benefits are recognized to the extent that realization of such benefits is considered more likely than not. The effect on future tax assets and liabilities of a change in income tax rates is recognized in earnings in the period that includes the substantive enactment date.

(i) Employee future benefits:

The Company maintains defined benefit plans providing pension, other retirement, and post-employment benefits to most of its employees. Pension plan assets are valued at fair value for purposes of calculating the expected return on plan assets. The cost of pension and other post-employment benefits (including medical benefits, dental care, life insurance, and certain compensated absences) related to the employees' current service is charged to income annually. The cost is computed on an actuarial basis using the projected benefit method estimating the usage frequency and cost of services covered and management's best estimates of investment yields, salary escalation, and other factors. The Company has elected to use the corridor method to amortize actuarial gains or losses (such as changes in actuarial assumptions and experience gains or losses) over the average remaining service life of active employees. Under the corridor method, amortization is recorded only if the accumulated net actuarial gains or losses exceed 10% of the greater of the accrued pension benefit obligation and the value of the plan assets.

(j) Financial instruments:

The Company manages its foreign exchange exposure on anticipated U.S. dollar sales through the use of derivatives including options, forward and range forward contracts. Derivatives are not used for trading purposes. Option premiums are amortized over the option term.

1. Significant accounting policies (continued):

(k) Cash and cash equivalents:

Cash and cash equivalents are restricted to investments that are readily convertible into a known amount of cash, that are subject to minimal risk of changes in value and which have an original maturity of three months or less. As well, changes in short-term borrowings, other than overdrafts which are an integral part of the day-to-day cash management process, are treated as financing activities.

(l) Use of estimates:

The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination and evaluation of reserves for environmental matters and the useful life of assets for depreciation and evaluation of net recoverable amount. Actual results could differ from those estimates.

2. Acquisition:

On September 24, 2001, Bowater Incorporated, our ultimate parent company, acquired all the issued and outstanding shares of Alliance Forest Products Inc. ("Alliance"). Immediately after the acquisition, the assets and liabilities of Alliance Forest Products Inc.'s US operations were sold to a subsidiary of Bowater Incorporated and Alliance Forest Products Inc. changed its name to Bowater Canadian Forest Products Inc.

On September 24, 2001, the Company acquired from Bowater Incorporated all of the issued and outstanding shares of Bowater Canadian Forest Products Inc. This transaction is an exchange between entities under common control and consequently is accounted for using "continuity-of-interests" accounting, since the date of acquisition by Bowater Incorporated on September 24, 2001. Accordingly, assets and liabilities of Bowater Canadian Forest Products Inc. are consolidated by the Company at their carrying value in the books of Alliance Forest Products Inc.

The net book value of these assets and liabilities acquired on September 24, 2001 amounts to $826.6 million. The consideration paid by the Company is $763.5 million for which a note payable was issued to Bowater Incorporated. As at September 24, 2001, the shareholder's equity of the Company, paid-in surplus, has been increased by $63.1 million, representing the excess of the net book value of the assets and liabilities transferred to the Company over the consideration paid.

2. Acquisition (continued):

The results of operations of Bowater Canadian Forest Products Inc. are included in the Company's statement of operations since September 24, 2001.

Alliance is an integrated company specializing in timber harvesting and forest management, as well as the production and sale of newsprint, uncoated speciality paper, pulp, lumber and related products. The acquisition added two modern, low-cost supercalendered and speciality paper mills in Québec, enabling the Company to offer a full spectrum of groundwood paper grades.

Details of the acquisition are as follows:

		Bowater Canadian Forest Products Inc.
		(in millions of dollars)
Net assets acquired:		
Working capital:		
Bank indebtedness	$	(368.1)
Non-cash working capital		133.4
		(234.7)
Other assets and liabilities:		
Intercompany accounts receivable		851.3
Investments		14.6
Fixed assets		653.2
Goodwill		38.6
Other assets		1.1
Long-term debt and other liabilities		(428.8)
Future income taxes		(68.7)
		1,061.3
		826.6
Excess of net assets transferred from Bowater Incorporated over amount paid		(63.1)
	$	763.5
Consideration paid in:		
Note payable to Bowater Incorporated	$	763.5

3. Interest expense, net:

		2001		2000
		(in millions of dollars)		
Interest on long-term debt (1)	$	81.2	$	91.1
Interest on short-term debt		14.8		0.2
Amortization of deferred financing costs		0.3		0.6
		96.3		91.9
Interest income (2)		(5.2)		(6.7)
Interest capitalized on capital assets		(4.1)		(4.2)
	$	87.0	$	81.0

(1) The Company is charged interest on advances from the ultimate parent company. In 2001, such interest amounted to $14.9 million ($5.8 million in 2000).

