SOLID GROWTH
COLOURFUL CHANGE

MISSION

To provide all members of the communities in which we serve the opportunity to participate in the co-operative ownership of a full service financial institution, for their economic and social benefit.

VISION

To be the preferred financial institution of our members by providing quality products, excellent service and responsible management of resources.

COMMITMENT

To respect the dignity of individuals.
To assist in the development of each person's self-reliance.
To provide quality service and competitive products.
To protect the financial resources of members.
To improve the quality of life within our communities.

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IN MEMORIAM

This year, Kawartha Credit Union lost Lorie Johnson, a valued member of the Senior Management Team. Lorie was a bright, enthusiastic team player who was deeply committed to Kawartha's success. Always approachable and proactive, Lorie led her team to great heights, and was in large part responsible for the warm, family-like environment we enjoy today. Lorie is greatly missed, but never forgotten.

REPORT TO THE MEMBERS

As our cover suggests, 2006 has indeed been a year of *Solid Growth* and *Colourful Change* at Kawartha Credit Union. We have made great strides in a number of key areas, all with the intent of improving the service we bring to our members.

SOLID GROWTH

In financial terms Kawartha had another solid year. Assets under management grew by $58 million or 15% – right on our long-term target. As in the past few years, this growth came organically from a mix of new members and more business from our existing members. Balance sheet assets increased $28.5 million or 7.6%. We experienced strong loan growth, particularly in the area of consumer credit and wrote a record volume of loans in both numbers and dollar value, as noted in the Credit Statistics on page 5. Kawartha maintained its healthy financial position with regulatory capital of 7.7% and liquidity of 11% at year end, both well in excess of statutory requirements. The Credit Union was positioned to take advantage of the interest rate increases throughout 2006. Consequently, the financial margin increased to 3.5% of average assets, despite continued competition in the industry. Other income declined in 2006 because we were not able to repeat the one-time gains we earned in 2005, but remained satisfactory at 0.92% of average assets. Net income of $3.5 million or 0.89% of average assets was up 10% over 2005 and ahead of budget. This provided a return on average equity of 11.6%, which allowed us to pay a 7% dividend on Class A Investment Shares again in 2006.

We also expanded our facilities last year; we doubled the size of our Lindsay and Chemong Road branches, and construction of our new full-service Huntsville branch commenced in October. In addition, we negotiated an expansion to the Lansdowne Place branch, allowing us to add two more offices to improve member service. Other improvements to our facilities included a new office in the Trenton branch, interior and exterior renovation of the Cobourg branch, and adding new ATMs to both the South River and Emsdale branches.

Another area of growth has been our people – both in numbers and skills. At the end of the year, Kawartha employed 174 staff, and spent over $100,000 on staff training and development to help our people grow professionally and to better serve our members. We participated in the Best Small & Medium Sized Employer program this year, with 94% of our staff completing the survey. We were very proud of our overall rating which placed Kawartha in the Best Employer category.

Supporting the communities we operate in has been a part of Kawartha Credit Union for many years and is very important to us. As detailed on page 7 of this report, total community support in 2006 grew to over $87,000.

Kawartha has held an investment in one of our supplier companies for several years. Due to financial irregularities at that company, we expect to suffer a loss of $1.2 million. Full details are provided in note 3 to the financial statements. This unfortunate occurrence does not affect the security of member deposits, nor will it affect our plans for future growth. The Credit Union remains strong and will continue to flourish. As noted above, our net income is up 10% over last year, despite fully providing for the aforementioned loss.

Board of Directors – Back Left to Right: *Lloyd Churchill, Earl Robbins, Carl Silvestri (Chair), Ellen Menzies (Recording Secretary), Ken Stickle*
Front Left to Right: *Harvey Spry, Robert George, Janice James, Ellen Stewart, Dave McKnight*

REPORT TO THE MEMBERS (continued)

COLOURFUL CHANGE

They say the only constant is change and that has certainly been the case for us this year. Highlights of 2006 include:

- We welcomed three new Senior Managers to the Kawartha team. These bright, enthusiastic, seasoned individuals add a fresh and innovative perspective to the Kawartha family. Together, we'll accomplish great things for our members.
- The renovation of our Lindsay and Chemong Road branches, and the construction of the new Huntsville location present a new Kawartha image to the communities we serve. The natural materials used in these facilities reflect the values of Kawartha: wood, stone and metal speak to our strength and solid, enduring presence. The extensive use of glass communicates our accessibility and the notion of transparency. These branches have a warm, inviting feel to them, and reinforce our image as a professional, secure financial institution. We have received great member feedback on these changes.
- We have implemented an innovative new marketing strategy to attract existing and prospective members in our communities. Through the use of striking nature-themed visuals and messages in exciting advertising vehicles, we are committed to reaching our communities in call-to-action formats that are meaningful and relevant to their financial needs.

Our plans for 2007 and beyond include innovative plans for growth. We are in the process of introducing three new Investment Specialists in order to improve our Wealth Management offering. Their knowledge and skills will further enhance the one-on-one guidance we can offer our members. At the same time, we are developing a new website, with improved functionality and new features. We are also expanding our Commercial Credit activities, to better serve the small businesses in our communities.

As we continue to grow, we will strive to retain the comfortable feel of a smaller financial institution while staying competitive with the big banks. We are committed to working hard to stay true to our values and the things that have made Kawartha successful in the past.

