PHOTOS: COBOURG, ONTARIO

kawartha CREDIT UNION

www.kawarthacu.com

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kawartha CREDIT UNION

ANNUAL REPORT 2009

Staying the course

kawartha
CREDIT UNION

ANNUAL REPORT 2009

Victoria Hall, Cobourg Ontario

Management Team

Board of Directors and Senior Management Team

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REPORT TO THE MEMBERS

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

When setting our plans for 2009 we knew the economic conditions were going to be challenging, with the probability of recession quite high. However, after a careful review of the situation, the Board and management made a decision to take a relatively optimistic approach to managing through what we expected to be a difficult business environment. In other words, we would stay the course as much as prudently possible in pursuit of our goal: to reach $1 billion in assets by September 30, 2012 by staying true to our values and our purpose.

Some of the implications of that decision were that we would not enact layoffs or salary freezes to control expenses and we would continue supporting our members and communities through expanded lending and an enhanced Community Involvement Program. We set more modest growth targets and forecast reduced profitability compared to previous years.

Quite candidly, as the year unfolded it became clear we had underestimated the depth of the recession and resultant shocks to the business. Which is why we are particularly pleased to report that within this context Kawartha Credit Union had a successful year in 2009, exceeding our reduced growth and profitability objectives. Through the balance of this report we will detail the highlights of the financial results and other significant accomplishments and provide our view of the year ahead.

MEMBER SERVICE EXCELLENCE

During July and August, a comprehensive telephone survey of our membership was completed. We contracted a firm specializing in this type of work to survey a representative sample of our members including a broad cross-section by age, gender and home branch, excluding commercial members and those under eighteen years of age. Key findings included the assessment that *"Kawartha is doing an outstanding job in delivering excellent member service, and has a satisfied member base that is willing to recommend Kawartha to others, and to consider it for their own future financial needs."*

While the report includes an overall satisfaction score of 94% and indicates that 86% of members surveyed are likely to recommend Kawartha, it also provides information on several areas where there is room for improvement. Our commitment is to focus not only on maintaining the high member satisfaction score but more importantly to develop strategies to improve in those areas identified by our members. Now that we have a baseline measurement, we will take action to improve and continue surveying our members to measure our progress.

During 2009 we distributed $1.37 million in Affinity Shares to our members as a reward for doing business with Kawartha and paid $86,000 in dividends at the rate of 6% on Affinity shares previously issued. It is our intent that this will be an ongoing program with distributions to members every year, subject to financial constraints. The more business a member does with Kawartha, the more shares they receive.

During 2009 we continued to invest in a number of facilities upgrades to improve member service. After a lengthy review of our options we expanded and completely reconfigured our

REPORT TO THE MEMBERS (continued)

Bancroft branch, as the business had outgrown our previous facility. Special thanks are owed to the Bancroft members and staff alike for their patience while we renovated the branch around them. Additionally, in response to member feedback, we renovated our Kinmount branch, including a new ATM creatively located inside this smaller branch. We also installed a new ATM in our branch in Little Britain.

PEOPLE

During May and June, our 220 employees completed the Best Small and Medium Employers in Canada survey for the third time, with over 98% participation. This is a national survey sponsored by Queen's University School of Business, Hewitt Associates and the Globe & Mail. While the relative rankings of the participating companies will not be announced until early 2010, we have received a report on Kawartha's employee engagement, noting the overall score has increased to 84% from 81% in 2007. We attribute this improvement to a number of initiatives introduced since the last survey - including medical and dental benefits for part-time employees and the creation of an Employee Wellness Program. In the past year we promoted thirty-six employees while another twenty-seven participated in temporary short term transfers to different positions as part of our employee development initiatives. We also had three directors graduate from the Credit Union Directors Achievement program, a national credit union director accreditation program.

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

FINANCIAL RESULTS

Interest rates were the story of the year for Kawartha. The rapid and significant decline in rates that started in fiscal 2008 continued in the first half of fiscal 2009 impacting Kawartha in several ways. From a lending perspective, the historically low mortgage rates caused considerable refinancing activity and lured first-time home buyers into the market, resulting in a record volume of mortgages being granted, as noted in our credit statistics on page 6. From a deposit perspective, the low rates caused depositors to prefer short term or redeemable deposits as they were unwilling to lock in for longer terms at low rates, resulting in interest rate risk management challenges. From a profitability perspective, it should be noted that deposit rates did not fall to the same extent as loan rates, causing a reduction of the financial margin. As a result, Kawartha made the difficult decision to hold its Prime lending rate at 4.0% while others continued to drop their prime rates as low as 2.25%. We did this to maintain an acceptable level of profitability in order to ensure the financial stability of the credit union. Many others who continued to reduce their prime rates engaged in other tactics as well, including increasing the spread over prime, resulting in the final rate charged to borrowers being close to our lending rates.

In 2009, total assets under management grew by $62 million or 11% to end the year at $642 million. Balance sheet assets grew by $76 million or 14%, higher than the total because we repurchased $20 million of previously securitized mortgages. As noted above, the low interest rates created loan demand, resulting in personal loans and lines of credit increasing by $4.5 million or 4% and residential mortgages increasing by $49 million or 23% on the balance sheet. The portfolio of securitized mortgages declined by $14.3 million due to the repurchase noted above. We had another record year in commercial lending, with growth of $35 million or 31%, continuing to shift our asset mix in the desired direction. Deposit growth of $44 million or 9% was above plan but well below our loan growth, resulting in new borrowings from Central of $29 million and a draw down of liquidity. Capital grew by $3.3 million or 8%, primarily due to earnings. In 2009 Kawartha distributed $1.37 million in Affinity shares to members, based on the volume of business done with the credit union, bringing the total outstanding to $2.8 million.

Net income of $3.4 million or 0.61% of average assets was down 10% from 2008 but exceeded budget by $798,000. This provided a return on average equity of 8.5%, below our target range of 13% - 16% but supported payment of a 7% dividend on Class A Investment Shares totalling $887,000 and a 6% dividend on Class B Affinity Shares totalling $168,000. Once again, Kawartha maintained its healthy financial position with regulatory capital of 7.0% on a leverage basis or 12.4% on a risk adjusted basis and liquidity of 10.8% at year end, both well in excess of statutory and Board policy requirements.