(2) The Company earns interest on some advances to the affiliates. In 2001, such interest amounted to $5.0 million ($6.4 million in 2000).

4. Loss on early repayment of long-term debt:

During 2000, the loss recognized as a result of early repayment of long-term debt consisted of premium costs as well as the unamortized issue costs.

5. Other expenses:

		2001		2000
		(in millions of dollars)		
Net foreign exchange loss	$	29.9	$	20.8
Write-off of capital assets		5.7		–
Goodwill amortization		0.4		–
Write-off of deferred start-up costs		–		6.8
Gain on disposal of capital assets		–		(3.9)
Gain from disposal of other assets		–		(3.1)
Other		2.2		–
	$	38.2	$	20.6

5. Other expenses (continued):

During 2000, Bowater Maritimes Inc., a 67%-owned subsidiary of the Company, wrote off the unamortized balance of its deferred start-up costs, amounting to $6.8 million as it was determined that there was no future benefits to the Company.

6. Income taxes:

Income taxes attributable to earnings before non-controlling interest consist of:

	Current	Future	Total
		(in millions of dollars)	
Year ended December 31, 2001	21.2	(3.8)	17.4
Year ended December 31, 2000	19.5	38.3	57.8

Income taxes attributable to earnings before non-controlling interest differ from the amounts computed by applying the combined federal and provincial income tax rate of 30.15% (33.09% in 2000) to earnings before non-controlling interest as a result of the following:

	2001	2000
	(in millions of dollars)	
Earnings before non-controlling interest	$ 10.4	$ 172.4

	2001	2000
	(in millions of dollars)	
Computed "expected" income taxes	$ 3.1	$ 57.0
Increase (reduction) in income taxes resulting from:		
Valuation allowance	12.2	(0.3)
Adjustment to future tax assets and liabilities for enacted changes in tax laws and rates	(3.1)	(2.6)
Large companys tax	2.7	2.5
Recognition of a previously unrecognized temporary difference	2.8	–
Other	(0.3)	1.2
	$ 17.4	$ 57.8

6. Income taxes (continued):

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2001 and 2000 are presented below:

	2001	2000
	(in millions of dollars)	
Future tax assets:		
Non-capital loss carryforwards	$ 58.1	$ 12.7
Investment tax credit carryforwards	17.3	16.6
Foreign exchange losses	15.9	15.9
Liabilities	15.5	13.7
Other	9.2	13.7
	116.0	72.6
Less: valuation allowance	46.2	6.1
Total future tax assets	69.8	66.5
Future tax liabilities:		
Plant and equipment - differences in net book value and undepreciated capital cost	239.0	145.2
Other	36.0	53.3
Total future tax liabilities	275.0	198.5
Net future tax liability	$ (205.2)	$ (132.0)

	2001	2000
	(in millions of dollars)	
As reported in the consolidated balance sheet:		
Non-current future tax assets	$ 22.9	$ 31.0
Non-current future tax liability	(228.1)	(163.0)
Net future tax liability	$ (205.2)	$ (132.0)

The non-capital losses and investment tax credits carryforwards expire at various dates between 2002 and 2011.

7. Short-term investment:

The short-term investment represents preferred shares investment in an electric power company. These preferred shares bear a 4% cumulative dividend and are redeemable at the issuer's option until 2002.

8. Inventories:

	2001	2000
	(in millions of dollars)	
Raw materials	$ 71.9	$ 16.4
Work in process	10.7	0.7
Repair materials and other operating supplies	56.2	34.2
Finished products	52.7	27.1
	$ 191.5	$ 78.4

9. Advances to affiliates:

	2001	2000
	(in millions of dollars)	
Note receivable from Bowater Mersey Paper Company Ltd., bearing interest at prevailing market rates, without repayment terms (1)	$ 78.2	$ 75.2
Note receivable from Bowater Canada Inc., without interest and without repayment terms	525.5	–
	$ 603.7	$ 75.2

(1) The prevailing market rate is established as the prime rate plus 1%.

