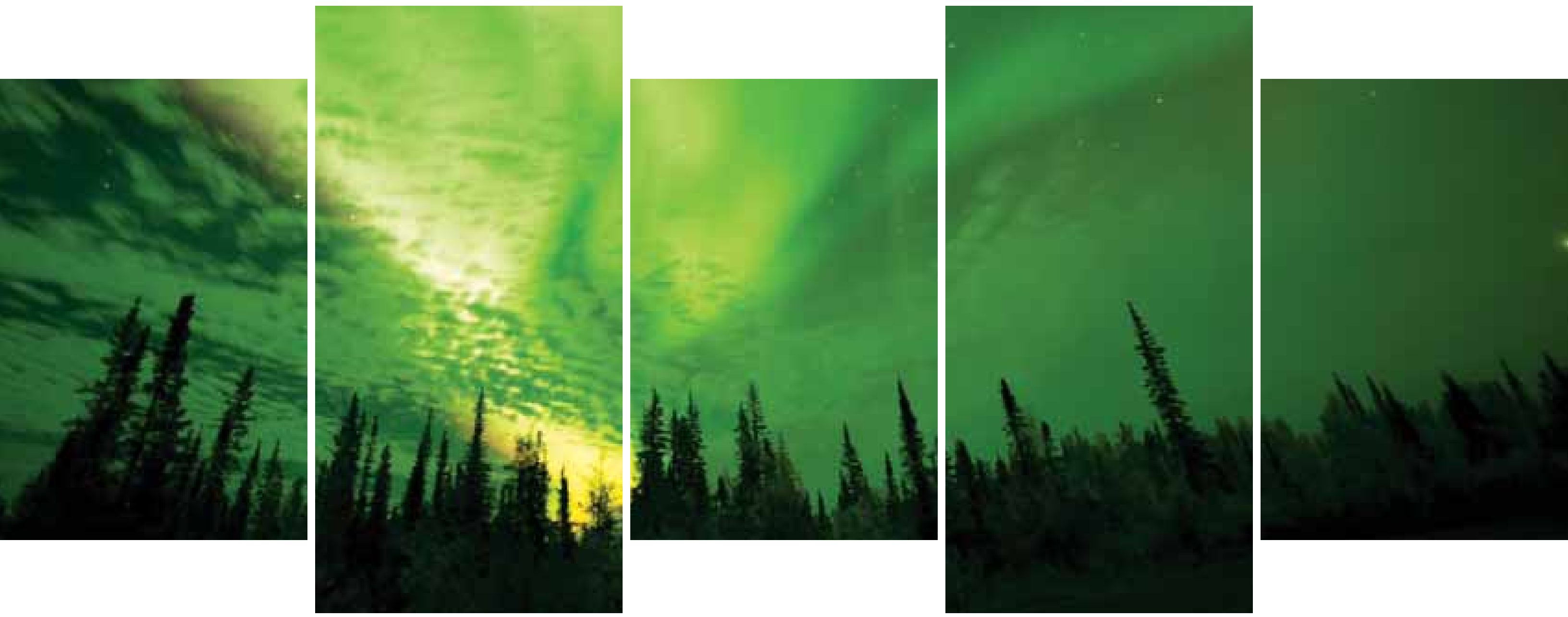
Annual Report 2010

The future looks bright



kawartha
CREDIT UNION

kawartha
CREDIT UNION

Annual Report 2010

Management Team

Board of Directors and Senior Management Team

TABLE OF CONTENTS

REPORT TO THE MEMBERS

The future looks bright for Kawartha Credit Union. We have a clear focus on the important issues and a renewed commitment to the path we have been following. Our financial results improved greatly in 2010, due in part to an improving economy, but also because of actions taken in prior years. The company is financially strong and well positioned for the future. We have a number of exciting initiatives planned for the coming year with several of them already underway.

STRATEGIC DIRECTION

As a result of the annual Strategic Planning process the Board confirmed Kawartha's overarching strategic direction of leveraging above average member and employee engagement to drive superior financial performance. We hope this is welcome news to members and employees alike because it confirms our commitment, as a company, to continuing to improve in these two key areas.

We define member service excellence as making a positive impact on our members' lives by offering the advice, products and services you need, delivered with convenience and traditional Kawartha Credit Union values. This member service excellence will be our primary means of achieving our goals: earning our members' trust and confidence; treating our members with fairness and integrity; having our members feel proud to belong to Kawartha; and ultimately, for our members to feel strongly enough to recommend Kawartha to friends and family.

Kawartha is blessed with a terrific group of employees who are very committed to the company's success. We are focused on using information derived from the Best Small and Medium Employers in Canada survey to enhance that commitment. Each year management uses the feedback received from our employees via this survey to improve as an employer. This continuous improvement process is directed at encouraging all employees to be devoted to the company's success with their hearts and their minds.

