ANNUAL REPORT 2007

A SOLID FOUNDATION FOR GROWTH

kawartha CREDIT UNION

www.kawarthacu.com

BRACEBRIDGE • BURK'S FALLS • BANCROFT • COBOURG • COE HILL • EMSDALE

HUNTSVILLE • KINMOUNT • KEENE • LINDSAY • LITTLE BRITAIN

MAGNETAWAN • PARRY SOUND • PETERBOROUGH • SOUTH RIVER • TRENTON

kawartha CREDIT UNION

KAWARTHA CREDIT UNION MANAGEMENT TEAM

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Cover photo by David Rattle

REPORT TO THE MEMBERS

This year's annual report theme is *A Solid Foundation for Growth* because 2007 has seen the completion of a number of initiatives aimed at laying a solid base for the future of Kawartha – a future of continued profitable growth.

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

FINANCIAL RESULTS

In 2002, your Board and Management set an ambitious goal to double the asset size of your credit union: to reach $500 million in assets by September 30, 2007. We set that goal because we firmly believed that growth was essential to ensure the continuing success of our company. We are thrilled to announce that we met that goal in July, 2007 and ended the year with $516 million in assets under management. We are very proud of our success in reaching this goal, and we hope you will share our sense of achievement and celebration.

In 2007, assets under management grew by $71 million or 15% – right on our long-term target. Balance sheet assets grew by $77 million or 19%, led by excellent consumer and commercial lending results, the details of which are on page 6. We also achieved improved deposit growth of $46 million or 13%, thanks to the introduction of a new deposit product. Capital grew by $3.7 million or 12%, primarily due to continuing strong profitability. Net income of $4.4 million or 1.0% of average assets was up 27% over 2006 and ahead of budget. This provided a return on average equity of 13.3%, consistent with our target range of 13% – 16% and supported the payment of a 7% dividend on Class A Investment Shares totalling $887,000. Once again, Kawartha maintained its healthy financial position with regulatory capital of 7.1% and liquidity of 12.9% at year end, both well in excess of statutory requirements and providing a solid foundation for continuing financial growth.

MEMBER SERVICE

During 2007 we continued to invest in a number of upgrades to improve member service. We completed construction of the new Huntsville branch with the grand opening in March. Kawartha has been well-received in Huntsville, where membership more than doubled last year. We expanded the Lansdowne Place branch to add two more offices and welcomed an Investment Manager to the branch to augment our investment counselling services. We had no sooner completed the expansion when a mishap related to the Mall renovation resulted in extensive water damage. We want to take this opportunity to thank the Lansdowne members for their patience with some reduced services during the restoration work, and to thank the Lansdowne staff for not only putting up with less than ideal working conditions but maintaining their composure and focus on member service. We added an office to the Cobourg branch and added an Investment Specialist to help with our investment counselling services in Cobourg. We completed two renovations at the Monaghan Road branch, creating a new space for the Commercial Services and Marketing Departments, and we added two more offices within the branch to improve member service in investments and estate services. Behind the scenes, we implemented a number of upgrades to our technology to improve member service. We completed the full connection to the Exchange network, providing our members with access to over 2,100 ATMs across the country for surcharge-free withdrawals and deposits. This network of ATMs is on the same scale as those owned by the chartered banks. We also revamped our website providing not only a fresh new look but a simpler, easier to

REPORT TO THE MEMBERS (continued)

navigate layout and added features such as online loan applications, email money transfers, and additional bill payment options via Kawartha Direct online banking.

In addition to Huntsville, we added three new branches this year. In March, we welcomed the members of Mariposa Community Credit Union (MCCU) to Kawartha when we acquired the Little Britain and Kinmount branches. MCCU had run into difficulty and we were proud to help by ensuring continued financial services in those two communities. We are pleased to report that both branches are growing, having almost doubled in size within six months of joining Kawartha. In September, we welcomed the members of Peterborough Industrial Credit Union to Kawartha, following their overwhelming support for a merger with Kawartha. We have retained the branch inside the Peterborough Quaker Plant and extended the hours to better accommodate member needs. Further improvements are being planned.

All of these changes have added capacity and services, laying a solid foundation for growth in member service.