LOOKING AHEAD

Current indications are that the recession may have come to an end, though the general view is that we have a slow recovery ahead of us. Consequently, we have set what we believe are conservative growth plans for 2010 along with improved profitability expectations. We have a number of significant projects planned for the coming year, largely driven by technology advances. We are in the process of selecting a new computer system for the credit union; something which will be a major expenditure and undertaking, but which we expect will produce efficiencies and improved member service as well as position the company solidly for the future. We are also in the midst of planning to replace our debit cards with Chip cards in order to reduce fraud losses and enhance member security and thus member service. We are currently piloting mobile banking; accessing account information via text messaging and expect to launch that product in early 2010. October 1st marked the enactment of some fairly significant changes to our governing legislation. Consequently we will be bringing recommendations for by-law amendments to the membership, as well as considering how we can take advantage of the new legislation to improve the business.

In closing, our encouraging member survey results remind us that our best source of new business is word of mouth. If you like what we do, please recommend Kawartha to your friends and family. Together, we can create an even stronger credit union where we can all be a part of something special.

On behalf of the Board and Management team, our sincere thanks to our tremendously dedicated employees for your efforts to make Kawartha successful through your commitment to member service excellence. Your hard work has helped us to navigate a challenging year with positive results. We also want to thank our members for rewarding us with your support. We will continue to do our best to earn your trust and your business.

Respectfully,

Robert Wellstood	**Ken Stickle**
Chief Executive Officer	*Chair of the Board*

CREDIT STATISTICS

Total applications for consumer and commercial credit	6,916		
Total declined requests for consumer and commercial credit	1,190		
Accounts in arrears greater than 90 days	171	$	3,149,153

APPROVED CREDIT

Consumer Loans	1,821	$	26,960,130
Consumer Lines of Credit	1,670		38,344,050
Consumer Overdraft Agreements	222		125,250
Residential Mortgages	723		104,723,089
Commercial Mortgages	73		45,792,848
Agricultural Mortgages	2		525,000
Commercial Loans	8		281,248
Agricultural Loans	1		50,000
Commercial Lines of Credit	32		1,586,705
Commercial Overdrafts	5		6,000
Total Approved Credit	**4,557**	**$**	**218,394,320**

COMMERCIAL DEVELOPMENT 2009

COMMERCIAL LOANS BY TYPE OF BUSINESS

Type of Business	# of Loans		Disbursed
Agriculture, Forestry, Fishing & Hunting	4	$	640,000
Construction	9		976,001
Manufacturing	5		204,256
Wholesale Trade	2		666,739
Retail Trade	19		7,222,936
Transportation & Warehousing	2		270,000
Real Estate - Rental & Leasing	20		19,173,722
Professional Services	2		30,000
Management of Companies & Enterprises	1		406,250
Administrative, Support, Waste Management	1		1,000
Education Services	4		152,750
Health Care & Social Assistance	4		2,998,023
Arts, Entertainment & Recreation	4		1.820,000
Accomodation & Food Services	16		9,808,501
Other Services	14		2,036,000
Public Administration	1		50,000
TOTAL	**108**	**$**	**46,456,178**

COMMERCIAL LOANS BY SIZE

Size			
Less than $25,000	20	$	220,780
$25,000 to $99,999	21		1,242,654
$100,000 to $499,999	35		7,792,924
over $500,000	32		37,199,820
TOTAL	**108**	**$**	**46,456,178**

2009 COMMUNITY INVOLVEMENT PROGRAM

Caring is at the heart of Kawartha Credit Union and giving back through our Community Involvement Program binds us to our roots. Our commitment to building strong communities and financially independent members is part of our difference – it's what we mean when we say "join us and be part of something special."

As a socially responsible company, we make significant and positive contributions to the communities we serve. For Kawartha Credit Union, "giving back" includes economic benefits resulting from our day-to-day operations, support for community initiatives, and the volunteer activities of our employees who freely donate their time and talents. We support causes that matter most to our members, including hospitals, health-care programs, youth, education, community development, and the environment. Our community investments, whether in the form of corporate donations or staff participation, make a difference. In 2009, we donated $125,000 (roughly 3% of our our pre-tax earnings) to important causes in the regions that encompass our 19 branches.

EMPLOYEE INVOLVEMENT

Our generous and enthusiastic employees lend important contributions to a variety of organizations, campaigns and events. They build strong community relationships and this year they participated in almost 90 independent initiatives – above and beyond those we support through our corporate Community Involvement Program. We are extremely proud of our employees and their good works.

Kawartha Credit Union's Community Involvement Program supported the following initiatives in 2009:

- Junior Achievement
- City of Kawartha Lakes Boys & Girls Club
- Kawartha Haliburton Childrens' Foundation
- Learning Disabilities Association
- Quinte Childrens' Foundation
- Food For Kids, Peterborough
- City of Kawartha Lakes Food For Kids
- North Hastings High School Breakfast Program
- Food For Learning, Hastings/Prince Edward County
- Northumberland Food For Thought
- Bracebridge Arts Council
- 4th Line Theatre Workshops
- Burk's Falls Community Centre
- Risk Watch

YOUTH AND EDUCATION

Education plays a key role in nurturing the potential of today's youth, and in enhancing their personal fulfillment.

West Parry Sound Health Centre Foundation – Debbie McMurray (right), Parry Sound Branch Manager, presents a $5,000 cheque to Lynne Atkinson, Executive Director for the Foundation.

Northumberland Food for Thought – L to R: Dana Farrell, Cobourg Branch Manager, and Rita Reynolds, Cobourg Assistant Branch Manager, present a $1,000 cheque to Kimberly Leadbeater, Public Health Dietitian and Susan Greenwood, County Nutrition Coordinator.

Cobourg Relay for Life

HEALTHCARE

Kawartha Credit Union strives to benefit the greatest number of people in the communities we serve by supporting local health centers and broader health concerns.

- Peterborough Dragon Boat Festival (Platinum Sponsor)
- Parry Sound Cardiac "Do It For Life" Walk
- Huntsville District Memorial Hospital Foundation
- Burk's Falls & District Health Centre (Miles for Coins)
- Northumberland Hills Hospital Foundation
- Trenton Memorial Hospital Foundation
- South Muskoka Hospital Foundation
- North Hastings Hospital Foundation
- Peterborough Regional Health Centre
- Ross Memorial Hospital (Lindsay)
- West Parry Sound Health Centre
- Peterborough Aids Resource Network (P.A.R.N.)
- Hospice North Hastings
- Victoria's Quilts

COMMUNITY SUPPORT AND DEVELOPMENT

From festivals to the arts, from shelters to community centers, our contributions help to strengthen the infrastructures that support sustainability and independence.