We also have strategic goals in the areas of management and brand strength. We are committed to effectively and efficiently managing all aspects of the business and all risks to which the credit union is exposed. Kawartha has a well defined enterprise risk management process and during the past year participated in a working group drawn from the credit union system looking at best practices in this area. We are dedicated to improving the brand recognition and perceptions of Kawartha, not only amongst our members but the population at large in the communities we serve.

We have new key performance indicators for each of these areas by which we will measure the company's progress in meeting our goals. The Board and senior management believe strongly that the events of the past few years have changed the financial services industry and reaffirm our belief that Kawartha Credit Union needs to continue to grow. We believe that this strategic direction will ensure profitable growth that is consistent with our members' best interests.

FINANCIAL RESULTS

As we set our plans for 2010 we expected gradual increases in interest rates would accompany a return to growth in the economy. We expected a slow recovery in the economy would assist us to modest growth and improved profitability. The first half of our fiscal year unfolded mostly as predicted. The Bank of Canada increased the trendsetting Overnight rate three times for a total of 0.75% in response to growth in the economy. However, the second half of the year was marked by volatility in global financial markets brought on by concerns about sovereign debt defaults in some European countries, leading to renewed speculation of a double dip recession. This halted interest rate increases in Canada and led to further quantitative easing in the United States as that country continues its struggle to recover. As a result, longer term interest rates declined again, unemployment remains high and economic growth projections have been reduced. Effective July 1, 2010, the Harmonized Sales Tax (HST) was introduced in Ontario at 13% and while this may prove to be good for tax revenues and consequently the Provincial finances, it has not helped our business.

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

For Kawartha the impacts have been varied and somewhat conflicting. The near-historically low mortgage rates caused

REPORT TO THE MEMBERS (continued)

continued strong mortgage demand early in the year, but the housing market slowed dramatically in the summer, coincident with the introduction of the HST. As volumes declined price competition amongst financial institutions picked up, putting pressure on the profitability of the mortgage business. At the same time, Kawartha temporarily lost the ability to securitize mortgages due to the restructuring of that program by Central 1 Credit Union (Central) in preparation for the pending introduction of International Financial Reporting Standards (IFRS).
This meant we lost a relatively inexpensive source of funds and consequently needed to increase our borrowings from Central. Continuing high unemployment and the volatility in financial markets have combined to keep consumer confidence low, resulting in lower demand for consumer loans and lines of credit as members reduced spending on larger items or concentrated on paying down their debt. We believe the prospect of higher interest rates caused depositors to shift their preference from guaranteed investment certificates (GICs) to lower yielding but less permanent demand deposits. With the shift to an interest rate outlook that sees rates increasing much more slowly, we experienced an increase in demand for GICs in the last half of the year. The net effect for the year was overall good growth in demand deposits, but weaker term deposit growth, resulting in modest deposit growth overall. Our small business members took advantage of the optimism in the first half of the year and low rates to continue borrowing to expand their businesses or refinance to lower costs, but as consumers pulled back in the summer we saw that reflected in commercial lending activity. The result, as noted below, was good growth in the commercial loan portfolios.

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

In 2010, total assets under management grew by $75 million or 12% to end the year at $717 million. Balance sheet assets grew by $64 million or 11% as most growth was on-balance sheet due to our temporary inability to securitize. As noted above, low demand resulted in personal loans and lines of credit increasing by just $4.9 million or 4%. The total residential mortgage portfolio grew by $36 million or 12%, with $25 million or 10% on the balance sheet and $11 million in the pool of securitized mortgages. We had another excellent year in commercial lending, with growth of $28 million or 19% bringing the portfolio to just over 25% of total loan portfolios. This marks the realization of a target we have held for many years. Deposit growth of $33 million or 6% was well below our loan growth again this year, resulting in new borrowings from Central of $24 million. Members' Equity grew by $4.7 million or 11%, primarily due to earnings. 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 10.7% at year end, both well in excess of statutory and Board policy requirements.

From a profitability perspective, continued low interest rates allowed the repricing of term deposits along with the shift to demand deposits and the short term borrowings from Central to reduce our cost of funds, resulting in an improvement in the financial margin and net income.

Net income of $5.4 million or 0.86% of average assets was up 58% from 2009 and exceeded budget by $1.1 million. This provided a return on average equity of 12.3%, close to our target range of 13% - 16% and supported the payment of a 7% dividend on Class A Investment Shares totalling $887,000 and a 6% dividend on Class B Affinity Shares of $225,000, in November, 2010. The improvement in profitability was largely in the financial margin, which benefitted from improvements in deposit costs, as noted above. This was partially offset by lower non-interest revenue, due to lower securitization income, and by higher overheads which were up 10% in support of the growth of the company but below plan by $834,000. Loan loss expenses were down 38% from 2009, reflecting improvements in the economy and fewer bankruptcies.

During fiscal 2010 Kawartha distributed $1.0 million to our members in the form of Affinity Shares, as a reward for doing business with Kawartha, bringing the total outstanding to $3.8 million. Last year we paid $169,000 in dividends at the rate of 6% on Affinity Shares previously issued. This is 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.