Cheque Presentation – Dragon Boat Festival

GOVERNANCE

In early 2007, your Board of Directors reviewed the governance sections of Kawartha's by-laws, policies, and practices. This review was undertaken because of increasing governance demands by regulators, pending legislative changes and difficulty in attracting qualified candidates for Board positions. At our Special General Meeting in August, members approved by-law changes which raise the qualifications required of Directors, introduced a requirement to complete a Board approved training program, and enhanced the profile and responsibilities of the Nominating Committee in order to attract a sufficient number of qualified candidates. Policy changes included specifying a training program with a time limit for completion, and new terms of reference for the Nominating Committee. We believe that these changes, in conjunction with the revised credit union legislation, provide a solid governance foundation for the credit union as it continues to grow.

Ongoing lobbying efforts within the credit union system finally produced some results in the form of improvements in our legislation. Key changes include the introduction of Class 1 and Class 2 credit unions, with simplified rules for the smaller Class 1 units and greater flexibility in the capital, lending, and interest rate risk rules for the larger Class 2 credit unions. Important provisions still to be dealt with include prudent person liquidity rules, and new regulations on permitted business activities and subsidiary ownership. There is still room for improvement in Ontario credit union legislation in order to put us on a level playing field with credit unions in other provinces, but these changes represent a start.

SUPPORTING OUR COMMUNITIES

Kawartha has a proud tradition of giving back to the communities we serve. We support causes that matter most to our members, including hospitals, health-care programs, youth, education, and the environment. In 2007, we invested $94,200 in the regions that encompass our 19 branches through donations to charitable and non-profit organizations. In 2008, we will continue to support important causes in our communities with $100,000 in charitable contributions.

As part of our Community Involvement 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.

Senior Management Team – Left to Right: *Crystal Dayman, Jennifer Mowry, Julian Sellers, Louise Coleman, Stuart Forsyth, Rob Wellstood, Laurianne Gruzas, Wanda Byrne.*

We institute a formal process of evaluating applications for donations which involves approval at three levels of our company. Applications are considered using a variety of criteria, and we make every effort to ensure that the causes we support address the unique needs of each community. The percentage of funding given is determined by the number of members we serve in each area, assuring fair distribution of funds across all our communities.

Contributing to the strength of our communities is part of laying a solid foundation. We are committed to our communities and their quality of life.

2008 AND BEYOND

Consolidation within the credit union system continues and we expect the pace to accelerate in the coming years, resulting in fewer but larger credit unions. It has spread to the second tier with the proposed merger of the Ontario and British Columbia Centrals scheduled to close at the end of the year and the hope that other provincial Centrals will follow. This consolidation is driven by the need for greater scale and efficiency to serve the larger credit unions. The creation of national credit unions or co-operative banks is being openly promoted and we believe it is only a matter of time before they become a reality. The baby boom generation has begun to retire, and this will have significant implications for credit unions in terms of the needs of both the membership and the workforce in the future. We will need to be flexible to meet these needs, while at the same time facing a loss of key knowledge and skills as long term employees retire. Technological advances promise new products and services with greater potential for self-service in all aspects of the business, but these advances come with a substantial cost. Products on the immediate horizon include debit cards with imbedded computer chips, wireless access via cell phones, and other electronic devices. The competition continues to raise the bar in terms of price and delivery channels and even service. In addition, the entry of large retailers into the financial services sector is well documented in the press.

This leads us to the inescapable conclusion that we need greater financial resources to afford the technology and human resources required for us to meet and beat the competition. We need scale to remain relevant in a consolidated credit union system, and we need economies of scale to remain profitable in a more competitive industry. While we are proud of our accomplishments over the past five years, they simply lay a foundation for future growth. To remain a preferred choice for our members, we must continue to grow and acquire resources. The real challenge for the future is to continue to grow rapidly without losing sight of what is important – our purpose and our values – which set Kawartha apart from our competitors.

On behalf of the Board and Management team, we want to thank all Kawartha staff for their dedication to service excellence. Through their efforts, we have built a solid foundation for the future. We also want to thank our members for rewarding us with your support and loyalty. We will continue to do our best to earn your trust and your business.