- Peterborough YMCA
- Peterborough & Victoria County YWCA/Crossroads Shelter
- Kawartha Lakes Food Source
- Victoria Womens' Resources Services
- Northumberland Services For Women
- Womens' Own Resource Centre (South River)
- Esprit Place Family Resource Centre (Parry Sound)
- Homegrown Homes (Peterborough)
- Chrysalis Womens' Shelter (Huntsville)
- Maggie's Resource Centre (Bancroft)
- North Hastings Community Trust
- Keene Pumpkin Festival
- Festival of the Sound

ENVIRONMENT

Educating children about environmental sustainability helps them to take an active and knowledgeable role in protecting and preserving their future.

- Peterborough Childrens' Water Festival
- Haliburton/Muskoka Water Festival

In addition to the organizations mentioned here, Kawartha Credit Union contributes funds and gifts-in-kind to a variety of community-based causes that result in the most positive community advantage.

YMCA – Crystal Dayman (right), V.P. Marketing & Corporate Communications, presents a $5,000 cheque to Bob Gallagher, CEO of the YMCA of Peterborough and Mary Carolyn Hart, YMCA Board Chair.

Peterborough Dragon Boat Festival

Ted On The Road – Kawartha Credit Union CEO Rob Wellstood (left) presents a cheque to Ted "Ted On The Road" Dawes and Sue Amsbury, Tour Manager, to support Ted's walk from Ottawa to Toronto to raise funds for leukemia research.

AUDITORS' REPORT

To the Members
Kawartha Credit Union Limited

We have audited the balance sheet of Kawartha Credit Union Limited as at September 30, 2009 and the statements of income, cash flows, members' equity and comprehensive income 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, 2009 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 Accountants

Peterborough, Ontario
October 26, 2009

REPORT FROM THE AUDIT COMMITTEE

The Audit Committee's function is to assist the Board of Directors fulfill its oversight responsibilities. It does this 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 six directors and has 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 in force as at September 30, 2009.

The Audit Committee met five times during the 2009 fiscal year to complete its responsibilities. Key activities included:

- Review the financial statements and 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; and
- Review risk management issues.

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: Lloyd Churchill, Robert George, Harvey Spry, Carl Silvestri, Janice James, Earl Robbins

BALANCE SHEET

At September 30

	2009	2008
Assets		
Cash resources (Note 1b)	$ 19,289,813	$ 33,900,361
Liquidity deposits	39,812,779	35,822,871
Loans to members (Note 3a)	527,619,879	439,500,630
Investments (Note 4)	6,068,813	7,351,765
Other assets	4,257,273	4,046,618
Capital assets (Note 5)	5,366,775	5,537,266
Derivative financial instruments (Note 16)	16,869	27,318
	$ 602,432,201	**$ 526,186,829**
Liabilities		
Term loans (Note 8a)	$ 29,000,000	$ -
Members' deposits (Note 6a)	526,269,022	482,245,925
Accounts payable and accrued liabilities	5,146,013	5,276,439
Derivative financial instruments (Note 16)	99,577	459
	560,514,612	**487,522,823**
Members' Equity		
Class A Investment shares (Note 13)	12,494,685	12,494,685
Class B Affinity shares (Note 13)	2,797,335	1,438,014
Membership shares (Note 13)	836,930	825,453
Contributed surplus	181,468	169,301
Retained earnings	25,625,985	24,065,094
Accumulated other comprehensive income	(18,814)	(328,541)
	41,917,589	38,664,006
	$ 602,432,201	**$ 526,186,829**

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

		2009		2008
Financial Revenue				
Interest on loans to members (Note 3c)	$	27,354,204	$	27,324,121
Investment income		2,439,404		1,584,941
		29,793,608		28,909,062
Financial Expense				
Interest on deposits (Note 6b)		13,799,270		13,040,882
Interest on borrowings		74,263		903,606
		13,873,533		13,944,488
Financial Margin		15,920,075		14,964,574
Other Income		5,809,865		5,422,169
		21,729,940		20,386,743
Operating Expenses				
Salaries and employee benefits		8,729,511		8,100,922
Loan loss expense (Note 3d)		1,149,614		937,485
Occupancy		1,830,664		1,744,967
Banking costs		562,065		544,797
Other expenses (Note 12)		2,158,226		1,864,899
Data costs		965,144		915,216
Deposit insurance		359,031		294,663
Promotion		1,090,615		852,530
Directors' expenses		106,912		109,755
		16,951,782		15,365,234
Operating Income		4,778,158		5,021,509
Other Items				
Write down of investments (Note 4)		625,557		100,000
Vault cash program (recovery) loss		(113,600)		(43,000)
		511,957		57,000
Income before income taxes		4,266,201		4,964,509
Income tax expense (Note 20)		835,000		1,170,000
Net Income	**$**	**3,431,201**	**$**	**3,794,509**

The accompanying notes are an integral part of these financial statements

STATEMENT OF CASH FLOWS

For the year ended September 30

		2009		2008
Cash Provided by Operations (Note 14)				
Net income	$	3,431,201	$	3,794,509
Adjustments to cash basis of accounting				
Amortization of capital assets		1,021,831		997,047
Changes in liquidity deposits		(3,989,908)		(3,227,506)
Changes in other assets		(210,655)		(540,752)
Changes in derivative financial instruments		69,293		(34,899)
Changes in accounts payable		(130,426)		121,541
Changes in allowance for loan losses		593,761		479,975
Net mortgage securitization premium		(142,931)		(138,455)
Write down of investments		625,557		100,000
		1,267,723		1,551,460
Cash Provided by (Advanced to) Members				
Increase in members' deposits		44,023,098		74,404,759
Increase in shares		1,370,798		1,443,444
Dividends paid to members net of tax savings		(758,837)		(626,957)
Class B Affinity share issuance net of tax savings		(1,111,473)		(903,014)
Increase in contributed surplus		12,167		-
(Increase) decrease in loans to members		(87,796,497)		(52,265,078)
		(44,260,744)		22,053,154
Financing Activities				
Term loans advanced (repaid)		29,000,000		(35,000,000)
Proceeds of mortgage securitization		19,332,989		28,292,948
Repurchase of mortgages under securitization		(20,106,570)		-
		28,226,419		(6,707,052)
Investment Activities				
Purchases of capital assets		(851,340)		(678,271)
(Increase) decrease in investments		1,007,394		(5,225,147)
		156,054		(5,903,418)
Increase (decrease) in Cash Resources During the Year		(14,610,548)		10,994,144
Cash Resources - Beginning of the Year		33,900,361		22,906,217
Cash Resources - End of the Year	**$**	**19,289,813**	**$**	**33,900,361**