On behalf of the Board and management team, we want to thank all staff for their dedication to service excellence. It is through their efforts that Kawartha has developed a strong record of success.

We also want to thank our members for your continued support. We will continue to do our best to earn your trust and your business. If we can serve you better, please tell us. If not, please tell your family and friends.

Respectfully,

Carl Silvestri
Chair of the Board

Robert Wellstood
Chief Executive Officer

Senior Management Team – Back Left to Right: *Laurianne Gruzas, Julian Sellers, Crystal Dayman*
Middle: *Wanda Byrne, Louise Coleman, Stuart Forsyth* ***Front:*** *Robert Wellstood*

CREDIT STATISTICS

	#'s		
Total applications for credit	**7902**		
Rejected requests	**1236**		
Accounts in arrears greater than 90 days	**129**	**$**	**2,310,507**

APPROVED CREDIT

Consumer Loans	2277	$	30,607,017
Consumer Lines of Credit	2041		35,891,000
Consumer Overdraft Agreements	218		102,400
Residential Mortgages	556		71,075,620
Commercial Loans	12		545,548
Commercial Lines of Credit	33		2,664,500
Commercial Overdraft Agreements	28		43,100
Commercial Mortgages	50		12,755,320
Total Approved Credit	**5215**	**$**	**153,684,505**

COMMERCIAL DEVELOPMENT

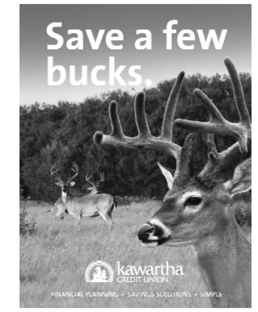
COMMERCIAL LOANS BY TYPE OF BUSINESS

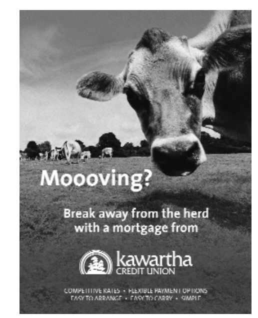
Type of Business	# of Loans		Disbursed
Agriculture, Forestry, Fishing & Hunting	2	$	25,000
Construction	14		746,300
Manufacturing	6		587,750
Wholesale Trade	1		48,000
Retail Trade	14		922,040
Transportation & Warehousing	2		218,536
Real Estate - Rental & Leasing	22		4,545,254
Professional Services	5		138,055
Educational Services	4		125,500
Health Care & Social Assistance	1		240,500
Arts, Entertainment & Recreation	11		2,181,383
Accomodation & Food Services	16		5,697,450
Other Services	25		532,700
TOTAL	**123**	**$**	**16,008,468**

COMMERCIAL LOANS BY SIZE

Size			
Less than $25,000	54	$	353,574
$25,000 to $99,999	23		1,180,384
$100,000 to $499,999	33		7,329,713
over $500,000	13		7,144,797
TOTAL	**123**	**$**	**16,008,468**

MARKETING AND COMMUNITY INVESTMENT





With the implementation of a new marketing strategy in 2006, Kawartha Credit Union has created a focus which speaks to the beauty and natural characteristics of the regions we serve. Using animal and nature images, we appealed to the sensibilities of our communities with a simple, "back-to-basics" approach.

We introduced new vehicles for communication, including bus backs, outdoor billboards, and LCD screens at sports arenas, in addition to traditional promotional practices, such as in-branch posters and brochures, statement inserts, transit shelters, newspaper, radio and website.

This new direction seems to be serving us well: we have exceeded all of our lending and mortgage campaign targets, and our projections for 2007 are looking bright. In addition, we have captured the attention of younger members with our light-hearted nature themes. Young children are beginning to look for our bus backs, transit shelters and posters, and many members have requested copies of our posters for their children. This proves that it's never too early to build brand recognition; after all, these are our members of the future.

As we continually strive to set ourselves apart from other financial institutions in the products, service, convenience and aesthetic appeal we deliver, our overall marketing strategy is further enhanced by our Community Investment Program.

Kawartha Credit Union has a long history of giving back to the communities we serve throughout north and east-central Ontario. We support the causes that matter most to our members, including hospitals, health-care programs, education, and the environment. In 2006, we invested $87,357 in the regions that encompass our 16 branches through donations to charitable and non-profit organizations. In 2007, we will continue to support important causes in our communities with $94,200 in charitable contributions.

As part of our Community Investment Program, Kawartha Credit Union actively supports the annual Dragon Boat Festivals in Peterborough (Platinum Sponsor) and Parry Sound (Gold Sponsor) with substantial sponsorship funds, and with the participation of our staff in the races.

Through our marketing efforts and our Community Investment Program, Kawartha Credit Union continues to reach existing and potential members by making a difference in their lives, communities and causes. It's a simple approach that makes an impact, and in return we hope they will continue to reward us with their loyal membership.

AUDITORS' REPORT

To the Members
Kawartha Credit Union Limited

We have audited the balance sheet of Kawartha Credit Union Limited as at September 30, 2006 and the statements of income, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Credit Union's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material mistatement. 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 financial statements present fairly, in all material respects, the financial position of the Credit Union as at September 30, 2006 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

BDO Dunwoody LLP

Chartered Accountants

Peterborough, Ontario
October 31, 2006

REPORT FROM THE AUDIT COMMITTEE

The Audit Committee's function is to assist the Board of Directors in fulfilling its oversight responsibilities by reviewing the financial information and reporting processes including the risks and controls related to those processes which management and the Board have established.