10. Capital assets:

			2001
	Cost	Accumulated amortization	Net book value
			(in millions of dollars)
Land	$ 36.8	$ –	$ 36.8
Buildings and equipment	3,725.4	1,908.7	1,816.7
Timberlands	35.4	14.7	20.7
	$ 3,797.6	$ 1,923.4	$ 1,874.2

			2000
	Cost	Accumulated amortization	Net book value
			(in millions of dollars)
Land	$ 31.5	$ –	$ 31.5
Buildings and equipment	2,519.5	1,330.5	1,189.0
Timberlands	37.3	15.7	21.6
	$ 2,588.3	$ 1,346.2	$ 1,242.1

The Company and its subsidiaries have timber harvesting licensing arrangements in the provinces of New Brunswick, Québec and Ontario.

11. Other assets:

	2001	2000
		(in millions of dollars)
Pension assets	$ 68.0	$ 59.0
Deferred financing costs, net of accumulated amortization	2.4	2.1
Long-term investments (1)	10.1	–
Other, net of amortization	8.2	6.1
	$ 88.7	$ 67.2

11. Other assets (continued):

(1) The major long-term unconsolidated investment is a $9.0 million investment representing 30% ownership interest in a sawmill partnership.

12. Advances from affiliates:

	2001	2000
	(in millions of dollars)	
Advances from affiliates, bearing interests at various rates between 8.05% and 8.15%, without repayment terms	$ 1,196.0	$ –
Advances from the ultimate parent company, bearing interest at prevailing market rates, without repayment terms (1)	211.1	83.1
	$ 1,407.1	$ 83.1

(1) The prevailing market rate is established as the mid-grade 30-day commercial paper index.

13. Long-term debt:

	2001	2000
	(in millions of dollars)	
Bowater Pulp and Paper Canada Inc.:		
Debentures:		
9.25% due 2002 (US$59.1 million) (i)	$ 94.3	$ 89.1
10.25% due 2003 (US$7.4 million)	11.7	11.1
10.85% due 2014	125.0	125.0
Senior Notes:		
10.625% Series A due 2010 (US$98.0 million)	156.4	147.7
10.50% Series B (2001: US$91.8 million; 2000: US$102 million) (ii)	146.5	153.7
10.60% Series C due 2011 (US$70.0 million)	111.7	105.5
10.26% Series D (US$22.0 million) (ii)	35.1	33.2
Senior notes repaid in 2001	–	131.2
Bowater Canadian Forest Products Inc.:		
Non-interest bearing loan with the government of Quebec	14.8	–
Non-interest bearing notes	0.8	–
Balance carried forward	696.3	796.5

13. Long-term debt:

		2001		2000
		(in millions of dollars)		
Balance brought forward	$	696.3	$	796.5
Bowater Maritimes Inc.:				
11.0% promissory notes from non-controlling shareholders due 2003		6.0		6.0
Bank term loan, repaid in 2001		–		17.3
		702.3		819.8
Less current portion of long-term debt		114.5		164.0
	$	587.8	$	655.8

Bowater Pulp and Paper Canada Inc.:

(i) During 2000, the Company repaid US$19.8 million principal amount of its 9.25% debenture for a cash price, including interest and a premium, US$20.8 million.

(ii) The Series B Senior Notes are payable at the rate of US$10.2 million per year with the final payment due 2010. The Series D Senior Notes are payable at the rate of US$2.2 million per year commencing 2002 with the final payment due 2011.

The Company has available a $15 million demand credit facility of which $8.7 million was drawn as of December 31, 2001. Amounts drawn under this demand credit facility bear interest at prime rate less 3% if amounts are drawn in Canadian dollars or bank base rate less 4% if amounts are drawn in US dollars. This demand credit facility is renewable annually.

In October 2001, the Company has obtained a new $160 million 364-day credit facility (US$100 million). No amounts were outstanding at December 31, 2001 under this credit facility, except for standby letters of credit of $25.2 million. The ultimate parent company, Bowater Incorporated, guarantees this US$100 million 364-day credit facility entirely.