The accompanying notes are an integral part of these financial statements

STATEMENT OF MEMBERS' EQUITY

For the year ended September 30

	2009	2008
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
Class B Affinity Shares		
Opening balance	1,438,014	-
Net share issuance	1,371,473	1,438,014
Shares forfeited	(12,152)	-
Ending balance	2,797,335	1,438,014
Membership Shares		
Opening balance	825,453	820,023
Net change during the year	11,477	5,430
Ending balance	836,930	825,453
Contributed Surplus		
Opening balance	169,301	169,301
Net change during the year	12,167	-
Ending balance	181,468	169,301
Retained Earnings		
Opening balance	24,065,094	21,800,556
Add: net income	3,431,201	3,794,509
	27,496,295	25,595,065
Less: Class B Affinity share issuance	(1,371,473)	(1,438,014)
Related tax savings	275,000	535,000
Less: Dividends paid to members	(975,837)	(886,957)
Related tax savings	202,000	260,000
Ending balance	25,625,985	24,065,094
Accumulated Other Comprehensive Income		
Opening balance	(328,541)	(117,998)
Other comprehensive income (loss)	309,727	(210,543)
Ending balance	(18,814)	(328,541)
Total Equity	**$ 41,917,589**	**$ 38,664,006**

STATEMENT OF COMPREHENSIVE INCOME

For the year ended September 30

	2009	2008
Net Income (Page 12)	$ 3,431,201	$ 3,794,509
Other Comprehensive Income		
Gains (losses) on financial derivatives designated as cash flow hedges net of tax effect	(40,273)	139,457
Fair value adjustment on the investment in ABCP 2008 Limited Partnership (Note 4)	350,000	(350,000)
	309,727	(210,543)
Comprehensive Income	**$ 3,740,928**	**$ 3,583,966**

The accompanying notes are an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS At September 30, 2009

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 Central 1 Credit Union Limited (Central).

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 Central or are government backed. Carrying value of investments approximates market value. Investments mature within two years and provide a yield of 1.59%.

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
All loan assets are subject to recurring review and assessed for possible impairments. The Credit Union considers evidence of impairment at both a specific loan and a non-specific collective level. The specific portion of the allowance for impaired loans is calculated in accordance with generally accepted accounting principles as interpreted by By-law No. 6 of the Deposit Insurance Corporation of Ontario. The non-specific portion of the allowance is estimated based on historical loan losses incurred along with management's best estimate of future losses.

Loans are written off in the period in which they are identified. If an allowance for impairment has been recognized in relation to a loan, write-offs are made against the allowance. If no allowance for impairment has been previously recognized, write-offs are recognized as an expense in the statement of income.

f) Employee Future Benefits
The Credit Union sponsors a defined contribution pension plan. Contributions to the plan during the year were $356,721 (2008 - $305,830).

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 their services. The cost of employee future benefits earned by employees is actuarially determined using the projected benefit 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, 2008.

g) Mortgage Securitization
The Credit Union occasionally securitizes mortgages by selling them to Central 1 Credit Union Limited. 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.

h) 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.

i) 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. The principal estimates used in the preparation of these financial statements are the determination of the liability for post-retirement benefits, the non-specific allowance for impaired loans, the estimated useful life of capital assets, future tax assets and liabilities and the fair value of the investment in ABCP 2008 Limited Partnership along with all other fair value disclosures. Actual results could differ from management's best estimates as additional information becomes available in the future.

j) 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 for the period. Under Section 3855 of the Canadian Institute of Chartered Accountants accounting standards, any financial asset or liability whose fair value can be readily measured may be classified on initial recognition as being held for trading. This designation is then irrevocable. Kawartha Credit Union has classified its 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, in which case they are recorded at cost. The change in fair value is reported in other comprehensive income until they are derecognized unless it has been determined that an other than temporary decline in fair value exists. Any other than temporary declines in value are reported as a charge to income. Kawartha Credit Union has classified its investments as available for sale.

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 its term loans and members' deposits as other liabilities.

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.

k) Derivative Financial Instruments and Hedges
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 speculative purposes.

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, 2009 describes the Credit Union's derivative financial instruments including those eligible for hedge accounting and the risk management policy relative to derivative financial instruments.

l) 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 which is presented as an equity item on the Balance Sheet.

2. NEW ACCOUNTING PRONOUNCEMENTS

Recent accounting pronouncements that have been issued but are not yet effective, and have a potential implication for the Credit Union, are as follows:

a) International Financial Reporting Standards
The CICA is converging Canadian GAAP with International Financial Reporting Standards ("IFRS") over a transition period which will end in 2011. The impact of the transition to IFRS on the Credit Union's financial statements has yet to be determined.

3. LOANS TO MEMBERS

a) Summary

	2009	2008
Personal loans	$ 124,958,944	$ 120,486,693
Residential mortgages	258,675,785	209,637,944
Commercial loans	146,309,434	111,218,755
	529,944,163	441,343,392
Accrued interest receivable	878,844	766,605
	530,823,007	442,109,997
Allowance for impaired loans	(3,203,128)	(2,609,367)
Net loans to members	**$ 527,619,879**	**$ 439,500,630**

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, 2009 is 4.00% 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:

	2009	2008
Personal loans	$ 124,846,000	$ 120,225,000
Residential mortgages	266,576,000	209,520,000
Commercial loans	148,527,000	109,922,000
	$ 539,949,000	**$ 439,667,000**

The key economic assumptions used in measuring the fair value of member loans at September 30, 2009 were as follows:

	Personal Loans	Residential Mortgages	Commercial Loans
Prepayment rate	11%	5%	6%
Weighted-average term to maturity	1.65 years	2.46 years	2.60 years
Market rate	8.00%	3.75%	6.00%

c) Interest Income

	2009	2008
Personal loans	$ 7,361,499	$ 8,641,290
Residential mortgages	12,488,440	11,794,110
Commercial loans	7,504,265	6,888,721
	$ 27,354,204	**$ 27,324,121**

Personal loans are comprised of term loans, which account for 47% of the portfolio, and lines of credit which account for the remaining 53% of the portfolio. Repayment terms vary with the term length and loan type. Security may include collateral mortgages on real property, lodgment 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 40 years.