The Audit Committee is composed of four directors and has adopted a mandate that includes all of the tasks specified for Audit Committees in the Credit Unions and Caisse Populaires Act, 1994 and the associated regulations.

The Audit Committee met five times during the 2006 fiscal year to complete its responsibilities.

Key activities included:

- Review the financial statements and the results of the year end audit with the external auditor;
- Review the performance of the Auditors and their proposed engagement letter;
- Ensure that the regulatory filings were submitted on time;
- Review the Credit Union's policies, procedures, and controls for legislative compliance;
- Review the disaster recovery plan;
- Monitor the adherence of Directors, Officers, and employees with the Credit Union's policies and code of conduct;
- Review outstanding legal issues;
- Review accounting issues;
- Review risk management issues; and
- Review director and officer expense claims.

Management has implemented all Committee recommendations and there are no matters which the Committee believes should be reported to the members or which are required to be disclosed pursuant to the Act or the regulations

Respectfully submitted,

Harvey Spry

Harvey Spry, Committee Chair
Committee: Janice James, Lloyd Churchill, Robert George

BALANCE SHEET

At September 30

		2006		2005
Assets				
Cash resources (Note 1b)	$	38,937,715	$	30,147,158
Loans to members (Note 2a)		355,534,114		337,140,205
Investments (Note 3)		2,390,388		2,339,490
Other assets		4,332,755		3,301,295
Capital assets (Note 4)		4,912,905		4,633,470
	$	**406,107,877**	**$**	**377,561,618**
Liabilities				
Term loans (Note 7a)	$	8,500,000	$	12,000,000
Members' deposits (Note 5a)		361,596,748		334,043,028
Accounts payable and accrued liabilities		4,514,738		2,787,701
		374,611,486		**348,830,729**
Members' Equity				
Class A investment shares (Note 12)		12,494,685		12,494,685
Membership shares (Note 12)		755,663		761,993
Contributed surplus		169,301		169,301
Retained earnings		18,076,742		15,304,910
		31,496,391		28,730,889
	$	**406,107,877**	**$**	**377,561,618**

Approved by the Board:

Carl J. Silvestri — Director

Harvey Spry — Director

The accompanying notes are an integral part of these financial statements

STATEMENT OF INCOME

For the year ended September 30

		2006		2005
Financial Revenue				
Interest on loans to members (Note 2c)	$	21,992,801	$	19,193,175
Investment income		929,333		620,200
		22,922,134		19,813,375
Financial Expense				
Interest on deposits (Note 5b)		8,375,532		8,016,827
Interest on borrowings (Note 7a)		726,969		456,424
		9,102,501		8,473,251
Financial Margin		13,819,633		11,340,124
Other Income		3,606,017		3,941,708
		17,425,650		15,281,832
Operating Expenses				
Salaries and employee benefits		6,149,220		5,832,567
Loan loss expense (Note 2d)		386,091		397,813
Occupancy		1,324,952		1,217,655
Banking costs		519,515		516,753
Other expenses (Note 11)		1,541,570		1,391,771
Data costs		796,892		779,591
Deposit insurance		263,565		235,920
Promotion		805,382		879,220
Directors' expenses (Note 10)		54,126		48,462
		11,841,313		11,299,752
Operating Income		5,584,337		3,982,080
Other Items				
Write down of investments (Note 3)		242,548		–
Vault cash program loss (Note 3)		956,000		–
		1,198,548		–
Income before income taxes		4,385,789		3,982,080
Income tax expense (Note 18)		892,000		806,000
Net Income	**$**	**3,493,789**	**$**	**3,176,080**

The accompanying notes are an integral part of these financial statements

CASH FLOW STATEMENT

For the year ended September 30

		2006		2005
Cash Provided by Operations (Note 13)				
Net Income	$	3,493,789	$	3,176,080
Adjustments to Cash Basis of Accounting				
Amortization of Capital Assets		808,070		823,851
Changes in Other Assets		(1,031,460)		(616,940)
Changes in Accounts Payable		1,727,036		901,523
Changes in Allowance for Loan Losses		47,391		39,265
Gain on Mortgage Securitization		(79,706)		(263,486)
Write Down of Investments		242,548		–
		5,207,668		4,060,293
Cash Provided by (Advanced to) Members				
Increase (Decrease) in Members' Deposits		27,553,720		34,997,300
Increase (Decrease) in Shares		(6,330)		29,030
Dividends Paid to Members		(721,957)		(583,649)
(Increase) Decrease in Loans to Members		(48,946,481)		(53,506,367)
		(22,121,048)		(19,063,686)
Financing Activities				
Term Loans Advanced (Repaid)		(3,500,000)		9,000,000
Proceeds of Mortgage Securitization		30,584,888		9,731,809
		27,084,888		18,731,809
Investment Activities				
Purchases of Fixed Assets (net of disposals)		(1,087,505)		(559,000)
Increase in Investments		(293,446)		(444,382)
		(1,380,951)		(1,003,382)
Increase (Decrease) in Cash Resources During the Year		8,790,557		2,725,034
Cash Resources - Beginning of the Year		30,147,158		27,422,124
Cash Resources - End of the Year	**$**	**38,937,715**	**$**	**30,147,158**