Amounts drawn under the 364-day credit facility bear interest at US base rate plus the applicable margin if amounts are drawn in US dollars or at Canadian prime rate plus the applicable margin if amounts are drawn in Canadian dollars or at LIBOR rate plus the applicable margin if amounts are drawn in Euros. The applicable margin is established in connection with the currency drawn and in connection with the Moody's and Standard & Poor's rating of the ultimate parent company unsecured long-term public debt.

As of December 31, 2001, the Company was in compliance with all its debt indentures.

13. Long-term debt (continued):

All of the Company's long-term debt is unsecured.

Bowater Maritimes Inc.:

Bowater Maritimes Inc. has available a $20 million demand credit facility of which no amount was drawn as of December 31, 2001 ($17.3 million in 2000). Amounts drawn under this demand credit facility bear interest at prime rate less 3.75% if amounts are drawn in Canadian dollars or bank base rate less 4.25% if amounts are drawn in US dollars. This demand credit facility is renewable annually.

Based on exchange rates as of December 31, 2001, repayments required on long-term debt over the next five years are as follows:

	2002	2003	2004	2005	2006	2007 and thereafter	Total
						(in millions of dollars)	
Bowater Pulp and Paper Canada Inc.	$ 114.5	$ 31.8	$ 19.8	$ 19.8	$ 19.8	$ 475.0	$ 680.7
Bowater Canadian Forest Products Inc.	–	–	–	–	–	15.6	15.6
Bowater Maritimes Inc.	–	6.0	–	–	–	–	6.0
	$ 114.5	$ 37.8	$ 19.8	$ 19.8	$ 19.8	$ 490.6	$ 702.3

14. Capital stock:

Authorized:

As at December 31, 2001, the Company's authorized share capital consisting of an unlimited number of common shares and 1,000 non-voting preferred shares.

	2001	2000
	(in millions of dollars)	
Issued and paid:		
68,054,936 common shares	$ 959.0	$ 959.0
1,000 preferred shares	0.1	0.1
	$ 959.1	$ 959.1

15. Related party transactions:

The Company, in the normal course of business, has sold to a company under common control $1,052.5 million ($1,012.3 million in 2000) of its manufactured products at a price established and agreed to by the related parties. Also, Bowater Incorporated, the ultimate parent company, reallocates administrative expenses to the Company. In 2001, the Company was charged $8.9 million from this reallocation ($0.2 million in 2000).

16. Statement of cash flows:

Non-cash investing and financing activities items:

	2001	2000
	(in millions of dollars)	
Investing activities:		
Additions in capital assets which were in accounts payable and accrued charges at the end of the year	$ 6.5	$ 2.3
Business acquisition which has been financed by a note payable to the ultimate parent company	763.5	–
Financing activities:		
Dividend which has been accounted in the advances from the ultimate parent company	1.7	1.8
Increase in a note payable to the ultimate parent company to finance the business acquisition	763.5	–
Increase in advances from affiliates which repaid a portion of the bank indebtedness	342.1	–
Increase in advances from affiliates which repaid a portion of the long-term debt	374.9	–
Decrease in bank indebtedness which has been paid by the ultimate parent company	(342.1)	–
Decrease in long-term debt which has been paid by the ultimate parent company	(374.9)	–

17. Commitments and contingencies:

(a) Commitments:

Minimum payments required under operating leases are as follows:

	(in millions of dollars)
2002	$ 5.4
2003	4.5
2004	3.6
2005	2.6
2006	2.5
Subsequent years	6.3
	$ 24.9

In connection with the acquisition of Bowater Canadian Forest Products Inc., the Company assumed various long-term supply contracts, the more significant including a steam supply contract at its Dolbeau, Québec, operation. Our Dolbeau operation's steam supply contract expires in 2023 and has total commitments of approximately $224.0 million ($10.2 million in years 1-5 and $173.0 million thereafter).

At December 31, 2001, the Company has range forward contracts for periods of up to one year for notional amounts totalling US$165.5 million (US$183.0 million in 2000). The notional amount of range forward contracts is the amount of foreign currency bought or sold at maturity and is not a measure of the Company's exposure. The range forward contracts protect the Company against the exchange rate between the United States dollar and the Canadian dollar rising above an average of US$0.75 during 2002. However, in the event of a weakened Canadian dollar, the Company would be obligated to sell United States dollars at rates which average US$0.58 in 2002 under the range forward contracts. Range forwards will expire unexercised if, at the date of maturity, the value of the Canadian dollar falls between the high and low values specified in the range forward contracts. Based on the spot rate of exchange at December 31, 2001, there was an unrealized loss of $1.2 million (loss of $7.9 million in 2000) with respect to these range forward contracts.