Respectfully,

Carl J. Silvestri

Carl Silvestri
Chair of the Board

Robert Wellstood
Chief Executive Officer

CREDIT STATISTICS

Total applications for credit	**7579**		
Rejected requests	**1067**		
Accounts in arrears greater than 90 days	**162**	**$**	**2,719,674**

APPROVED CREDIT

Consumer Loans	2246	$	29,247,464
Consumer Lines of Credit	1939		34,944,350
Consumer Overdraft Agreements	235		115,750
Residential Mortgages	550		73,242,694
Commercial Loans	14		336,530
Commercial Lines of Credit	50		2,528,000
Commercial Overdraft Agreements	11		12,200
Commercial Mortgages	53		23,421,980
Total Approved Credit	**5098**	**$**	**163,848,968**

COMMERCIAL DEVELOPMENT

COMMERCIAL LOANS BY TYPE OF BUSINESS

Type of Business	# of Loans		Disbursed
Agriculture, Forestry, Fishing & Hunting	3	$	13,540
Construction	16		2,160,500
Manufacturing	3		155,480
Retail Trade	19		965,204
Transportation & Warehousing	6		385,319
Finance & Insurance	1		20,000
Real Estate – Rental & Leasing	30		6,517,295
Professional Services	3		370,000
Administrative, Support, Waste Management	2		6,000
Health Care & Social Assistance	1		171,154
Arts, Entertainment & Recreation	14		4,350,318
Accomodation & Food Services	21		9,928,750
Other Services	8		1,005,150
Public Administration	1		250,000
TOTAL	**128**	**$**	**26,298,710**

COMMERCIAL LOANS BY SIZE

Size			
Less than $25,000	51	$	466,692
$25,000 to $99,999	25		1,134,255
$100,000 to $499,999	35		7,942,057
over $500,000	17		16,755,706
TOTAL	**128**	**$**	**26,298,710**

AUDITORS' REPORT

To the Members
Kawartha Credit Union Limited

We have audited the balance sheet of Kawartha Credit Union Limited as at September 30, 2007 and the statements of income, comprehensive income, members equity 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 misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Credit Union as at September 30, 2007 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, Licensed Public Accountant

Peterborough, Ontario
October 30, 2007

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 2007 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 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, Committee Chair
Committee: Janice James, Lloyd Churchill, Robert George, Ken Stickle

BALANCE SHEET

At September 30

		2007		2006
Assets				
Cash resources (Note 1b)	$	22,906,217	$	19,164,149
Liquidity deposits (Note 1b)		32,595,365		19,773,566
Loans to members (Note 3a)		415,881,468		357,133,998
Investments (Note 4)		2,576,618		2,390,388
Other assets		3,494,417		2,732,872
Capital assets (Note 5)		5,856,043		4,912,905
Derivative financial instruments (Note 16)		112,993		–
	$	**483,423,121**	**$**	**406,107,878**
Liabilities				
Term loans (Note 8a)	$	35,000,000	$	8,500,000
Members' deposits (Note 6a)		407,841,166		361,596,748
Accounts payable and accrued liabilities		5,154,898		4,514,739
Derivative financial instruments (Note 16)		260,490		–
		448,256,554		**374,611,487**
Members' Equity				
Class A investment shares (Note 13)		12,494,685		12,494,685
Membership shares (Note 13)		820,023		755,663
Contributed surplus		169,301		169,301
Retained earnings		21,800,556		18,076,742
Accumulated other comprehensive income		(117,998)		–
		35,166,567		31,496,391
	$	**483,423,121**	**$**	**406,107,878**

Approved by the Board:

Director

Director

The accompanying notes are an integral part of these financial statements

STATEMENT OF INCOME

For the year ended September 30

	2007	2006
Financial Revenue		
Interest on loans to members (Note 3c)	$ 25,171,028	$ 21,992,801
Investment income	1,190,748	929,333
	26,361,776	22,922,134
Financial Expense		
Interest on deposits (Note 6b)	10,012,158	8,375,532
Interest on borrowings (Note 8a)	1,087,320	726,969
	11,099,478	9,102,501
Financial Margin	15,262,298	13,819,633
Other Income	4,103,703	3,606,017
	19,366,001	17,425,650
Operating Expenses		
Salaries and employee benefits	7,078,729	6,149,220
Loan loss expense (Note 3d)	695,992	386,091
Occupancy	1,659,047	1,324,952
Banking costs	571,448	519,515
Other expenses (Note 12)	1,689,597	1,541,570
Data costs	841,933	796,892
Deposit insurance	280,675	263,565
Promotion	720,159	805,382
Directors' expenses (Note 11)	61,650	54,126
	13,599,230	11,841,313
Operating Income	5,766,771	5,584,337
Other Items		
Write down of investments (Note 4)	–	242,548
Vault cash program (recovery) loss	(104,000)	956,000
	(104,000)	1,198,548
Income before income taxes	5,870,771	4,385,789
Income tax expense (Note 19)	1,445,000	892,000
Net Income	**$ 4,425,771**	**$ 3,493,789**

The accompanying notes are an integral part of these financial statements

CASH FLOW STATEMENT

For the year ended September 30

	2007	2006
Cash Provided by Operations (Note 14)		
Net Income	$ 4,425,771	$ 3,493,789
Adjustments to Cash Basis of Accounting		
Amortization of Capital Assets	928,511	808,070
Changes in Liquidity Deposits	(12,821,799)	(4,098,567)
Changes in Other Assets	(761,545)	(1,050,721)
Changes in Accounts Payable	640,159	1,727,037
Changes in Allowance for Loan Losses	302,286	47,391
Tax Effect Related to Derivative Financial Instruments	29,499	–
Gain on Mortgage Securitization	–	(79,706)
Write Down of Investments	–	242,548
	(7,257,118)	1,089,841
Cash Provided by (Advanced to) Members		
Increase (Decrease) in Members' Deposits	46,244,418	27,553,720
Increase (Decrease) in Shares	64,360	(6,330)
Dividends Paid to Members	(701,957)	(721,957)
(Increase) Decrease in Loans to Members	(59,049,758)	(48,927,221)
	(13,442,937)	(22,101,788)
Financing Activities		
Term Loans Advanced (Repaid)	26,500,000	(3,500,000)
Proceeds of Mortgage Securitization	–	30,584,888
	26,500,000	27,084,888
Investment Activities		
Purchases of Fixed Assets (net of disposals)	(1,871,647)	(1,087,505)
(Increase) in Investments	(186,230)	(293,446)
	(2,057,877)	(1,380,951)
Increase in Cash Resources During the Year	3,742,068	4,691,990
Cash Resources – Beginning of the Year	19,164,149	14,472,159
Cash Resources – End of the Year	**$ 22,906,217**	**$ 19,164,149**

The accompanying notes are an integral part of these financial statements

STATEMENT OF MEMBERS' EQUITY

For the year ended September 30

		2007		2006
Class A Investment Shares				
Opening Balance	$	12,494,685	$	12,494,685
Net change during the year		–		–
Ending Balance		12,494,685		12,494,685
Membership Shares				
Opening Balance		755,663		761,993
Net change during the year		64,360		(6,330)
Ending Balance		820,023		755,663
Contributed Surplus				
Opening Balance		169,301		169,301
Net change during the year		–		–
Ending Balance		169,301		169,301
Retained Earnings				
Opening Balance		18,076,742		15,304,910
Add: Net Income		4,425,771		3,493,789
		22,502,513		18,798,699
Less: Dividends Paid, Net of Tax Savings				
Class A Investment Shares		886,957		886,957
Related Tax Savings		(185,000)		(165,000)
Ending Balance		21,800,556		18,076,742
Accumulated Other Comprehensive Income				
Opening Balance		–		–
Cumulative effect of adopting new accounting policies		–		–
Other Comprehensive Income		(117,998)		–
Ending Balance		(117,998)		–
Total Equity	**$**	**35,166,567**	**$**	**31,496,391**

STATEMENT OF COMPREHENSIVE INCOME

For the year ended September 30

		2007		2006
Net Income (Page 10)	$	4,425,771	$	3,493,789
Other Comprehensive Income				
Gains (Losses) on Financial Derivatives Designated as Cash Flow Hedges		(147,497)		–
Related Tax Effect		29,499		–
		(117,998)		–
Comprehensive Income	**$**	**4,307,773**	**$**	**–**

The accompanying notes are an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS At September 30, 2007

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 and Liquidity Deposits
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. Carrying value of investments approximates market value. Investments mature within one year and provide a yield of 4.40%. 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, 2007.