Overall, the Board and management are pleased with the financial results of 2010, particularly within the context of the slower than expected economic recovery. Asset growth was slightly lower than our long term target of 15%, but exceeded plan. Profitability returned to pre-recession levels and significantly exceeded plan. Return on equity improved significantly, contributing to a strengthening of our capital level.

ACCOMPLISHMENTS

During the past year twenty-two employees were promoted while another fourteen participated in temporary short term transfers to different positions as part of our employee development initiatives. We had ten employees receive accreditations in their area of expertise and have thirty-six more working towards an accreditation.

We launched mobile banking to our members, giving access to account information using your cell phone. Development of this product continues and we expect to introduce new features within the year, to make your banking more convenient. Agricultural lending commenced in late 2009 and has continued to grow as we develop our reputation in our rural markets. We expanded and renovated our Magnetawan branch, demonstrating our commitment to this small community.

The Board of Directors formed a Governance Committee in 2010. Its mandate is to assist the Board to create, promote, monitor, enhance and approve policies and programs for corporate governance, Board and committee composition and Director education. The Committee has already made a number of recommendations that have been accepted by the Board and has a full schedule for 2011.

LOOKING AHEAD

Current indications are that the Ontario economy will recover slowly, putting downward pressure on growth as our members remain rightly cautious about the future. The interest rate outlook is for continued low rates, with at best modest increases in the second half of 2011. In response, we have tempered our desire for growth with the belief that the market will offer fewer opportunities, and have set conservative growth plans for 2011 along with continued expectations of good profitability.

As noted at the outset of this report, we have a number of major projects under way. While they are enabled by technology advances they are designed with member service excellence in mind. The Board recently approved the establishment of a member contact centre with extended hours to better support members after our branches are closed and with mobile representatives who will visit members. We continue our process of selecting a new computer system for the credit union; a major undertaking which we expect will produce efficiencies and improved member service as well as position the company solidly for the future. We are in the process of replacing our debit cards with Chip cards in order to reduce fraud losses and enhance member security and thus member service. We continue to review our branch network for needed improvements.

In closing, the Board and management are excited about the future of the credit union. Our employees have embraced our member service excellence strategy. Our members have responded by bringing us more business and by referring others to Kawartha. The result has been growth and profitability that is above average for the credit union system. But, we know we can improve and our commitment is to do our best.

On behalf of the Board and management team, we offer our sincere thanks to all our employees for your dedication to Kawartha's success. Through your efforts the company has enjoyed another strong year. To our members, we thank you for your ongoing 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	**5,606**		
Total declined requests for consumer and commercial credit	**1,225**		
Accounts in arrears greater than 90 days	**107**	**$**	**2,590,281**

APPROVED CREDIT

Consumer Loans	1,770	$	25,974,837
Consumer Lines of Credit	1,612		37,796,206
Consumer Overdraft Agreements	217		114,060
Residential Mortgages	631		98,869,095
Commercial Mortgages	88		44,330,037
Agricultural Mortgages	7		3,150,000
Commercial Loans	5		911,533
Agricultural Loans	7		255,027
Commercial Lines of Credit	37		3,523,500
Commercial Overdrafts	7		7,200
Total Approved Credit	**4,381**	**$**	**214,931,495**

COMMERCIAL DEVELOPMENT 2010

COMMERCIAL LOANS BY TYPE OF BUSINESS

Type of Business	# of Loans		Disbursed
Agriculture, Forestry, Fishing & Hunting	23	$	4,806,527
Construction	10		2,180,823
Manufacturing	5		316,563
Wholesale Trade	1		18,000
Retail Trade	12		4,331,992
Transportation & Warehousing	1		1,505,000
Information	1		1,400
Finance and Insurance	2		241,675
Real Estate - Rental & Leasing	25		14,440,569
Professional Services	1		500
Administrative, Support, Waste Management	3		55,000
Education Services	1		60,250
Health Care & Social Assistance	4		2,441,472
Arts, Entertainment & Recreation	7		1,372,106
Accomodation & Food Services	28		15,704,519
Other Services	10		1,814,057
Public Administration	1		791,050
TOTAL	**135**	**$**	**50,081,503**

COMMERCIAL LOANS BY SIZE

Size		
Less than $25,000	22	270,218
$25,000 to $99,999	15	802,510
$100,000 to $499,999	57	11,611,355
over $500,000	41	37,397,420
TOTAL	**135**	**50,081,503**

2010 COMMUNITY INVOLVEMENT PROGRAM

Credit unions are known for putting the heart in banking, and Kawartha Credit Union is no exception. From our corporate Community Involvement Program to the volunteer efforts of our employees, we "walk the talk" and demonstrate our commitment to building strong communities. We really mean it when we say "join us and be part of something special."