Loans to members had the following average yields at September 30, 2009:

	Principal	Yield
Variable rate loans	$ 177,013,431	5.32%
Fixed rate loans with maturities within one year	41,414,702	5.50%
Fixed rate loans with maturities beyond one year	311,516,030	5.77%
	$ 529,944,163	

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

	Personal Loans	Residential Mortgages	Commercial Loans	Total
2009				
Opening	$ 1,560,712	$ 240,081	$ 808,574	$ 2,609,367
Recoveries	50,974	-	-	50,974
Loan loss expense	1,014,840	33,495	101,279	1,149,614
	2,626,526	273,576	909,853	$ 3,809,955
Write-offs	(601,776)	-	(5,051)	(606,827)
Ending	**$ 2,024,750**	**$ 273,576**	**$ 904,802**	**$ 3,203,128**
Principal balance of impaired loans	**$ 2,379,849**	**$ 3,413,359**	**$ 699,752**	**$ 6,492,960**
2008				
Opening	$ 1,208,681	$ 212,985	$ 707,726	$ 2,129,392
Recoveries	49,020	-	-	49,020
Loan loss expense	785,231	28,394	123,860	937,485
	2,042,932	241,379	831,586	3,115,897
Write-offs	(482,220)	(1,298)	(23,012)	(506,530)
Ending	**$ 1,560,712**	**$ 240,081**	**$ 808,574**	**$ 2,609,367**
Principal balance of impaired loans	**$ 1,440,275**	**$ 1,662,121**	**$ 650,074**	**$ 3,752,470**

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 $1,340,000 (2008 – $1,228,000). At September 30, 2009, there were no formally restructured loans outstanding (2008 - none).

4. INVESTMENTS

	2009	2008
Credit Union Central of Ontario, Membership	$ 660,844	$ 4,207,359
Central 1 Credit Union Limited, Membership	3,157,088	101
ABCP 2008 Limited Partnership	2,233,324	3,126,748
Co-operators General Insurance, Class A Series A	12,557	12,557
Credential Securities Inc., Debenture	5,000	5,000
	$ 6,068,813	**$ 7,351,765**

Central 1 Credit Union Limited (Central) purchased substantially all of the assets of Credit Union Central of Ontario (CUCO) as at July 1, 2008. During the year certain CUCO membership shares were exchanged for the required membership shares in Central. CUCO retained certain assets excluded from the sale to Central and received Class E shares in Central as part of the consideration. The disposition of the assets held by CUCO has still to be determined and accordingly the Credit Union continues to hold CUCO membership shares. CUCO's net deficit position as at December 31, 2008 necessitated a write-down of $120,000. Management believes there has been no further impairment in the value of these shares.

The initial membership shares in Central were determined based on the percentage of the Credit Union's assets to the total member credit unions' assets. Central has a policy designed to ensure its capital is sufficient to support its operations and to comply with regulatory requirements. Each year Central rebalances the membership shareholdings based on the proportion of each credit union's assets to the total assets of all Central's member credit unions as reported in their most recent audited financial statements. Dividends on these shares are at the discretion of the Board of Directors of Central. The Credit Union received dividends amounting to 2% of the membership shares in 2009. 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 and accordingly, they are carried at cost. Management believes that there has been no impairment in either of these investments.

As a pre condition of the sale of assets, CUCO was required to divest itself of investments in certain third party asset backed commercial paper (ABCP). In 2008, members of CUCO approved a resolution to create ABCP 2008 Limited Partnership (ABCP LP) to acquire these investments, funded by member credit unions in proportion to their share investment in CUCO. As a result, on June 30, 2008, the excluded ABCP with a total par value of $186,916,000 was acquired by the ABCP LP at its estimated fair value of $133,564,000 including accrued interest, net of expenses, and other assets. As there was no liquid market for these ABCP investments, the fair values used to determine the acquisition price were provided by Edenbrook Hill Capital Ltd., a firm engaged by CUCO to provide an independent valuation of the assets underlying the ABCP investments.

The valuation for each credit union's share of the ABCP LP was provided to them before closing and the Credit Union recorded the investment in ABCP LP units at a fair value of $3,476,748. The ABCP LP is governed by a Board of Directors that was elected by the limited partners and each limited partner will record its appropriate share of net income or loss in the ABCP LP as determined by Canadian generally accepted accounting principals and subject to annual external audit.

Based on information available in 2008, the Credit Union classified the investment as Available for Sale (AFS) and determined that the fair value had suffered a temporary impairment of $350,000 at September 30, 2008, which was recognized by a charge to Other Comprehensive Income. On January 23, 2009, the LP reported that a restructuring of $32 billion of ABCP, including that held by it, had been completed resulting in the LP exchanging 100% of its holdings for new long term notes. On February 10, 2009, the Deposit Insurance Corporation of Ontario issued a directive requiring that all credit unions carry their investment in the LP at a value not to exceed the fair value determined by the LP from time to time and that the decline in fair value of the investment units should be treated as "other than temporary". Accordingly, all changes in value, including that recorded in fiscal 2008, have been charged to income in the current fiscal year and $350,000 has been removed from Accumulated Other Comprehensive Income (AOCI).

During the past year the Credit Union received distributions from the LP of $737,866 which were recorded as a return of the capital invested. At September 30, 2009 the LP provided an estimate of fair value of the investment which indicated a further decline of $155,557, which in combination with the $350,000 removed from AOCI resulted in a total of $505,557 recorded as a charge against income.

Uncertainty remains with respect to the timing and amount of future cash flows on the notes held by the LP that could give rise to a material change in the value of ABCP LP's holdings and thus the value of the units. The Credit Union performed a sensitivity analysis of certain fair value assumptions. Based on a 20% favourable and a 20% unfavourable change in the discount rate, the Credit Union determined that the fair value adjustment could range from approximately $294,000 to $691,000.