The accompanying notes are an integral part of these financial statements

STATEMENT OF RETAINED EARNINGS

For the year ended September 30

	2006	2005
Opening Balance	$ 15,304,910	$ 12,712,479
Add: Net Income	3,493,789	3,176,080
	18,798,699	15,888,559
Less: Dividends Paid, Net of Tax Savings		
Class A Investment Shares	886,957	723,649
Related Tax Savings	(165,000)	(140,000)
Ending Balance	**$ 18,076,742**	**$ 15,304,910**

The accompanying notes are an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS At September 30, 2006

1. SIGNIFICANT ACCOUNTING POLICIES

a) Nature of Business
Kawartha Credit Union Limited is incorporated under the Credit Unions and Caisses Populaires Act and is a member of the Deposit Insurance Corporation of Ontario and of Credit Union Central of Ontario.

b) Cash Resources
The term “cash resources” as used in these financial statements consists of cash on hand and fixed rate term investments which are issued by Credit Union Central of Ontario or are government backed. Investments are carried at the lower of cost or net realizable value. Carrying value of investments approximates market value. Investments mature within one year and provide a yield of 4.08%. The Credit Unions and Caisses Populaires Act, 1994 requires that the Credit Union maintain adequate liquidity, defined as a minimum of 8% of borrowings and member deposits, in certain classes of short term or liquid assets as defined in the regulations. The Credit Union complies with requirements regarding adequate liquidity at September 30, 2006.

c) Capital Assets and Amortization
Capital assets are recorded at acquisition cost. The Credit Union provides amortization on substantially all its property and equipment using the straight line method at the rates set out below, designed to amortize costs over the expected useful life of the respective assets.

Parking lot	25 years
Building	25 - 50 years
Building - interior renovations	10 years
Equipment - computer	3 - 5 years
- furniture & other	5 - 10 years
Leasehold improvements	Remaining term of the lease
Member files	5 – 10 years

d) Income Taxes
The Credit Union follows the asset and liability method of accounting for income taxes, whereby future tax assets and liabilities are recognized for the expected future tax consequences attributable to temporary differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases.

e) Allowance for Impaired Loans
Each allowance for impaired loans recorded in the accounts of the Credit Union is calculated in accordance with generally accepted accounting principles as interpreted by By-law No. 6 of the Deposit Insurance Corporation of Ontario. This requires management to make estimates. Actual results could differ from management’s best estimates.

f) Employee Future Benefits
The Credit Union sponsors a defined contribution pension plan. Contributions to the plan during the year were $239,695 (2005 - $216,295).

The Credit Union also provides health and dental benefits for its retired employees who were employed on a full time basis prior to November 1, 2003. The Credit Union recognizes these post retirement costs in the period in which the employees render the services. The cost of employee future benefits earned by employees is actuarially determined using the Projected Unit Credit actuarial cost method prorated on services and management’s best estimate of retirement ages of employees, employee turnover and expected health care costs. The most recent actuarial valuation of the obligation was performed for October 1, 2005.

g) Derivative Instruments
The Credit Union periodically enters into derivative contracts to manage financial risks associated with movements in interest rates and other financial indices. The Credit Union does not enter into derivative financial instruments for trading or speculative purposes.

When derivatives are used to manage exposures, the Credit Union determines for each derivative whether hedge accounting can be applied. Where hedge accounting can be applied, a hedge relationship is designated as a fair value hedge or a cash flow hedge of a specifically identified group of assets or liabilities. The Credit Union also formally assesses and documents, both at the inception and over the term of the hedge, whether these derivatives are effective in offsetting changes in fair values or cash flows of hedged assets or liabilities.

h) Mortgage Securitization
The Credit Union occasionally securitizes mortgages by selling them to Credit Union Central of Ontario. Transfers of mortgages to Central are treated as sales provided that control over the transferred mortgages has been surrendered and consideration other than beneficial interests in the transferred mortgages has been received in exchange. Gains on these transactions are reported as other income on the statement of income. The amount of these gains are based on the present value of expected future cash flows using management’s best estimates and key assumptions such as prepayment rates, excess spread, credit losses and discount rates. The Credit Union has a contractual obligation to service the loans on behalf of the transferee, and as a result, a servicing liability is recognized on the date of the transfer and amortized over the term of the transferred loans.

i) Revenue Recognition
Interest income on member loans and investments is recorded as revenue using the accrual method based on the number of days the loan or investment is outstanding.

Other income includes service charges and various fees. Service charges are generally for monthly services and are charged and recorded as revenue on a monthly basis. Fees are recorded as revenue when the service generating the fee has been provided.

j) Financial Instruments

The Credit Union utilizes various financial instruments. Unless otherwise noted, it is management's opinion that the Credit Union is not exposed to significant interest, currency or credit risks arising from these financial instruments and the carrying amounts approximate fair values.