As a socially responsible company, "giving back" includes economic benefits resulting from our day-to-day operations and support for community initiatives. We support causes that matter most to our members, including hospitals, health-care programs, youth, education, community development, and the environment. In 2010, we invested $125,000 (2.3% of our after-tax net earnings) to important causes that matter most to our members in the regions that encompass our 19 branches. Kawartha Credit Union contributes funds and gifts-in-kind throughout the year to a variety of community-based causes that affect the most positive community advantage.

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 over 50 initiatives above and beyond those we support through our corporate Community Involvement Program. Kawartha's Board and Management Team are extremely proud of our employees and their good works.

The following initiatives were funded by our Community Involvement Program during the 2010 fiscal year:

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)
- Kinmount District Health Services
- West Parry Sound Health Centre
- Peterborough Aids Resource Network (P.A.R.N.)
- Hospice North Hastings

YOUTH AND EDUCATION

Literacy and learning improve quality of life, enhance prosperity, and encourage the development of a skilled and well-educated workforce.

- Risk Watch
- Learning Disabilities Association
- Food For Kids, Peterborough
- Food For Kids, City of Kawartha Lakes
- Food For Learning, Hastings/Prince Edward County
- Northumberland Food For Thought
- Haliburton Kawartha Pine Ridge District Health Unit (Breakfast Program)
- Junior Achievement
- Festival of the Sound - Children's Music Scores Program
- Academy Theatre Foundation – Children's Workshops
- 4th Line Theatre – Youth Workshops
- Fleming College Bursary
- Trent University Bursary
- Loyalist College Bursary
- City of Kawartha Lakes Boys & Girls Club
- Kawartha Haliburton Children's Foundation
- Quinte Children's Foundation – Playing For Keeps Program

ENVIRONMENT

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

- Peterborough Children's Water Festival
- Haliburton/Muskoka Water Festival
- Camp Kawartha Environment Centre

COMMUNITY SUPPORT AND DEVELOPMENT

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
- Kawartha Food Share
- Victoria County Women's Resources Services
- Northumberland Services For Women (transitional housing)
- Women's Own Resource Centre – Rural Outreach (South River)
- Esprit Place Family Resource Centre – Transitional Support (Parry Sound)
- Homegrown Homes (Peterborough)
- Chrysalis Women's Shelter (Huntsville)
- Maggie's Resource Centre (Bancroft)
- North Hastings Children's Services (Bancroft)
- Burk's Falls Community Centre

Peterborough Dragon Boat Festival – Robert Wellstood (middle), CEO, presents a $15,000 cheque for Platinum Sponsorship of the Peterborough Dragon Boat Festival to John Gullick, Joan Bates and Carol Mutton.

Peterborough Risk Watch Network – Al Mackay (middle), Lansdowne Place Peterborough Branch Manager, presents a $1,000 cheque to Constable Jeff Clark (left), Peterborough Lakefield Community Police Service, Becky Downe, Public Health Nurse, and Maureen Crowley (right), Public Educator, Peterborough Fire Department.

Ondine Brandon, Administration Manager, and the Administration Department present a cheque for $2,000 to Chris Kawalek, General Manager, Kawartha Food Share.

Peterborough Dragon Boat Festival

Cobourg Relay for Life

AUDITORS' REPORT

To the Members
Kawartha Credit Union Limited

We have audited the balance sheet of Kawartha Credit Union Limited as at September 30, 2010 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, 2010 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

BDO Canada LLP

Chartered Accountants, Licensed Public Accountants

Peterborough, Ontario
October 29, 2010

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 four 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.

The Audit Committee met five times during the 2010 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

Harvey Spry, Committee Chair
Committee: Harvey Spry, Carl Silvestri, Earl Robbins, Ellen Stewart

BALANCE SHEET

At September 30

	2010	2009
Assets		
Cash resources (Note 1b)	$ 18,570,299	$ 19,289,813
Liquidity deposits	45,939,417	39,812,779
Loans to members (Note 3a)	585,792,750	527,619,879
Investments (Note 4)	6,009,429	6,068,813
Other assets	4,407,409	4,257,273
Capital assets (Note 5)	4,938,471	5,366,775
Derivative financial instruments (Note 15)	1,007,432	16,869
	$ 666,665,207	**$ 602,432,201**
Liabilities		
Term loans (Note 8a)	$ 53,000,000	$ 29,000,000
Members' deposits (Note 6a)	557,834,528	526,269,022
Accounts payable and accrued liabilities	8,034,728	5,146,013
Derivative financial instruments (Note 15)	1,165,568	99,577
	620,034,824	**560,514,612**
Members' Equity		
Class A Investment Shares (Note 12)	12,494,685	12,494,685
Class B Affinity Shares (Note 12)	3,757,239	2,797,335
Membership Shares (Note 12)	844,781	836,930
Contributed surplus	209,533	181,468
Retained earnings	29,330,595	25,625,985
Accumulated other comprehensive income	(6,450)	(18,814)
	46,630,383	41,917,589
	$ 666,665,207	**$ 602,432,201**

Approved by the Board:

Ken Stickle

Director

Director

The accompanying notes are an integral part of these financial statements

STATEMENT OF INCOME

For the year ended September 30

		2010		2009
Financial Revenue				
Interest on loans to members (Note 3c)	$	30,850,765	$	27,354,204
Investment income		880,561		2,439,404
		31,731,326		29,793,608
Financial Expense				
Interest on deposits (Note 6b)		10,546,782		13,799,270
Interest on borrowings		463,826		74,263
		11,010,608		13,873,533
Financial Margin		20,720,718		15,920,075
Other Income		4,609,384		5,809,865
		25,330,102		21,729,940
Operating Expenses				
Salaries and employee benefits		9,797,605		8,729,511
Loan loss expense (Note 3d)		708,065		1,149,614
Occupancy		1,982,228		1,830,664
Banking costs		585,879		562,065
Other expenses (Note 11)		2,178,391		2,158,226
Data costs		1,070,676		965,144
Deposit insurance		440,364		359,031
Promotion		1,148,716		1,090,615
Directors' expenses		124,263		106,912
		18,036,187		16,951,782
Operating Income		7,293,915		4,778,158
Other Items				
Write down of investments		-		625,557
Vault cash program recovery		-		(113,600)
		-		511,957
Income before income taxes		7,293,915		4,266,201
Income tax expense (Note 19)		1,856,000		835,000
Net Income	**$**	**5,437,915**	**$**	**3,431,201**

The accompanying notes are an integral part of these financial statements

STATEMENT OF CASH FLOWS

For the year ended September 30

	2010	2009
Cash Provided by Operations (Note 13)		
Net income	$ 5,437,915	$ 3,431,201
Adjustments to cash basis of accounting		
Amortization of capital assets	927,535	1,021,831
Changes in other assets	(150,136)	(210,655)
Changes in derivative financial instruments	87,792	69,293
Changes in accounts payable	2,888,715	(130,426)
Changes in allowance for loan losses	(88,516)	593,761
Net mortgage securitization premium	(186,834)	(142,931)
Write down of investments	-	625,557
	8,916,471	5,257,631
Cash Provided by (Advanced to) Members		
Increase in members' deposits	31,565,505	44,023,098
Increase in shares	967,755	1,370,798
Dividends paid to members net of tax savings	(881,661)	(758,837)
Class B Affinity share issuance net of tax savings	(851,644)	(1,111,473)
Increase in contributed surplus	28,065	12,167
(Increase) decrease in loans to members	(78,908,749)	(87,796,497)
	(48,080,729)	(44,260,744)
Financing Activities		
Changes in liquidity deposits	(6,126,638)	(3,989,908)
Term loans advanced (repaid)	24,000,000	29,000,000
Proceeds of mortgage securitization	21,011,228	19,332,989
Repurchase of mortgages under securitization	-	(20,106,570)
	38,884,590	24,236,511
Investment Activities		
Purchases of capital assets	(499,231)	(851,340)
(Increase) decrease in investments	59,385	1,007,394
	(439,846)	156,054
Increase (Decrease) in Cash Resources During the Year	(719,514)	(14,610,548)
Cash Resources - Beginning of the Year	19,289,813	33,900,361
Cash Resources - End of the Year	**$ 18,570,299**	**$ 19,289,813**

The accompanying notes are an integral part of these financial statements

STATEMENT OF MEMBERS' EQUITY

For the year ended September 30

	2010	2009
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	2,797,335	1,438,014
Net share issuance	987,969	1,371,473
Shares forfeited	(28,065)	(12,152)
Ending balance	3,757,239	2,797,335
Membership Shares		
Opening balance	836,930	825,453
Net change during the year	7,851	11,477
Ending balance	844,781	836,930
Contributed Surplus		
Opening balance	181,468	169,301
Net change during the year	28,065	12,167
Ending balance	209,533	181,468
Retained Earnings		
Opening balance	25,625,985	24,065,094
Add: net income	5,437,915	3,431,201
	31,063,900	27,496,295
Less: Class B Affinity share issuance	(1,019,644)	(1,371,473)
Related tax savings	168,000	275,000
Less: Dividends paid to members	(1,055,661)	(975,837)
Related tax savings	174,000	202,000
Ending balance	29,330,595	25,625,985
Accumulated Other Comprehensive Income		
Opening balance	(18,814)	(328,541)
Other comprehensive income (loss)	12,364	309,727
Ending balance	(6,450)	(18,814)
Total Equity	**$ 46,630,383**	**$ 41,917,589**

STATEMENT OF COMPREHENSIVE INCOME

For the year ended September 30

	2010	2009
Net Income (Page 12)	$ 5,437,915	$ 3,431,201
Other Comprehensive Income		
Gains (losses) on financial derivatives designated as cash flow hedges net of tax effect	12,364	(40,273)
Fair value adjustment on the investment in ABCP 2008 Limited Partnership (Note 4)	-	350,000
	12,364	309,727
Comprehensive Income	**$ 5,450,279**	**$ 3,740,928**

The accompanying notes are an integral part of these financial statements

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 1.57%.