17. Commitments and contingencies (continued):

(a) Commitments:

The range forward contracts as at December 31, 2001 expire as follows:

	Average floor rate (US$)	Notional average ceiling rate (US$)	amount (in millions of US dollars)
2002	$ 0.5779	$ 0.7495	$ 91.0
2003	0.5991	0.7523	74.5
			$ 165.5

The range forward contracts as at December 31, 2000 expire as follows:

	Average floor rate (US$)	Notional average ceiling rate (US$)	amount (in millions of US dollars)
2001	$ 0.6840	$ 0.7138	$ 183.0

The Company has also entered into call option contracts for periods up to two years for notional amounts totalling US$40.0 million and US$49.5 million, maturing in 2002 and 2003, respectively. The call option contracts protect the Company against the exchange rate between the United States dollar and the Canadian dollar rising above an average of US$0.7500 during 2002 and of US$0.7553 during 2003.

(b) Contingencies:

The Company is involved in various legal proceedings relating to contracts, commercial disputes, taxes, environmental issues, employment and workers' compensation claims and other maters. We periodically review the status of these proceedings with both inside and outside counsel. Our management believes that the ultimate disposition of these matters will not have a material adverse effect on our operations or our financial condition taken as a whole.

17. Commitments and contingencies (continued):

(b) Contingencies (continued):

Countervailing and antidumping duties:

On April 2, 2001, petitions for the imposition of antidumping and countervailing duties on Softwood Lumber from Canada were filed with the U.S. Department of Commerce ('USDOC') and the U.S. International Trade Commission ('USITC'), by certain U.S. industry and trade groups (the 'Petitioners').

In response to the petitions, the USITC conducted a preliminary injury investigation and on May 16, 2001 determined that there was a reasonable indication that the lumber industry in the United States was threatened with material injury by reason of softwood lumber imports from Canada.

On August 9, 2001, the USDOC issued its preliminary determination on the countervailing duty and imposed a preliminary duty rate of 19.31% to be posted by cash deposits or bonds on the sales of softwood lumber to the U.S. after August 16, 2001. As at December 31, 2001 the Company has accrued $5.5 million of countervailing duty covering shipments of lumber to the U.S. between September 24, 2001 (the date of acquisition) and December 15, 2001. As at September 24, 2001 the Company had accrued $1.6 million between August 17, 2001 and September 24, 2001. Since the Company posted bonds to cover the duty, this amount is included in accounts payable and accrued charges on the Company's consolidated balance sheet. The preliminary duty rate of 19.31% was suspended on December 15, 2001, 120 days after the preliminary determination, in accordance with U.S. law. The Company is not currently subject to countervailing duty and is awaiting the USITC's final determination of injury, if any, which is currently scheduled to occur in May 2002. Any adjustment to the financial statements resulting from a change in the final countervailing duty rate will be made prospectively.

On October 31, 2001, the USDOC issued its preliminary determination on the antidumping duty and imposed a preliminary duty rate of 12.58% on all of the Company's shipments to the U.S. beginning on November 6, 2001. During the year, the Company accrued $2.3 million related to antidumping duty for shipments to the U.S. from November 6, 2001 to December 31, 2001. The Company has posted bonds for this amount and it is also included in accounts payable and accrued charges on the December 31, 2001 balance sheet. The Company is currently, and will continue to be, subject to antidumping duty until May 2002. Any adjustments to the financial statements resulting from a change in the antidumping duty rate will be made prospectively.

17. Commitments and contingencies (continued):

(b) Contingencies (continued):

The Company and other Canadian forest product companies, the Federal Government and Canadian provincial governments ('Canadian Interest') categorically deny the US allegations and strongly disagree with the preliminary determinations made by the USITC and USDOC. Canadian interests continue to aggressively defend the Canadian industry in this trade dispute. Depending on the outcome of the final phase of the investigation, Canadian Interests may appeal the decision of these administrative agencies to the appropriate courts, North American Free Trade Agreement ('NAFTA') panels and the World Trade Organization ('WTO').