2. LOANS TO MEMBERS

a) Summary

	2006	2005
Personal loans	$ 110,524,798	$ 96,458,775
Residential mortgages	176,790,294	175,418,215
Commercial loans	69,464,614	66,532,246
	356,779,706	338,409,236
Accrued interest receivable	581,514	510,684
	357,361,220	338,919,920
Allowance for impaired loans	(1,827,106)	(1,779,715)
Net loans to members	$ 355,534,114	$ 337,140,205

b) Fair Value Information

Variable rate loans are based on a "prime rate plus" formula. The rate above prime is determined by the type of security offered and the borrowers' credit worthiness. The Credit Union's prime rate at September 30, 2006 is 6.00% and fluctuates with the market. The net carrying value of variable rate loans to members approximates their fair value. Fixed rate loans are offered at rates which are determined by the level of market rates, the type of security offered and the borrowers' credit worthiness. The fair values of fixed rate loans are estimated by discounted cash flow techniques using interest rates currently offered for loans with similar risk characteristics and terms to maturity.

Accordingly, the estimated fair values of member loans at September 30, are as follows:

	2006	2005
Personal loans	$ 110,730,000	$ 96,817,000
Residential mortgages	176,175,000	177,305,000
Commercial loans	69,985,00	65,243,000
	$ 356,890,000	$ 339,365,000

c) Interest Income

	2006	2005
Personal loans	$ 7,777,411	$ 5,828,743
Residential mortgages	9,438,013	8,955,939
Commercial loans	4,777,377	4,408,493
	$ 21,992,801	$ 19,193,175

Personal loans are comprised of term loans, which account for 56% of the portfolio, and lines of credit which account for the remaining 44% of the portfolio. Repayment terms vary with the term length and loan type. Security may include collateral mortgages on real property, lodgement of title documents, investments, personal property and wage assignments. All personal loans are open for prepayment without penalty. Mortgage loans are secured by residential properties. Repayment is in the form of blended payments, with amortization periods ranging up to 30 years.

Loans to members had the following average yields at September 30, 2006:

	Principal	Yield
Variable rate loans	$ 114,090,682	7.97%
Fixed rate loans with maturities within one year	34,427,194	6.16%
Fixed rate loans with maturities beyond one year	208,261,830	5.96%
	$ 356,779,706	

d) Activity in the allowance for impaired loans has been as follows

	Personal Loans	Residential Mortgages	Commercial Loans	Total
2006				
Opening	$ 791,044	$ 246,780	$ 741,891	$ 1,779,715
Recoveries	18,247	2,168	–	20,415
Loan loss expense	419,128	(38,424)	5,387	386,091
	1,228,419	210,524	747,278	$ 2,186,221
Write-offs	(213,455)	(1,261)	(144,399)	(359,115)
Ending	$ 1,014,964	$ 209,263	$ 602,879	$ 1,827,106
Principal balance of impaired loans	$ 740,760	$ 1,432,993	$ 136,754	$ 2,310,507
2005				
Opening	$ 749,932	$ 216,023	$ 774,495	$ 1,740,450
Recoveries	20,219	6,269	9,120	35,608
Loan loss expense	297,874	24,488	75,451	397,813
	1,068,025	246,780	859,066	2,173,871
Write-offs	(276,981)	–	(117,175)	(394,156)
Ending	$ 791,044	$ 246,780	$ 741,891	$ 1,779,715
Principal balance of impaired loans	$ 537,682	$ 993,205	$ 752,043	$ 2,282,930

The allowance for impaired loans consists of an allowance for specific impaired loans and an allowance for non-specific groups of loans. The allowance for non-specific loans amounts to $1,185,000 (2005 – $1,233,000). At September 30, 2006, there were no formally restructured loans outstanding (2005 - none).

3. INVESTMENTS

	2006	2005
Credit Union Central of Ontario, Membership	$ 2,372,828	$ 2,079,382
Co-operators General Insurance, Class A Series A	12,557	12,557
Credential Securities Inc., Debenture	5,000	5,000
CU-Connection Limited, Common shares	1	96,250
CU-Connection Limited, Class A Preference shares	1	120,701
CU-Connection Limited,Class B Preference shares	1	25,600
	$ 2,390,388	$ 2,339,490

Credit Union Central of Ontario membership shares must be maintained at 0.60% of the Credit Union's total assets at December 31 each year. The shares are redeemable at cost only if there is a reduction in the Credit Union's total assets at December 31 each year or upon withdrawal of membership from Central. Accordingly, there is no separately quoted market value. Dividends on these shares are at the discretion of the Board of Directors of Central. Dividends received on these shares in 2006 amounted to $84,368 (2005 - $36,788). The fair values of the shares in Central and The Co-operators are not readily determinable because of the lack of a resale market for them. Management believes that there is no permanent impairment in any of these investments.

The CU-Connection Limited Class A Preference shares are non-voting, redeemable and retractable. Dividends are cumulative at a rate to be fixed by the Board of Directors of CU-Connection from time to time. Dividends received on these shares in 2006 amounted to Nil (2005 - Nil). The CU-Connection Limited Class B Preference shares are non-voting, redeemable and retractable. Dividends are non-cumulative at a rate to be fixed by the Board of Directors of CU-Connection from time to time. As at year end, management believes these investments to be permanently impaired, and as a result, they have been written down to reflect their estimated fair value.