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 Canadian 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 $402,285 (2009 - $356,721).

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 financial instruments. 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 15 to the financial statements for the year ending September 30, 2010 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

	2010	2009
Personal loans	$ 129,860,867	$ 124,958,944
Residential mortgages	283,439,460	258,675,785
Commercial loans	174,604,624	146,309,434
	587,904,951	529,944,163
Accrued interest receivable	1,002,411	878,844
	588,907,362	530,823,007
Allowance for impaired loans	(3,114,612)	(3,203,128)
Net loans to members	**$ 585,792,750**	**$ 527,619,879**

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, 2010 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:

	2010	2009
Personal loans	$ 129,325,000	$ 124,846,000
Residential mortgages	300,805,000	266,576,000
Commercial loans	168,615,000	148,527,000
	$ 598,745,000	**$ 539,949,000**

The key economic assumptions used in measuring the fair value of member loans at September 30, 2010 were as follows:

	Personal Loans	Residential Mortgages	Commercial Loans
Prepayment rate	10%	8%	5%
Weighted-average term to maturity	1.90years	2.41years	1.97years
Market rate	7.50%	3.00%	6.00%

c) Interest Income

	2010	2009
Personal loans	$ 7,546,656	$ 7,361,499
Residential mortgages	13,193,247	12,488,440
Commercial loans	10,110,862	7,504,265
	$ 30,850,765	**$ 27,354,204**

Personal loans are comprised of term loans, which account for 46% of the portfolio, and lines of credit which account for the remaining 54% of the portfolio. Repayment terms vary with the term length and loan type. Security may include collateral mortgages on real property, 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 35 years.

Loans to members had the following average yields at September 30, 2010:

	Principal	Yield
Variable rate loans	$ 189,793,140	5.66%
Fixed rate loans with maturities within one year	52,745,558	5.57%
Fixed rate loans with maturities beyond one year	345,366,253	5.46%
	$587,904,951	

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

	Personal Loans	Residential Mortgages	Commercial Loans	Total
2010				
Opening	$ 2,024,750	$ 273,576	$ 904,802	$ 3,203,128
Recoveries	44,780	-	-	44,780
Loan loss expense	429,366	86,707	191,992	708,065
	2,498,896	360,283	1,096,794	$ 3,955,973
Write-offs	(786,454)	(45,015)	(9,892)	(841,361)
Ending	**$ 1,712,442**	**$ 315,268**	**$ 1,086,902**	**$ 3,114,612**
Principal balance of impaired loans	**$ 1,946,207**	**$ 2,986,742**	**$ 1,545,802**	**$ 6,478,751**
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**

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 $1,499,700 (2009 – $1,340,000). At September 30, 2010, there were no formally restructured loans outstanding (2009 - none).

4. INVESTMENTS

	2010	2009
Credit Union Central of Ontario, Membership	$ 14,549	$ 660,844
Central 1 Credit Union Limited, Membership	3,896,277	3,157,088
ABCP 2008 Limited Partnership	2,081,046	2,233,324
Co-operators General Insurance, Class A Series A	12,557	12,557
Credential Securities Inc., Debenture	5,000	5,000
	$ 6,009,429	**$ 6,068,813**

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 last two years CUCO membership shares were exchanged for the required membership shares in Central on a tax free basis with the residual value representing the Credit Union's interest in the remaining net assets as at June 30, 2010. CUCO membership shares have been written down by $119,095.

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 2010 (2009 - 2%). The Credit Union also received an extraordinary dividend declared by the Directors of Central amounting to 10% of the membership shares based on Central's extraordinary results in 2009. The fair values of the shares in Central, the Co-operators and Credential Securities 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 any 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. The ABCP LP appointed Kilgour Advisory Group to be their investment manager. 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.

Based on information available in 2008, the Credit Union classified the investment as Available for Sale (AFS). 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." During 2009 the value of the ABCP investment declined to $2,233,324.

During the past year the Credit Union received distributions from the LP of $152,277 which were recorded as a return of the capital invested reducing the value to $2,081,046. At September 30, 2010 the LP provided an estimate of fair value of the investment of $2,403,024, an increase in value of $321,977 during the year. The AFS accounting designation and DICO directive requires the Credit Union to defer this potential revenue until the asset has been liquidated.

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 on the fair value assumptions and based on a 10% favourable and a 10% unfavourable change in the valuation, the Credit Union determined that the fair value could increase or decrease $245,000.