The final amount of countervailing and antidumping duties that may be assessed on Canadian softwood lumber exports to the U.S. cannot be determined at this time and will depend on determinations yet to be made by the USDOC and USITC and any reviewing courts, North American Free Trade Agreement ('NAFTA') or World Trade Organization ('WTO') panels to which those determinations may be appealed (note 20).

18. Employee future benefits:

The Company's pension plans are principally defined benefit pension plans and cover substantially all employees. Benefits from these plans are based on years of service and either career earnings or final average earnings.

The Company also provides post-retirement benefits to eligible employees. The costs of these benefits, which are principally health care, are accounted for during the employees' active service period.

The unrecognized net transition amount is being amortized over the average expected future service periods of employees.

18. Employee future benefits (continued):

The following table provides a reconciliation of the changes in the plans' benefit obligations and fair value of plan assets for the fiscal years ended December 31, 2001 and 2000 and a statement of the funded status as of December 31, 2001 and 2000:

	2001		2000	
	Pension plans	Other benefit plans	Pension plans	Other benefit plans
				(in millions of dollars)
Change in benefit obligation:				
Benefit obligation, beginning of year	$ 899.5	$ 62.8	$ 916.2	$ 59.4
Benefit obligation, date of acquisition	202.7	6.2	–	–
Service cost	13.1	2.1	11.9	2.0
Interest cost	65.8	4.4	61.0	3.9
Plan participants' contributions	6.3	–	6.4	–
Plan amendments	–	(2.0)	–	1.2
Benefits paid	(61.6)	(3.8)	(63.5)	(3.7)
Actuarial loss (gain)	11.4	3.9	(32.5)	–
Benefit obligation, end of year	$ 1,137.2	$ 73.6	$ 899.5	$ 62.8

	2001		2000	
	Pension plans	Other benefit plans	Pension plans	Other benefit plans
				(in millions of dollars)
Change in plan assets:				
Fair value of plan assets, beginning of year	$ 917.4	$ –	$ 857.3	$ –
Fair value of plan assets, date of acquisition	113.2	–	–	–
Actual return on plan assets	(68.9)	–	98.1	–
Employer contributions	8.5	–	19.1	–
Plan participants' contributions	6.3	–	6.4	–
Benefits paid	(61.6)	–	(63.5)	–
Fair value of plan, end of year	$ 914.9	$ –	$ 917.4	$ –

18. Employee future benefits (continued):

	2001		2000	
	Pension plans	Other benefit plans	Pension plans	Other benefit plans
			(in millions of dollars)	
Reconciliation of funded status:				
Funded status	$ (222.3)	$ (73.6)	$ 17.9	$ (62.8)
Employer contributions after–measurement date	7.4	–	3.1	–
Unrecognized actuarial gain	161.2	3.8	(55.2)	(0.3)
Unrecognized net transition asset	66.5	48.3	73.6	55.9
Unrecognized prior service cost	0.6	1.1	–	1.2
Valuation allowance	(0.2)	–	(1.0)	–
Employer other contributions	–	0.1	–	–
Net amount recognized	$ 13.2	$ (20.3)	$ 38.4	$ (6.0)

The following table provides the amounts recognized in the consolidated balance sheets:

	2001		2000	
	Pension plans	Other benefit plans	Pension plans	Other benefit plans
			(in millions of dollars)	
Accrued benefit liability	$ (54.8)	$ (20.3)	$ (20.6)	$ (6.0)
Prepaid benefit costs	68.0	–	59.0	–
Net amount recognized	$ 13.2	$ (20.3)	$ 38.4	$ (6.0)

18. Employee future benefits (continued):

The following table presents the total of these plans that are not fully funded; these amounts are included in the current benefit obligation and fair value of plan assets at year-end as presented above.

	2001		2000	
	Pension plans	Other benefit plans	Pension plans	Other benefit plans
				(in millions of dollars)
Accrued benefit obligation	$ 1,112.7	$ 73.6	$ 318.9	$ 62.8
Fair value of plan assets	888.3	–	278.7	–
Funded status	$ (224.4)	$ (73.6)	$ (40.2)	$ (62.8)

The weighted average assumptions used in the measurement of the Company's benefit obligation are as follows:

	Pension plans	Other benefit plans
Discount rate	6.75%	6.75%
Expected return on plan assets	9.00%	–
Rate of compensation increase	3.75%	–