5. CAPITAL ASSETS

	2009		2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land and parking lot	$ 1,156,962	$ 49,041	$ 1,156,962	$ 48,905
Building	3,802,809	2,130,791	3,700,363	1,918,777
Equipment	6,339,629	5,007,020	5,818,435	4,541,258
Leasehold improvements	2,217,973	1,007,982	2,005,162	815,964
Member files	1,368,860	1,324,624	1,368,860	1,187,612
	$14,886,233	**$ 9,519,458**	**$14,049,782**	**$ 8,512,516**
Net book value		**$ 5,366,775**		**$ 5,537,266**
Amortization expense		**$ 1,021,831**		**$ 997,047**

6. MEMBERS' DEPOSITS

a)

	2009	2008
Chequing accounts	$ 109,523,735	$ 101,250,173
Demand savings accounts	42,115,807	36,562,135
Term deposits	246,890,677	232,828,373
Registered savings plans	94,304,314	84,692,716
Registered retirement income funds	18,576,936	17,601,314
Tax-free savings accounts	6,073,474	-
Accrued interest on member deposits	8,784,079	9,311,214
	$ 526,269,022	**$ 482,245,925**

b) Interest on Deposits

	2009	2008
Chequing accounts	$ 437,430	$ 547,658
Demand savings accounts	230,031	267,855
Term deposits	8,833,239	8,405,829
Registered savings plans	3,462,068	3,070,293
Registered retirement income funds	736,045	749,247
Tax-free savings accounts	100,457	-
	$ 13,799,270	**$ 13,040,882**

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 67% of the portfolio (2008- 73%).

Registered savings plans consist of fixed rate deposits which account for 98% (2008 - 97%) of the portfolio and variable rate deposits which comprise the remaining 2% (2008 - 3%) of the portfolio. Registered deposits which are callable by the depositor account for 61% of the portfolio (2008 - 62%), with the remaining 39% (2008 - 38%) being fixed for terms up to five years. Tax-free savings accounts and 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, 2009:

	Principal	Yield
Variable rate deposits due on demand	$ 154,193,395	0.43%
Fixed rate deposits with maturities within one year	218,561,925	2.82%
Fixed rate deposits with maturities beyond one year	144,729,623	3.93%
	$ 517,484,943	

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:

	2009	2008
Chequing and demand savings accounts	$ 151,640,000	$ 137,812,000
Term deposits	241,748,000	231,931,000
Registered plans	109,796,000	102,530,000
	$ 503,184,000	**$ 472,273,000**

The key economic assumptions used in measuring the fair value of member deposits at September 30, 2009 were as follows:

	Non Registered Deposits	Registered Deposits
Weighted-average term to maturity	1.18years	1.80years
Market rate	0.75%	0.75%

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, 2009 of $2,600,704 (2008 - $3,130,700) and the net periodic benefit cost for the year ending September 30, 2009 was determined by actuarial valuation using a discount rate of 5.5% (2008 - 5.0%).

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

	2009	2008
Accrued benefit obligation		
Balance at the beginning of the period	$ 3,130,700	$ 2,892,200
Service cost for the period	61,532	120,300
Interest cost for the period	136,141	149,900
Benefits cost for the period	(33,392)	(31,700)
Gain on A.B.O. recognized in the period	(883,757)	-
Past service costs accrued	189,480	-
Projected accrued benefit obligation at the end of the period as determined by actuarial valuation	2,600,704	3,130,700
Unamortized transitional obligation	(494,296)	(752,400)
Unamortized past service cost	(165,795)	-
Unamortized actuarial gain	1,329,443	600,800
Accrued liability	**$ 3,270,056**	**$ 2,979,100**
Components of net periodic benefit cost		
Service cost for the period	$ 61,532	$ 120,300
Interest cost for the period	136,141	149,900
Amortization of transitional obligation	258,104	258,100
Past service cost	23,685	-
Amortization of actuarial gain	(155,114)	(62,300)
Net periodic benefit cost	**$ 324,348**	**$ 466,000**

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

General Inflation (CPI rate) 2.0%
Interest (discount) rate 5.5%

Medical costs were assumed to increase at the CPI rate plus a further increase of 8.0% in 2009, then graded down by one percentage point each year until reaching the CPI rate plus 3.0% in 2014 and thereafter.

Dental costs were assumed to increase at the CPI rate plus 3.0% in 2009 and thereafter.

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

	Increase	Decrease
Total of service and interest cost	$ 45,000	$ (34,000)
Accrued benefit obligation	$ 462,000	$ (361,000)

8. COMMITMENTS

a) Credit Facilities

The Credit Union has authorized line of credit and term loan facilities with Central 1 Credit Union Limited totalling $50,750,000. As of September 30, 2009 the Credit Union had unused credit facilities totalling $21,750,000. 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, 2009, the Credit Union is committed to advance approximately $5,779,784 on mortgage loans and $15,572,847 on commercial loans. In addition, lines of credit which had been approved but not used at year-end totalled approximately $57,748,376.

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: 2010 - $770,063; 2011 - $726,207; 2012 - $676,488, 2013 - $654,526; 2014 - $611,833 and $3,439,117 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, 2009.

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 4.00% of total assets and 8.0% of risk-weighted assets. At September 30, 2009, the Credit Union is in compliance with the Act and regulation.

	2009	2008
Total regulatory capital is composed of Tier 1 and Tier 2 capital as follows:		
Tier 1 Capital		
Class A Investment Shares	$ 12,494,685	$ 12,494,685
Less Redeemable Portion of Class A Shares	(769,000)	(769,000)
Class B Affinity Shares	2,797,335	1,438,014
Membership Shares	836,930	825,453
Contributed Surplus	181,468	169,301
Retained Earnings	25,625,985	24,065,094
Total Tier 1 Capital	41,167,403	38,223,547
Tier 2 Capital		
Redeemable Portion of Class A Shares	769,000	769,000
General Provisions	1,340,000	1,228,000
Other Comprehensive Income	(18,814)	(328,541)
Total Tier 2 Capital	2,090,186	1,668,459
Tier 1 and Tier 2 Capital	43,257,589	39,892,006
Future Income Taxes	(1,106,813)	(1,168,126)
Total Regulatory Capital	**$ 42,150,776**	**$ 38,723,880**

Total assets are adjusted for credit risk, market risk and operational risk factors to come up with the total risk adjusted assets as follows:

Credit Risk	305,837,226	257,416,589
Market Risk	307,500	1,050,000
Operational Risk	34,396,610	32,545,927
	$ 340,541,336	**$ 291,012,516**

The applicable capital ratios are as follows:

Tier 1 Capital to Risk Adjusted Assets	12.09%	13.13%
Total Regulatory Capital to Risk Adjusted Assets	12.38%	13.31%
Total Regulatory Capital to Total Assets	7.00%	7.36%

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 4 loans advanced to restricted parties as defined by policy during the year, and there are 30 loans outstanding to such parties with an aggregate value of $1,342,675 at September 30, 2009.