In 2002, the Credit Union entered into a contract to provide $1.5 million of cash for an independent ATM operator. This contract, with 3791351 Canada Inc. ("CU-Connect", a subsidiary of CU-Connection Limited), required CU-Connect to manage the daily operation of the vault cash program for the Credit Union. During fiscal 2006, the independent ATM operator was placed into receivership for failure to meet its financial obligations. Also in 2006 it became evident that reconciliations were not being completed by CU-Connect as required by the contract. As a result of these two events, the Credit Union has discontinued the vault cash program and is attempting to recover its cash. Based on information available at the time of completing these financial statements, management estimates the Credit Union may recover only $544,000 from the $1.5 million cash provided. A provision for loss has been made based on the estimated recovery.

4. CAPITAL ASSETS

	2006 Cost	2006 Accumulated Amortization	2005 Cost	2005 Accumulated Amortization
Land and parking lot	$ 1,156,962	$ 48,635	$ 1,156,962	$ 48,162
Building	3,402,611	1,527,129	3,369,843	1,344,864
Equipment	4,632,903	3,708,947	4,008,984	3,349,741
Leasehold improvements	1,019,092	468,183	728,832	509,032
Member files	1,287,403	833,172	1,287,403	666,755
	$11,498,971	$ 6,586,066	$10,552,024	$ 5,918,554
Net book value		$ 4,912,905		$ 4,633,470
Amortization expense		$ 808,070		$ 823,851

5. MEMBERS' DEPOSITS

a)

	2006	2005
Chequing accounts	$ 98,293,011	$ 94,473,190
Demand savings accounts	35,861,724	36,035,860
Term deposits	139,748,441	121,463,457
Registered savings plans	62,763,518	58,661,310
Registered retirement income funds	18,274,643	18,038,971
Accrued interest on member deposits	6,655,411	5,370,240
	$ 361,596,748	$ 334,043,028

b) Interest on Deposits

	2006	2005
Chequing accounts	$ 581,970	$ 476,064
Demand savings accounts	281,851	275,741
Term deposits	4,731,935	4,599,862
Registered savings plans	2,177,931	2,065,977
Registered retirement income funds	601,845	599,183
	$ 8,375,532	$ 8,016,827

Chequing accounts and demand savings accounts are due on demand and bear interest at variable rates which depend upon the type of account and the balance maintained. Term deposits bear fixed rates of interest for terms up to five years. Interest can be paid monthly, annually or at maturity. Certain types of term deposits are callable by the depositor and account for 74% of the portfolio (2005- 75%).

Registered savings plans consist of fixed rate deposits which account for 96% (2005 - 96%) of the portfolio and variable rate deposits which comprise the remaining 4% (2005 - 4%) of the portfolio. Deposits which are callable by the depositor account for 65% of the portfolio (2005 - 63%), with the remaining 35% (2005 - 37%) being fixed for terms up to five years. The registered retirement income funds (RRIFs) are almost entirely fixed rate deposits for terms ranging up to five years. Members may make withdrawals from a RRIF on a regular schedule ranging from monthly to annually at amounts which vary according to individual needs.

Members' deposits have the following average yields at September 30, 2006:

	Principal	Yield
Variable rate deposits due on demand	$ 136,543,993	0.71%
Fixed rate deposits with maturities within one year	80,589,441	3.32%
Fixed rate deposits with maturities beyond one year	137,807,903	3.85%
	$ 354,941,337	

c) Fair Value Information

The carrying value of all variable rate deposits approximates their fair values. The fair values of fixed rate deposits are estimated by discounted cash flow techniques using interest rates currently offered for deposits with similar terms to maturity and assuming callable deposits are held to maturity. The estimated fair values of member deposits at September 30, are as follows:

	2006	2005
Chequing and demand savings accounts	$ 134,155,000	$ 130,509,000
Term deposits	143,384,000	127,186,000
Registered plans	83,120,000	75,019,000
	$ 360,659,000	$ 332,714,000

6. EMPLOYEE FUTURE BENEFITS

The Credit Union pays certain post retirement benefits of its retired employees. The Credit Union recognizes these post retirement costs in the period in which the employees render the services. The accrued benefit obligation at September 30, 2006 of $2,841,900 (2005 - $3,258,400) and the net periodic benefit cost for the year ending September 30, 2006 was determined by actuarial valuation using a discount rate of 5.0% (2005 - 5.5%).

Information about the Credit Union's defined benefit plans is as follows:

	2006	2005
Accrued benefit obligation		
Balance at the beginning of the period	$ 3,258,400	$ 2,918,300
Service cost for the period	127,800	193,000
Interest cost for the period	136,000	170,000
Benefits cost for the period	(27,500)	(22,900)
Actuarial gain recognized in the period	(652,800)	–
Projected accrued benefit obligation at the end of the period as determined by actuarial valuation	2,841,900	3,258,400
Unamortized transitional obligation	(1,268,600)	(1,526,700)
Unamortized actuarial gain	609,200	–
Accrued liability	$ 2,182,500	$ 1,731,700
Components of net periodic benefit cost		
Service cost for the period	$ 127,800	$ 193,000
Interest cost for the period	136,000	170,000
Amortization of transitional obligation	258,000	258,000
Amortization of actuarial gain	(43,600)	–
Net periodic benefit cost	$ 478,200	$ 621,000

The main actuarial assumptions employed for the valuations are as follows:

General Inflation (CPI rate)	2.1%
Interest (discount) rate	5.0%

Medical costs were assumed to increase at the CPI rate plus a further increase of 6.9% in 2006, then graded down by one percentage point each year until reaching the CPI rate plus 2.9% in 2010 and thereafter.