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 $281,231 (2006 - $239,695).

The Credit Union also provides health and dental benefits for 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 as at 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) Use of estimates
The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's best estimates as additional information becomes available in the future.

2. NEW ACCOUNTING POLICIES

On October 1, 2006, Kawartha Credit Union adopted the new standards of the Canadian Institute of Chartered Accountants (CICA) entitled "Financial Instruments – Recognition and Measurement" (Section 3855), "Hedges" (Section 3865) and "Comprehensive Income" (Section 1530). The main requirements of these standards are set out below.

a) Financial Instruments - Recognition and Measurement
Financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition. Financial assets purchased and sold, where the contract requires the asset to be delivered within an established time frame, are recognized on a trade-date basis. Transaction costs are recognized immediately in income or are capitalized, depending upon the nature of the transaction and the associated product.

Held for trading financial instruments continue to be recorded on the balance sheet at fair value with the change in fair value being reported in income under "Other income" for the period. Under Section 3855, any financial asset or liability whose fair value can be readily measured may be classified, on initial recognition or on adoption of this standard, as being held for trading. This designation is then irrevocable. Electing to classify financial instruments as held for trading under the fair value option is subject to the requirements set by the Deposit Insurance Corporation of Ontario. Kawartha Credit Union has classified it's cash resources, securitization assets, accounts payable and derivative financial instruments as held for trading.

Available for sale financial instruments continue to be recorded on the balance sheet at fair value unless they are not quoted on an active market. These are recorded at cost. The change in fair value is reported in other comprehensive income until they are derecognized. Kawartha Credit Union has classified its investments as available for sale. As these investments are not quoted on an active market they are carried at cost on the balance sheet.

Financial instruments that have a fixed maturity date, where the Credit Union intends and has the ability to hold to maturity, are classified as held to maturity and are accounted for at amortized cost using the effective interest rate method. Kawartha Credit Union has classified its liquidity deposits as held to maturity.

Loans and receivables and other liabilities are accounted for at amortized cost using the effective interest rate method. Kawartha Credit Union has classified its loans to members as loans and receivables and it's term loans and members' deposits as other liabilities.

The valuation techniques used to determine the fair value of financial instruments have remained the same despite the adoption of these new accounting standards. Thus fair value is based on the market price when an active market exists. Otherwise, it is estimated using valuation methods and techniques such as discounted cash flow analysis or option pricing models, based on observable market factors.

b) Derivative Financial Instruments and Hedges
Derivative financial instruments, including embedded derivatives which are required to be accounted for separately, are recorded on the balance sheet at fair value. Derivatives forming part of a hedging relationship can be designated as part of a fair value hedge or a cash flow hedge. In a fair value hedge, the hedging instrument and the impact of the designated risk on the hedged item are measured at fair value. When such changes in fair value are not completely offset, the resulting gain or loss is recognized under other income. For a cash flow hedge, gains or losses resulting from changes in the fair value of the effective portion of the derivative instrument will be recorded in other comprehensive income until the hedged item is recognized in income, at which time such change is recognized under interest income. The ineffective portion will be recognized immediately in income under other income. For derivative financial instruments that are not part of a hedging relationship, changes in fair value are recognized under other income.

Note 16 to the financial statements for the year ending September 30, 2007 describes the Credit Union's derivative financial instruments including those eligible for hedge accounting and the risk management policy relative to derivative financial instruments.

c) Comprehensive Income
Other comprehensive income includes, in particular, unrealized gains and losses on available-for-sale financial assets and the change in the effective portion of a cash flow hedge transaction. The financial statements include a Statement of Comprehensive Income and Accumulated Other Comprehensive Income is presented as a new equity item on the balance sheet.

d) Impact of the Adoption of the New Financial Instrument Requirements
The adoption of these new accounting standards has not resulted in any significant change in the risk management policies and hedging activities at Kawartha Credit Union. Moreover, as provided in the transitional provisions, the financial statements for prior periods were not restated following the adoption of these new standards.