11. OTHER STATUTORY INFORMATION

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

		2009		2008
Director remuneration in the year	$	76,700	$	75,600
Deposit insurance premium paid in the year	$	359,031	$	294,663

12. OTHER EXPENSES

		2009		2008
Other supplies and postage	$	401,959	$	409,032
Equipment costs		293,925		248,711
Central dues & regulatory assessments		133,252		119,858
Amortization of member files		137,012		182,028
Savings and loan life insurance		82,981		73,779
Education and staff development		496,331		379,498
Bonding insurance		133,637		114,829
Professional services		227,837		95,090
Collection costs		76,790		65,555
Telephone		117,188		102,645
Miscellaneous		49,497		62,064
Central annual meeting		7,817		11,810
	$	**2,158,226**	**$**	**1,864,899**

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 is authorized to issue an unlimited number of Non-Cumulative Redeemable Non-Voting Non-Participating Class B Affinity 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 on a date commencing five years after the issue date, subject to a maximum of 10% of the shares outstanding at the end of the previous fiscal year. On March 26, 2009 the Credit Union issued 1,371,473 Class B Series 2 Affinity Shares.

14. CASH FLOW STATEMENT

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

		2009		2008
Cash paid for interest	$	13,274,273	$	11,555,964
Cash paid for income taxes	$	336,494	$	1,143,436
Cash received for income taxes	$	196,658	$	-

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 speculative purposes and controls are in place to prevent and detect these activities.

The Credit Union enters from time to time into Interest Rate Swap contracts with Central to hedge the Credit Union's exposure to interest rate risks. As at September 30, 2009 the Credit Union had entered into Interest Rate Swap contracts with a total of $40,025,873 of notional principal. The Swap contracts are either pay fixed contracts or receive fixed contracts. In the case of pay fixed contracts the Credit Union pays interest on the notional principal at fixed interest rates and receives interest on the same notional principal at variable interest rates based on Bankers' Acceptance rates. In the case of receive fixed contracts the Credit Union pays interest on the notional principal at a variable rate based on Bankers' Acceptance rates and receives interest on the same notional principal at fixed rates. The relevant terms of these contracts are outlined below:

		Notional Amount	Rates	Maturities
Pay fixed	$	20,025,873	2.30% - 2.90%	2013 - 2014
Receive fixed		20,000,000	2.125%	2011

The pay fixed contracts are related to the mortgage securitization activity described in Note 19.

17. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

The Credit Union is exposed to the following risks as a result of holding financial instruments: credit risk, market risk and liquidity risk. The following is a description of those risks and how the Credit Union manages its exposure to them.

a) Credit Risk

Credit risk is the risk of financial loss to the Credit Union if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Credit Union's member loans.

Risk Measurement

Credit risk rating systems are designed to assess and quantify the risk inherent in credit activities in an accurate and consistent manner. Credit scoring is the primary risk rating system for assessing obligor and transaction risk for retail exposures.

Objectives, Policies, and Processes

The Credit Union's credit risk management principals are guided by its overall risk management principles. The Board of Directors is involved in the management of credit risks. The Board ensures that management has a framework, and policies, processes and procedures in place to manage credit risks and that the overall credit risk policies are complied with at the business and transaction level.

The Credit Union's credit risk policies set out the minimum requirements for management of credit risk in a variety of transactional and portfolio management contexts. The Credit Union's credit risk policies comprise the following:

i) Loan general policy statements including approval of lending policies, eligibility for loans, exceptions to policy, policy violations, liquidity, and loan administration.
ii) Loan lending limits, including schedule of assigned limits.
iii) Loan collateral security classifications which set loan classifications, advance ratios and amortization periods.
iv) Procedures outlining loan overdrafts, release or substitution of collateral, temporary suspension of payments and loans renegotiation.
v) Loan delinquency controls regarding procedures followed for loans in arrears.
vi) Internal controls policy regarding audit procedures for lending activities.

The Credit Union's maximum exposure to credit risk in relation to each class of recognised financial asset is the carrying amount of those assets as indicated on the balance sheet. The maximum credit risk exposure does not take into account the value of any collateral or other security held. The Credit Union's maximum exposure to credit risk related to member loans as at September 30, 2009 was as follows:

	2009
Loans that are not past due	$ 519,214,755
Loans that are past due	
under 30 days	4,713,638
30 to 89 days	2,663,870
90 -179 days	1,609,349
180 - 365 days	608,227
over 365 days	1,134,324
	$ 529,944,163

At a minimum all loans that are over 90 days past due are considered impaired. There are 306 loans with a combined principal of $6,492,960 considered to be impaired. The security shortfall on these loans totalled $1,792,319.

The Credit Union's credit risk policies, processes and methodologies have not changed materially in the past year.

b) Market Risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, equity or commodity prices, and credit spreads. The Credit Union is exposed to market risk in our asset/liability management activities. The level of market risk to which the Credit Union is exposed varies depending on market conditions and expectations of future price and yield movements.

Asset/Liability Management

Traditional banking activities, such as deposit taking and lending, expose the Credit Union to market risk, of which interest rate risk is the largest component. The Credit Union's goal is to manage the interest rate risk within established limits. The Credit Union manages both long term interest rate risk (equity risk) and short term interest rate risk (earnings risk). The Credit Union continually monitors the effectiveness of its interest rate mitigation activity.

Risk Measurement

The Credit Union's risk position is measured monthly. Measurement of risk is based on rates charged to clients as well as funds transfer pricing rates.

Objectives, Policies, and Processes

Management is responsible for managing the Credit Union's interest rate risk, monitoring approved limits and compliance with policies and operating standards. The Credit Union has established policies and related reporting to manage its exposure to fluctuating interest rates (referred to as interest rate risk). Without these policies, the Credit Union's earnings would be impacted, either positively or negatively, as interest rates change.

The Credit Union's major source of income is financial margin, the difference between interest earned on investments and member loans and interest paid on member deposits.

The objective of "interest rate sensitivity" management is to match interest-sensitive assets with interest-sensitive liabilities as to amount and as to term to their interest rate repricing dates, thus minimizing fluctuations of income during periods of changing interest rates.