5. CAPITAL ASSETS

	2010 Cost	2010 Accumulated Amortization	2009 Cost	2009 Accumulated Amortization
Land and parking lot	$ 1,156,962	$ 49,516	$ 1,156,962	$ 49,041
Building	3,863,992	2,309,011	3,802,809	2,130,791
Equipment	6,665,791	5,522,015	6,339,629	5,007,020
Leasehold improvements	2,329,941	1,226,296	2,217,973	1,007,982
Member files	1,368,860	1,340,237	1,368,860	1,324,624
	$15,385,546	**$10,447,075**	**$14,886,233**	**$ 9,519,458**
Net book value		**$ 4,938,471**		**$ 5,366,775**
Amortization expense		**$ 927,535**		**$ 1,021,831**

6. MEMBERS' DEPOSITS

a)

	2010	2009
Chequing accounts	$ 116,759,863	$ 109,523,735
Demand savings accounts	46,740,018	42,115,807
Term deposits	252,298,594	246,890,677
Registered savings plans	99,624,462	94,304,314
Registered retirement income funds	21,124,849	18,576,936
Tax-free savings accounts	14,393,292	6,073,474
Accrued interest on member deposits	6,893,450	8,784,079
	$ 557,834,528	**$ 526,269,022**

b) Interest on Deposits

	2010	2009
Chequing accounts	$ 391,469	$ 437,430
Demand savings accounts	251,577	230,031
Term deposits	5,905,615	8,833,239
Registered savings plans	3,043,625	3,462,068
Registered retirement income funds	698,050	736,045
Tax-free savings accounts	256,446	100,457
	$ 10,546,782	**$ 13,799,270**

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 (2009 - 67%).

Registered savings plans consist of fixed rate deposits which account for 98% (2009 - 98%) of the portfolio and variable rate deposits which comprise the remaining 2% (2009 - 2%) of the portfolio. Deposits which are callable by the depositor account for 58% of the portfolio (2009 - 61%), with the remaining 42% (2009 - 39%) 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, 2010:

	Principal	Yield
Variable rate deposits due on demand	$ 166,183,085	0.43%
Fixed rate deposits with maturities within one year	202,512,121	2.02%
Fixed rate deposits with maturities beyond one year	182,245,872	3.36%
	$ 550,941,078	

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:

	2010	2009
Chequing and demand savings accounts	$ 163,363,000	$ 151,640,000
Term deposits	255,882,000	241,748,000
Registered plans	134,340,000	109,796,000
	$ 553,585,000	**$ 503,184,000**

The key economic assumptions used in measuring the fair value of member deposits at September 30, 2010 were as follows:

	Non Registered Deposits	Registered Deposits
Weighted-average term to maturity	1.10 years	2.06 years
Market rate	1.53%	2.11%

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, 2010 of $2,778,120 (2009 - $2,600,704) and the net periodic benefit cost for the year ending September 30, 2010 was determined by actuarial valuation using a discount rate of 5.5% (2009 - 5.5%).

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

		2010		2009
Accrued benefit obligation				
Balance at the beginning of the period	$	2,600,704	$	3,130,700
Service cost for the period		64,917		61,532
Interest cost for the period		144,623		136,141
Benefits cost for the period		(32,124)		(33,392)
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		2,778,120		2,600,704
Unamortized transitional obligation		(236,192)		(494,296)
Unamortized past service cost		(142,110)		(165,795)
Unamortized actuarial gain		1,176,505		1,329,443
Accrued liability	**$**	**3,576,323**	**$**	**3,270,056**
Components of net periodic benefit cost				
Service cost for the period	$	64,917	$	61,532
Interest cost for the period		144,623		136,141
Amortization of transitional obligation		258,104		258,104
Past service cost		23,685		23,685
Amortization of actuarial gain		(152,938)		(155,114)
Net periodic benefit cost	**$**	**338,391**	**$**	**324,348**

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 7.0% in 2010, 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 2010 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 2010:

		Increase		Decrease
Total of service and interest cost	$	45,000	$	(34,000)
Accrued benefit obligation	$	462,000	$	(341,000)

8. COMMITMENTS

a) Credit Facilities
The Credit Union has authorized line of credit and term loan facilities with Central 1 Credit Union Limited totalling $93,000,000. As of September 30, 2010 the Credit Union had unused credit facilities totalling $40,000,000. The authorized lines of credit bear interest at 1.35% to 1.51%. 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, 2010, the Credit Union is committed to advance approximately $2,564,455 on mortgage loans and $12,518,166 on commercial loans. In addition, lines of credit which had been approved but not used at year-end totalled approximately $61,506,307.

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: 2011 - $902,624; 2012 - $854,166; 2013 - $834,153; 2014 - $793,387; 2015 – $670,458 and $4,054,788 in the aggregate.

d) Contingencies
The nature of the Credit Union's activities are such that there may be litigation pending or in progress at any time. There were no claims at September 30, 2010.

9. REGULATORY REPORTING

a) 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, 2010, the Credit Union is in compliance with the Act and regulation.