3. LOANS TO MEMBERS

a) Summary

	2007	2006
Personal loans	$ 118,040,808	$ 110,524,798
Residential mortgages	212,644,458	178,390,178
Commercial loans	86,625,604	69,464,614
	417,310,870	358,379,590
Accrued interest receivable	699,990	581,514
	418,010,860	358,961,104
Allowance for impaired loans	(2,129,392)	(1,827,106)
Net loans to members	**$ 415,881,468**	**$ 357,133,998**

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, 2007 is 6.25% 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:

	2007	2006
Personal loans	$ 117,945,000	$ 110,730,000
Residential mortgages	209,801,000	176,175,000
Commercial loans	86,302,000	69,985,000
	$ 414,048,000	**$ 356,890,000**

c) Interest Income

	2007	2006
Personal loans	$ 9,085,716	$ 7,777,411
Residential mortgages	10,342,521	9,438,013
Commercial loans	5,742,791	4,777,377
	$ 25,171,028	**$ 21,992,801**

Personal loans are comprised of term loans, which account for 55% of the portfolio, and lines of credit which account for the remaining 45% 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, 2007:

	Principal	Yield
Variable rate loans	$ 121,136,407	8.07%
Fixed rate loans with maturities within one year	46,322,471	6.09%
Fixed rate loans with maturities beyond one year	249,851,992	6.19%
	$ 417,310,870	

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

	Personal Loans	Residential Mortgages	Commercial Loans	Total
2007				
Opening	$ 1,014,964	$ 209,263	$ 602,879	$ 1,827,106
Recoveries	40,859	–	–	40,859
Loan loss expense	579,611	3,722	112,659	695,992
	1,635,434	212,985	715,538	$ 2,563,957
Write-offs	(426,753)	–	(7,812)	(434,565)
Ending	**$ 1,208,681**	**$ 212,985**	**$ 707,726**	**$ 2,129,392**
Principal balance of impaired loans	**$ 963,351**	**$ 1,431,338**	**$ 324,985**	**$ 2,719,674**
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**

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 $1,335,000 (2006 – $1,185,000). At September 30, 2007, there were no formally restructured loans outstanding (2006 - none).

4. INVESTMENTS

	2007	2006
Credit Union Central of Ontario, Membership	$ 2,559,061	$ 2,372,828
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
CU-Connection Limited, Class A Preference shares	–	1
CU-Connection Limited, Class B Preference shares	–	1
	$ 2,576,618	**$ 2,390,388**

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 2007 amounted to $99,000 (2006 - $84,368). 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.

Cu-Connection Limited ceased operations in 2007 and their residual value was written-off.

5. CAPITAL ASSETS

	2007 Cost	2007 Accumulated Amortization	2006 Cost	2006 Accumulated Amortization
Land and parking lot	$ 1,156,962	$ 48,770	$ 1,156,962	$ 48,635
Building	3,566,511	1,717,267	3,402,611	1,527,129
Equipment	5,370,808	4,107,390	4,632,903	3,708,947
Leasehold improvements	1,908,371	636,458	1,019,092	468,183
Member files	1,368,860	1,005,584	1,287,403	833,172
	$13,371,512	**$ 7,515,469**	**$11,498,971**	**$ 6,586,066**
Net book value		**$ 5,856,043**		**$ 4,912,905**
Amortization expense		**$ 928,511**		**$ 808,070**

6. MEMBERS' DEPOSITS

a)

	2007	2006
Chequing accounts	$ 101,658,203	$ 98,293,011
Demand savings accounts	36,900,538	35,861,724
Term deposits	174,718,460	139,748,441
Registered savings plans	68,690,971	62,763,518
Registered retirement income funds	18,000,852	18,274,643
Accrued interest on member deposits	7,872,142	6,655,411
	$ 407,841,166	**$ 361,596,748**

b) Interest on Deposits

	2007	2006
Chequing accounts	$ 554,387	$ 581,970
Demand savings accounts	261,789	281,851
Term deposits	6,077,208	4,731,935
Registered savings plans	2,435,457	2,177,931
Registered retirement income funds	683,317	601,845
	$ 10,012,158	**$ 8,375,532**

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 73% of the portfolio (2006- 74%).