Dental costs were assumed to increase at the CPI rate plus 2.9% in 2006 and thereafter.

7. COMMITMENTS

a) Credit Facilities

The Credit Union has authorized line of credit and term loan facilities with Credit Union Central of Ontario totalling $59,100,000. Security given is an assignment of loans receivable and a general security agreement covering all assets of the Credit Union.

b) Loan Commitments

At September 30, 2006, the Credit Union is committed to advance approximately $2,789,000 on mortgage loans and $6,741,000 on commercial loans. In addition, lines of credit which had been approved but not used at year-end totalled approximately $42,231,000.

c) Lease Agreements

The Credit Union has entered into lease agreements for branch offices, with minimum future payments in each of the next five years as follows: 2007 - $642,492; 2008 - $639,947; 2009 - $641,585, 2010 - $622,116; 2011 – $529,465 and $3,075,605 in the aggregate.

d) Index-Linked Term Deposit Hedge Contract

The Credit Union has outstanding $777,000 (2005 - $996,400) in Index-Linked Term Deposits to its members. The Index-Linked Term Deposits are three and five year deposits that pay interest at the end of the term, based on the performance of a variety of indices. The Credit Union has entered into hedge agreements with Credit Union Central of Ontario to offset the exposure to the indices associated with this product, whereby the Credit Union pays a fixed rate of interest annually for the term of each Index-Linked Term Deposit on the face value of the deposits sold. At the end of the term, the Credit Union receives an amount equal to the amount that will be paid to the depositors, based on the performance of the indices.

e) Contingencies

The nature of the Credit Union's activities are such that there is usually litigation pending or in progress at any time. With respect to claims at September 30, 2006 management believes the Credit Union has valid defences and appropriate insurance coverages in place. In the event any claims are successful, management believes that such claims are not expected to have a material effect on the Credit Union's financial position.

8. CAPITAL ADEQUACY

The Credit Unions and Caisses Populaires Act, 1994, requires the Credit Union to maintain adequate regulatory capital, consisting of membership shares, any other class of qualifying share capital that may be issued and retained earnings. Adequate capital is defined as 5.0% of total assets and 8.0% of risk-weighted assets. At September 30, 2006, the Credit Union is in compliance with the Act and regulations, with regulatory capital of $30,679,287, or 7.71% of total assets and 14.43% of risk-weighted assets.

9. RESTRICTED PARTY TRANSACTIONS

The Credit Union has enacted a policy requiring disclosure and Board approval of all restricted party transactions. Restricted parties have been defined in the policy to include anyone who is, or has been within the preceding twelve months, a Director or Officer of the Credit Union, their spouse or relatives residing within the same house. The Credit Unions and Caisses Populaires Act, 1994, provides a broader definition of restricted parties which includes all relatives of Directors and Officers. There was one loan advanced to restricted parties as defined by policy during the year, and there are 23 loans outstanding to such parties with an aggregate value of $1,143,148 at September 30, 2006.

10. OTHER STATUTORY INFORMATION

Pursuant to the requirements of the Credit Unions and Caisses Populaires Act, 1994, the following information is provided:

	2006	2005
Director remuneration in the year	$ 33,600	$ 32,100
Deposit insurance premium paid in the year	$ 263,565	$ 235,920

11. OTHER EXPENSES

	2006	2005
Other supplies and postage	$ 312,764	$ 325,302
Equipment costs	178,006	149,574
Central dues & regulatory assessments	104,560	112,882
Amortization of member files	166,417	166,417
Amortization of deferred charges	22,610	42,012
Savings and loan life insurance	62,039	57,345
Education and staff development	238,997	168,403
Bonding insurance	62,968	52,020
Professional services	134,328	74,242
Collection costs	52,356	58,257
Telephone	101,150	102,214
Miscellaneous	97,231	76,311
Central annual meeting	8,144	6,792
	$ 1,541,570	$ 1,391,771

12. SHARE CAPITAL

The Credit Union is authorized to issue an unlimited number of Membership shares with an issue price of $5 each. As a condition of membership, each member is required to hold $25 in membership shares. These shares are redeemable at cost only when membership is withdrawn, subject to certain statutory restrictions.

The Credit Union is authorized to issue an unlimited number of Class A shares, in series, with rights, privileges, restrictions and conditions to be determined by the Board of Directors, subject to statutory restrictions. The Credit Union has issued and outstanding 12,670,779 Non-Cumulative, Non-Voting, Non-Participating, Class A Series 1 Special Shares (Class A Investment Shares). The Class A Series 1 shares pay dividends at the discretion of the Board of Directors in the form of cash or additional shares. These shares are redeemable at the sole and absolute discretion of the Board of Directors and are subject to a maximum of 10% of the shares outstanding at the end of the previous fiscal year. The Credit Union has the option to redeem 7,675,391 of these shares in whole or in part at any time, and to redeem the remaining 4,995,388 shares in whole or in part after March 31, 2009.

The Credit Union is authorized to issue an unlimited number of Non-Cumulative Redeemable Non-Voting Non-Participating Class B Patronage shares. The Class B shares pay dividends at the discretion of the Board of Directors in the form of cash or additional shares. These shares are redeemable at the sole and absolute discretion of the Board of Directors, when a membership is withdrawn and subject to a maximum of 10% of the shares outstanding at the end of the previous fiscal year.