The following schedule shows the Credit Union's sensitivity to interest rate changes, after including the effect of interest rate swap agreements:

(in thousands)	Assets	Liabilities and Equity	Gap
Maturities			
Current	$ 176,521	$ 150,529	$ 25,992
< 6 months	56,065	165,821	(109,756)
1 year	52,228	89,940	(37,712)
2 years	87,266	61,144	26,122
3 years	74,790	45,278	29,512
4 years	60,274	38,403	21,871
5 years	65,742	32,508	33,234
> 5 years	147	-	147
	573,033	583,623	(10,590)
Non-interest sensitive items	29,399	18,809	10,590
	$ 602,432	**$ 602,432**	**$ -**

Amounts with floating (including adjustable) interest rates, or due on demand, are classified as variable rate products maturing in under one year, regardless of maturity. Amounts that are not interest sensitive are grouped together, regardless of maturity.

A significant amount of loans and deposits can be settled before maturity on payment of a penalty. An adjustment has been made for repayments that may occur prior to maturity based on recent member activity.

As at September 30, 2009, the weighted average rate for interest-bearing assets is 4.88% and for interest-bearing liabilities is 2.47%.

Based on the Credit Union's interest rate positions at September 30, 2009 the following table shows the potential before tax impact of 100 bps increase or decrease in interest rates on the Credit Union's net income.

	2009	2008
100 bp increase	$ 161,000	$ 279,000
100 bp decrease	$ (164,000)	$ (278,000)

The interest rate risk policy has been approved by the board of directors and for the year ended September 30, 2009 the Credit Union was in compliance with the policy.

The Credit Union's overall market risk policies and procedures have not changed materially in the past year.

c) Liquidity Risk

Liquidity risk is the risk that the Credit Union may be unable to generate or obtain sufficient cash or its equivalent in a timely and cost effective manner to meet the Credit Union's commitments as they come due.

Risk Measurement

The assessment of the Credit Union's liquidity position reflects management's estimates, assumptions and judgments pertaining to current and prospective firm-specific and market conditions and the related behaviour of our clients and counterparties.

Objectives, Policies and Processes

The Credit Union's liquidity and funding management framework is designed to ensure that adequate sources of reliable and cost-effective cash or its equivalents are continually available to satisfy its current and prospective financial commitments under normal and contemplated stress conditions.

The Credit Union monitors and manages its liquidity position and considers regulatory, operational and any other applicable restrictions. The Board of Directors is responsible for oversight of its liquidity framework.

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, 2009.

As at September 30, 2009 the position of the Credit Union is as follows:

Qualifying liquid assets on hand	$ 59,072,936
Total liquidity requirement	43,718,796
Excess of liquidity requirement	**$ 15,354,140**

The table below summarizes the contractual maturities of the Credit Union's member deposits and existing loan commitments as at September 30, 2009:

	on demand	less than one year	one to five years
Member deposits (Note 6)	$ 154,193,395	$ 218,561,925	$ 144,729,623
Loan commitments (Note 8)	57,748,376	21,352,631	-
	$ 211,941,771	**$ 239,914,556**	**$ 144,729,623**

There have been no material changes to the Credit Union's liquidity and funding management framework or levels of liquidity and funding risk in the past year.

18. SUBSEQUENT EVENT

On October 28, 2009, 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, 2009. The amount of the dividend will be $886,954, with a corresponding tax saving of $146,500.

On October 28, 2009, the Board of Directors of the Credit Union passed a resolution to declare a dividend of 6% on the Class B Affinity Shares, payable to the shareholders of record at September 30, 2009. The amount of the dividend will be $167,840, with a corresponding tax saving of $27,700.

19. MORTGAGE SECURITIZATIONS

During the year Kawartha Credit Union securitized residential mortgages of $19,274,206 (2008 - $28,154,493). The Credit Union retains mortgage servicing responsibilities but does not receive an explicit servicing fee for its servicing responsibilities.

The total amount of securitized mortgages under administration as at September 30, 2009 was $39,473,218 (2008 – $53,780,165)

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

	2009	2008
Net cash proceeds received	$ 19,332,989	$ 28,292,948
Premium	142,931	262,981

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

	2009	2008
Prepayment rate	8%	10%
Weighted-average term to maturity	4.5years	4.5years
Expected annual credit losses	-	-

At year end the key economic assumptions and the sensitivity of the current fair value of residual cash flows of an adverse change in the prepayment rate assumption is shown below:

	2009	2008
Carrying value of retained interests	$ 1,903,730	$ 1,630,598
Weighted-average term to maturity	3.580 years	3.682 years
Prepayment rate assumption	8%	8%
Impact of a 10% prepayment	$ (112,355)	$ (55,000)
Impact of a 20% prepayment	$ (323,183)	$ (109,000)

The cash flows from securitized mortgages under administration are based on variable rates which are estimated using a swap rate curve. Because a swap rate is being used a sensitivity analysis on an adverse change is not practical to complete.

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.

20. 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:

	2009	2008
Employee future benefits	$ 655,000	$ 655,000
Allowance for impaired loans	252,000	233,000
Capital assets	140,000	133,000
Other	60,000	39,000
	$ 1,107,000	**$ 1,060,000**

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:

	2009	2008
Income before income taxes	$ 4,266,201	$ 4,964,509
Statutory income tax rate	33.13%	34.16%
Expected income tax expense	1,413,392	1,695,876
Increase(decrease) in taxes resulting from:		
Available credit union small business deduction	(1,404,243)	(1,205,613)
General tax reduction unavailable	488,675	387,911
Non-deductible expenses and other reconciling items	337,176	291,826
Income tax expense	**$ 835,000**	**$ 1,170,000**

The income tax expense consists of the following:

	2009	2008
Current provision	$ 880,000	$ 885,000
Future provision	(45,000)	285,000
	$ 835,000	**$ 1,170,000**

KAWARTHA CREDIT UNION
STAFF RECOGNITION AWARDS

	2005	2006	2007	2008	2009
BRANCH AWARDS					
Highest Overall Growth %	Emsdale	Huntsville	Huntsville	Little Britain	Keene
Highest Overall Growth $	Lansdowne	Trenton	Monaghan	Monaghan	Monaghan
100% Club	Emsdale	South River	Kinmount	*No Entry*	*No Entry*
Community Commitment Award				Emsdale	Bancroft
INDIVIDUAL AWARDS					
Manager of the Year	Cathy Martin	Connie White	Dana Farrell	Connie White	Karen Woodman
Extra Mile Award	Shirley Davis	Eon Dalzell	Janice Barber Francine Currie	Carol Davis Linden Gage Lana Koch	Diana Andrews Susie Lodge Bonnie Rickward
Glen Davies Award	Donna Fuller	Janice O'Neill	Steve Olmstead	Kristy Tremblett	Suzanne Shannon