Registered savings plans consist of fixed rate deposits which account for 97% (2006 - 96%) of the portfolio and variable rate deposits which comprise the remaining 3% (2006 - 4%) of the portfolio. Deposits which are callable by the depositor account for 65% of the portfolio (2006 - 65%), with the remaining 35% (2006 - 35%) 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, 2007:

	Principal	Yield
Variable rate deposits due on demand	$ 140,427,418	0.69%
Fixed rate deposits with maturities within one year	128,512,407	3.74%
Fixed rate deposits with maturities beyond one year	130,523,487	4.01%
	$ 399,463,312	

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:

	2007	2006
Chequing and demand savings accounts	$ 138,559,000	$ 134,155,000
Term deposits	180,919,000	143,384,000
Registered plans	90,495,000	83,120,000
	$ 409,973,000	**$ 360,659,000**

7. 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, 2007 of $2,892,200 (2006 - $2,841,900) and the net periodic benefit cost for the year ending September 30, 2007 was determined by actuarial valuation using a discount rate of 5.0% (2006 - 5.0%).

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

	2007	2006
Accrued benefit obligation		
Balance at the beginning of the period	$ 2,841,900	$ 3,258,400
Service cost for the period	94,400	127,800
Interest cost for the period	130,300	136,000
Benefits cost for the period	(29,100)	(27,500)
Actuarial gain recognized in the period	(145,300)	(652,800)
Projected accrued benefit obligation at the end of the period as determined by actuarial valuation	2,892,200	2,841,900
Unamortized transitional obligation	(1,010,500)	(1,268,600)
Unamortized actuarial gain	663,100	609,200
Accrued liability	**$ 2,544,800**	**$ 2,182,500**
Components of net periodic benefit cost		
Service cost for the period	$ 94,400	$ 127,800
Interest cost for the period	130,300	136,000
Amortization of transitional obligation	258,200	258,000
Amortization of actuarial gain	(91,400)	(43,600)
Net periodic benefit cost	**$ 391,500**	**$ 478,200**

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 5.9% in 2007, 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 2007 and thereafter.

8. COMMITMENTS

a) Credit Facilities

The Credit Union has authorized line of credit and term loan facilities with Credit Union Central of Ontario totalling $41,750,000. Outstanding term loans bear interest at 5.45% - 5.65%, and the authorized line of credit bears interest at prime. 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, 2007, the Credit Union is committed to advance approximately $3,024,047 on mortgage loans and $7,603,554 on commercial loans. In addition, lines of credit which had been approved but not used at year-end totalled approximately $49,756,160.

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: 2008 – $708,539; 2009 – $700,354; 2010 – $682,197, 2011 – $600,014; 2012 – $551,109 and $3,242,213 in the aggregate.

d) Contingencies

The nature of the Credit Union's activities are such that there is usually litigation pending or in progress at any time. There were no claims at September 30, 2007.

9. 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 4.5% of total assets and 8.0% of risk-weighted assets. At September 30, 2007, the Credit Union is in compliance with the Act and regulations, with regulatory capital of $34,598,153, or 7.14% of total assets and 14.22% of risk-weighted assets.

10. 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 were 3 loans advanced to restricted parties as defined by policy during the year, and there are 32 loans outstanding to such parties with an aggregate value of $1,264,923 at September 30, 2007.

11. OTHER STATUTORY INFORMATION

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

	2007	2006
Director remuneration in the year	$ 47,200	$ 33,600
Deposit insurance premium paid in the year	$ 280,675	$ 263,565

12. OTHER EXPENSES

	2007	2006
Other supplies and postage	$ 327,064	$ 312,764
Equipment costs	254,010	178,006
Central dues & regulatory assessments	114,306	104,560
Amortization of member files	172,412	166,417
Amortization of deferred charges	–	22,610
Savings and loan life insurance	74,702	62,039
Education and staff development	275,096	238,997
Bonding insurance	82,621	62,968
Professional services	135,523	134,328
Collection costs	53,213	52,356
Telephone	76,412	101,150
Miscellaneous	113,752	97,231
Central annual meeting	10,486	8,144
	$ 1,689,597	**$ 1,541,570**

13. 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.

14. CASH FLOW STATEMENT

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

	2007	2006
Cash paid for interest	$ 8,795,427	$ 7,102,084
Cash paid for income taxes	$ 943,424	$ 956,916

15. 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.

16. DERIVATIVE FINANCIAL INSTRUMENTS

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.