13. CASH FLOW STATEMENT

The following amounts are included in the cash provided by operations:

	2006	2005
Cash paid for interest	$ 7,102,084	$ 7,415,186
Cash paid for income taxes	$ 956,916	$ 592,980

14. SEGMENT DISCLOSURES

The Credit Union operates in the loans and deposit-taking industry in Central Ontario and, based on the Credit Union's internal management reporting structure, only has one operating segment. Products and services offered to its members include personal and commercial loans, lines of credit and mortgages, chequing and savings accounts, registered and non-registered term deposits, registered retirement income funds, mutual funds and financial planning services.

15. DERIVATIVE INSTRUMENTS

The Credit Union enters from time to time into Interest Rate Swap contracts with Credit Union Central of Ontario to hedge the Credit Union's exposure to interest rate risks. The Credit Union does not hold or issue derivative financial instruments for trading or speculative purposes and controls are in place to prevent and detect these activities.

As at September 30, 2006 the Credit Union is not party to any Interest Rate Swap contracts.

Subsequent to year end the Credit Union entered into Interest Rate Swap contracts for a total of $60,000,000 of notional principal whereby it has agreed to pay at variable interest rates based on Bankers' Acceptance rates for 30 days and receive at fixed interest rates. These swap contracts, entered into on October 6, 2006, have fixed interest rates ranging from 4.15% to 4.27% and will mature from June 6, 2007 to March 6, 2008. The agreements are secured by a general security agreement covering all assets of the Credit Union.

16. SUBSEQUENT EVENT

On October 25, 2006, the Board of Directors of the Credit Union passed a resolution to declare a dividend of 7% on the Class A Investment Shares, payable to the shareholders of record at September 30, 2006. The amount of the dividend will be $886,955, with a corresponding tax saving of $185,000.

17. MORTGAGE SECURITIZATIONS

During the year Kawartha Credit Union securitized residential mortgages of $30,964,581 (2005 - $9,813,708). The Credit Union retains mortgage servicing responsibilities but does not receive an explicit servicing fee for its servicing responsibilities. The Credit Union's retained interest in the mortgages transferred consists of two elements. The first is the Credit Union's right to future cash flows arising from any excess of the mortgage cash flows over and above the contractual return due to Central. The second component of the retained interest is the credit enhancement provided to Central in the form of a cash collateral account.

Central, as holder of the securitized mortgages, has recourse only to the cash collateral account and cash flow from the securitized mortgages, they have no recourse to the Credit Union's other assets.

The total amount of securitized mortgages under administration as at September 30, 2006 was $38,629,380 (2005 – $9,774,897)

The following table summarizes the Credit Union's securitization activity for the period ended September 30.

	2006	2005
Net cash proceeds received	$ 30,584,888	$ 9,731,809
Excess spread and cash collateral account	880,764	440,464
Servicing liability	288,728	95,078

The key economic assumptions used in measuring the fair value of retained interests at the date of securitization were as follows:

	2006	2005
Prepayment rate	8%	0%
Weighted-average life	4.5years	4.6years
Expected annual credit losses	–	–
Residual cash flow discount rate	5.042%	4.955%

At year end the key economic assumptions and the sensitivity of the current fair value of residual cash flows of two different adverse changes in those assumptions are shown below:

	2006	2005
Carrying value of retained interests	$ 480,471	$ 369,992
Weighted-average life	3.975 years	4.6 years
Prepayment rate assumption	8%	0%
Impact of a 10% prepayment	$ (9,000)	$ (3,800)
Impact of a 20% prepayment	$ (23,000)	$ (11,400)
Residual cash flow discount rate	4.912%	4.955%
Impact of a 1% point adverse change	$ (9,000)	$ (9,000)
Impact of a 2% point adverse change	$ (18,000)	$ (17,000)

These sensitivities are hypothetical and should be used with caution. Changes in fair value based on a variation of assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of retained interests is calculated without changing any other assumption; generally, changes in one factor may result in changes in another, which may magnify or counteract the sensitivities.

18. INCOME TAXES

The effects of temporary differences, which give rise to the future income tax assets reported in other assets on the balance sheet, are as follows:

	2006	2005
Employee future benefits	$ 453,264	$ 322,440
Allowance for impaired loans	259,461	239,765
Capital assets	99,817	70,378
Other	4,561	(8,667)
	$ 817,103	**$ 623,916**

The provision for income taxes differs from the result which would be obtained by applying the combined Canadian Federal and Provincial Statutory income tax rates to income before income taxes. This difference results from the following items:

	2006	2005
Income before income taxes	$ 4,385,789	$ 3,982,080
Statutory income tax rate	36.12%	36.12%
Small business deduction	(15.35)%	(17.50)%
Effective income tax rate	20.77%	18.62%
Expected income tax expense	910,928	741,460
Change in tax expense resulting from:		
Non-deductible expenses and other reconciling items	(18,928)	64,540
Income tax expense	**$ 892,000**	**$ 806,000**

The income tax expense consists of the following:

	2006	2005
Current provision	$ 1,085,000	$ 890,000
Future provision	(193,000)	(84,000)
	$ 892,000	**$ 806,000**

kawartha
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