The assumed health care cost trend rate used in measuring the accumulated other benefits plans obligation was between 8.13% and 10.10% at the end of 2001 and is expected to decrease gradually to between 3.65% and 4.92% in 2006 and remain at that level thereafter. A one percentage point change in assumed health care cost would have the following effects:

	Other benefit plans	
	(in millions of dollars)	
Sensitivity analysis	1% increase	1% decrease
Effect on service and interest costs	$ 0.7	$ (0.5)
Effect on benefit obligation	7.9	(6.1)

18. Employee future benefits (continued):

The following table provides the components of net periodic benefit cost:

	2001		2000	
	Pension plans	Other benefit plans	Pension plans	Other benefit plans
			(in millions of dollars)	
Service cost	$ 13.1	$ 2.1	$ 11.9	$ 2.0
Interest cost	65.8	4.4	60.9	3.9
Expected return on plan assets	(81.5)	–	(75.4)	–
Amortization of transitional assets	7.1	4.6	7.1	4.6
Amortization of actuarial loss	0.9	(0.3)	–	0.2
Valuation allowance	(0.8)	–	1.0	–
Net periodic cost	$ 4.6	$ 10.8	$ 5.5	$ 10.7

19. Financial instruments:

Fair value:

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies. However, considerable judgment is necessary to develop these estimates. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different assumptions or methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

(i) Short-term financial assets are valued at their carrying amounts as presented in the balance sheet, which are reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

(ii) Rates currently available to the Company for long-term debt with similar terms and remaining maturities have been used to estimate the fair value of the long-term debt.

(iii) The fair value of derivatives generally reflects the estimated amounts that the Company would receive or pay to terminate the contracts at the reporting date, thereby taking into account the current unrealized gains or losses on open contracts.

(iv) The carrying amounts of the advance to affiliates approximate their fair value because of the relationship between the Company and the affiliates.

19. Financial instruments (continued):

Fair value (continued):

The estimated fair values of the Company's financial instruments which differ from their carrying values are as follows:

	2001	
	Carrying amount	Fair value
	(in millions of dollars)	
Financial liabilities:		
Long-term debt	$ 702.3	$ 768.7
Off-balance sheet:		
Range forward contracts liability	$ –	$ 1.2

	2000	
	Carrying amount	Fair value
	(in millions of dollars)	
Financial liabilities:		
Long-term debt	$ 819.8	$ 920.4
Off-balance sheet:		
Range forward contracts liability	$ –	$ 7.9

Credit risk:

The Company's financial assets that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, accounts receivable, and derivatives, which include the forward and range forward contracts. Cash and cash equivalents are in place with major financial institutions. Concentrations of credit risk with respect to receivables are limited due to the large number of customers and their dispersion across geographic areas. Counterparties to derivative instruments are major financial institutions and no one counterparty can hold more than a specified portion of the outstanding notional value of the contracts, thereby reducing exposure to credit risk.

19. Financial instruments (continued):

Interest rate risk:

The majority of the Company's long-term debt is at fixed interest rates, thus limiting the interest rate risk.

20. Subsequent events:

(a) Amalgamation:

On January 1, 2002, the operations of Bowater Pulp and Paper Canada Inc. and Bowater Canadian Forest Products Inc. were combined in an amalgamation. The combined company will be called Bowater Canadian Forest Products Inc.

(b) Countervailing and antidumping duties:

On March 22, 2002, the USDOC issued its final determination in the countervailing and antidumping duty investigations, adjusting the rate from 19.31% to 18.79% for the countervailing duty and reducing the Company's average rate from 12.58% to 8.43% for antidumping duty. The adjustment to the financial statements resulting from the change on these rates will be made prospectively.

On May 2, 2002, USITC determined that the U.S. softwood lumber industry in the United States is threatened with material injury by reason of imports of softwood lumber from Canada that the Department of Commerce has determined are subsidized and sold in the United States at less than fair value.

As a result of the Commission's affirmative threat determinations, the Department of Commerce will issue countervailing duty and antidumping duty orders on imports of this product from Canada. The countervailing duty and antidumping duty orders are scheduled to be published in the U.S. Federal Register on May 22, 2002. As of the publication date of the Orders in the U.S. Federal Register, the Company and other Canadian forest product companies will be required to post cash countervailing duty and antidumping duty deposits upon importation of subject product into the United States.