The Credit Union has outstanding $240,000 (2006 - $777,000) 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.

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. As at September 30, 2007 the Credit Union had entered into Interest Rate Swap contracts for a total of $40,000,000 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 have fixed interest rates ranging from 4.25% to 4.27% and will mature from January 9, 2008 to March 6, 2008. The agreements are secured by a general security agreement covering all assets of the Credit Union.

17. SUBSEQUENT EVENT

On October 24, 2007, 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, 2007. The amount of the dividend will be $886,955, with a corresponding tax saving of $260,000.

NOTES TO THE FINANCIAL STATEMENTS

18. MORTGAGE SECURITIZATIONS

During the year Kawartha Credit Union securitized residential mortgages of $nil (2006 - $30,964,581). 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, 2007 was $33,532,637 (2006 – $38,629,380)

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

	2007	2006
Net cash proceeds received	$ –	$ 30,584,888
Excess spread and cash collateral account	–	880,764
Servicing liability	–	288,728

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

	2007	2006
Prepayment rate	– %	8%
Weighted-average life	0.0years	4.5years
Expected annual credit losses	–	–
Residual cash flow discount rate	0.000%	5.042%

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:

	2007	2006
Carrying value of retained interests	$ 331,551	$ 480,471
Weighted-average life	2.75 years	3.975 years
Prepayment rate assumption	8%	8%
Impact of a 10% prepayment	$ (5,000)	$ (9,000)
Impact of a 20% prepayment	$ (11,000)	$ (23,000)
Residual cash flow discount rate	5.096%	4.912%
Impact of a 1% point adverse change	$ (3,000)	$ (9,000)
Impact of a 2% point adverse change	$ (9,000)	$ (18,000)

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.

19. 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:

	2007	2006
Employee future benefits	$ 746,000	$ 453,000
Allowance for impaired loans	415,000	259,000
Capital assets	144,000	100,000
Other	40,000	5,000
	$ 1,345,000	**$ 817,000**

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:

	2007	2006
Income before income taxes	$ 5,870,771	$ 4,385,789
Statutory income tax rate	36.12%	36.12%
Expected income tax expense	2,120,522	1,584,147
Increase (decrease) in taxes resulting from:		
Available credit union small business deduction	(756,377)	(1,026,460)
General tax reduction unavailable	216,108	293,274
Non-deductible expenses and other reconciling items	(135,253)	41,039
Income tax expense	**$ 1,445,000**	**$ 892,000**

The income tax expense consists of the following:

	2007	2006
Current provision	$ 1,973,000	$ 1,085,000
Future provision	(528,000)	(193,000)
	$ 1,445,000	**$ 892,000**

20. ACQUISITIONS

a) Mariposa Community Credit Union
On February 28, 2007 Kawartha Credit Union assumed select liabilities of Mariposa Community Credit Union totalling $6,557,047. In return Kawartha Credit Union received select assets of Mariposa Community Credit Union with an agreed upon fair value of $5,792,318 and the remaining $764,729 in cash.

b) Peterborough Industrial Credit Union
On September 14, 2007 Kawartha Credit Union assumed all liabilities of Peterborough Industrial Credit Union totalling $4,326,279. In return Kawartha Credit Union received all assets of Peterborough Industrial Credit Union with an agreed upon fair value of $4,624,139.

21. COMPARATIVE FIGURES

The comparative amounts presented in the financial statements have been restated to conform to the current year's presentation.

KAWARTHA CREDIT UNION
STAFF RECOGNITION AWARDS

	2003	2004	2005	2006	2007
BRANCH AWARDS					
Highest Overall Growth %	Burk's Falls	Cobourg	Emsdale	Huntsville	Huntsville
Highest Overall Growth $	Monaghan	Lansdowne	Lansdowne	Trenton	Monaghan
100% Club	Cobourg	South River	Emsdale	South River	Kinmount
INDIVIDUAL AWARDS					
Manager of the Year	Steve Self	Therese Touchette	Cathy Martin	Connie White	Dana Farrell
Extra Mile Award	Terri Maher	Kathy Warner	Shirley Davis	Eon Dalzell	Janice Barber Francine Currie
Glen Davies Award	Judy Emery	Susan Maloney	Donna Fuller	Janice O'Neill	Steve Olmstead