21. Segment information:

Factors management used to identify the Company's reportable segments:

The Company's reportable segments are business units responsible for the marketing and sales of different products. They are managed separately because of the different products that they are responsible for manufacturing and distributing.

21. Segment information (continued):

Description of the types of products and services from which each reportable segment derives its revenues:

On September 24, 2001, the Company completed the purchase of Bowater Canadian Forest Products Inc. As a result of the acquisition, the Company has three reportable segments: the Newsprint Division, Forest Products Division and the Canadian Forest Products Division. Segment information for the year ended December 31, 2000 have been reclassified to reflect the change to three reportable segments. The Newsprint Division is responsible for the manufacturing operations of one site in Canada. It is also responsible for the worldwide marketing of newsprint. The Forest Products Division operates one sawmill and manages 8.3 million acres of Crown-owned land in the province of Ontario on which the Company has cutting rights. This Division sells wood fibre to the Newsprint Division. The Canadian Forest Products Division operates four paper manufacturing sites in Canadian provinces of Quebec and New-Brunswick. The Division manages 0.4 million acres of timberland owned and over 24.4 million acres of Crown-owned land in the Canadian province of Quebec and New-Brunswick on which the Company has cutting rights. The Division also operates ten sawmills and one wood treatment plant, supplies wood to four paper mills and ten sawmills, and is responsible for the marketing and sales of the Company's Canadian lumber production. The Bowater Incorporated's Coated and Specialty Papers and Pulp Divisions have marketing and sales responsibility for all of the Company's market pulp sales and coated and specialty paper sales; however, the financial results from these sales are included in the Newsprint Division and Canadian Forest Products Division, depending upon which site manufactured the products. Accordingly, no results are reported for Bowater Incorporated's Coated and Specialty Papers and Pulp Divisions.

The accounting policies used in these business segments are the same as those described in the summary of significant accounting policies.

21. Segment information (continued):

The following tables summarize information about segment profit and loss and segment assets for the two years ended December 31, 2001 and 2000:

2001

	Newsprint Division	Forest Products Division	Canadian Forest Products Division	Company/ Other Eliminations	Total
					(in millions of dollars)
Net sales - including internal sales	$ 692.5	$ 171.5	$ 796.1	$ –	$ 1,660.1
Eliminations of internal sales	–	(171.5)	(95.7)	–	(267.2)
Net sales - external customers[(1)]	692.5	–	700.4	–	1,392.9
Amortization	58.0	0.6	58.6	–	117.2
Operating earnings (loss) before unusual items	73.9	(1.3)	69.9	(6.9)	135.6
Total assets	898.0	19.1	2,288.9	46.4	3,252.4
Capital expenditures	60.4	6.8	26.9	–	94.1

2000

	Newsprint Division	Forest Products Division	Canadian Forest Products Division	Company/ Other Eliminations	Total
					(in millions of dollars)
Net sales - including internal sales	$ 826.0	$ 189.1	$ 614.5	$ –	$ 1,629.6
Eliminations of internal sales	–	(189.1)	(94.4)	–	(283.5)
Net sales - external customers[(1)]	826.0	–	520.1	–	1,346.1
Amortization	53.6	0.7	44.5	–	98.8
Operating earnings (loss) before unusual items	210.1	(0.3)	65.2	0.5	275.5
Total assets	906.4	28.1	839.4	30.2	1,804.1
Capital expenditures	110.0	0.9	62.9	–	173.8

21. Segment information (continued):

	Net sales by product 2001	2000
	(in millions of dollars)	
Newsprint	$ 826.0	$ 845.1
Uncoated specialty papers	153.9	–
Market pulp	318.9	457.2
Lumber and other wood products	94.1	43.8
	$ 1,392.9	$ 1,346.1

	Net sales by country (2) 2001	2000
	(in millions of dollars)	
Canada	$ 175.9	$ 196.0
United States	992.6	899.8
United Kingdom	65.1	55.8
Japan	114.1	124.7
Other countries	45.2	69.8
	$ 1,392.9	$ 1,346.1

(1) Including net sales to the ultimate parent company.

(2) Net sales are attributed to countries based on the location of the customer. No one unaffiliated customer represented 10% or more of consolidated net sales.

22. Reclassification:

Certain prior years' numbers have been reclassified to conform with the presentation adopted for 2001.