		2010		2009
Total regulatory capital is composed of Tier 1 and Tier 2 capital as follows: **Tier 1 Capital, otherwise known as core capital, is the highest quality. It is comprised of the following:**				
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		3,757,239		2,797,335
Membership Shares		844,781		836,930
Contributed Surplus		209,533		181,468
Retained Earnings		29,330,595		25,625,985
Total Tier 1 Capital		45,867,833		41,167,403
Tier 2 Capital, otherwise known as supplementary capital, contributes to the overall strength of a financial institution as a going concern, but is of a lesser quality than Tier 1 capital relative to both permanence and freedom from charges. It is comprised of the following:				
Redeemable Portion of Class A Shares		769,000		769,000
General Provisions		1,499,700		1,340,000
Other Comprehensive Income		(6,450)		(18,814)
Total Tier 2 Capital		2,262,250		2,090,186
Tier 1 and Tier 2 Capital		48,130,083		43,257,589
Future Income Taxes		(1,145,813)		(1,106,813)
Total Regulatory Capital	**$**	**46,984,270**	**$**	**42,150,776**

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	340,925,747	305,837,226
Market Risk	892,500	307,500
Operational Risk	38,426,678	34,396,610
	$ 380,244,925	$ 340,541,336

The applicable capital ratios are as follows:

Tier 1 Capital to Risk Adjusted Assets	12.06%	12.09%
Total Regulatory Capital to Risk Adjusted Assets	12.36%	12.38%
Total Regulatory Capital to Total Assets	7.05%	7.00%

b) Remuneration of Officers and Employees
The Credit Unions and Caisses Populaires Act, 1994, requires credit unions to disclose remuneration paid during the year to the officers and employees of a credit union whose total remuneration for the year exceeded $150,000. If there are more than five officers and employees of a credit union whose total remuneration for the year was over $150,000, the five officers and employees with the highest total remuneration for the year are disclosed. The table below provides this information for the 2009 calendar year:

	Total Salary Received	Monetary Value of Benefits Received
Robert Wellstood	$ 203,327	$ 11,000

c) Other Statutory Information
Pursuant to the requirements of the Credit Unions and Caisses Populaires Act, 1994, the following information is provided:

	2010	2009
Director remuneration in the year	$ 100,200	$ 76,700
Deposit insurance premium paid in the year	$ 440,364	$ 359,031

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 5 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 $1,371,600 at September 30, 2010.

11. OTHER EXPENSES

	2010	2009
Other supplies and postage	$ 438,650	$ 401,959
Equipment costs	314,675	293,925
Central dues & regulatory assessments	124,740	133,252
Amortization of member files	15,612	137,012
Savings and loan life insurance	105,195	82,981
Education and staff development	509,209	496,331
Bonding insurance	194,711	133,637
Professional services	219,626	227,837
Collection costs	70,352	76,790
Telephone	120,528	117,188
Miscellaneous	61,662	49,497
Central annual meeting	3,431	7,817
	$ 2,178,391	$ 2,158,226

12. SHARE CAPITAL

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

The Credit Union is authorized to issue an unlimited number of Class A shares, in series, with rights, privileges, restrictions and conditions to be determined by the Board of Directors, subject to statutory restrictions. The Credit Union has issued and outstanding 12,670,779 Non-Cumulative, Non-Voting, Non-Participating, Class A Series 1 Special Shares (Class A Investment Shares). The Class A Series 1 shares pay dividends at the discretion of the Board of Directors in the form of cash or additional shares. These shares are redeemable at the sole and absolute discretion of the Board of Directors and are subject to a maximum of 10% of the shares outstanding at the end of the previous fiscal year.

The Credit Union 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 15, 2010 the Credit Union issued 998,744 Class B Series 2 Affinity Shares.

13. CASH FLOW STATEMENT

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

	2010	2009
Cash paid for interest	$ 12,437,411	$ 13,274,273
Cash paid for income taxes	$ 553,219	$ 336,494
Cash received for income taxes	$ 17,035	$ 196,658

14. SEGMENT DISCLOSURES

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

15. DERIVATIVE 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 tables below provide an overview of the Credit Union's derivative portfolio.

						2010
	Maturities of Derivatives (Notional Amounts)				**Fair Value**	
	Within 1 year	1 to 5 years	Total		Asset	Liability
Interest rate swaps:						
Receive fixed	$ 25,000,000	$ 80,000,000	$ 105,000,000		$ 754,930	$ -
Pay fixed	10,000,000	56,218,464	66,218,464		-	913,066
Index-linked options	-	3,347,742	3,347,742		252,502	252,502
Total	**$ 35,000,000**	**$139,566,206**	**$174,566,206**		**$ 1,007,432**	**$ 1,165,568**

						2009
	Maturities of Derivatives (Notional Amounts)				**Fair Value**	
	Within 1 year	1 to 5 years	Total		Asset	Liability
Interest rate swaps:						
Receive fixed	$ -	$ 20,000,000	$ 20,000,000		$ 16,869	$ -
Pay fixed	-	20,025,873	20,025,873		-	99,577
Index-linked options	-	-	-		-	-
Total	**$ -**	**$ 40,025,873**	**$ 40,025,873**		**$ 16,869**	**$ 99,577**

Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of the volume of outstanding transactions, but do not represent credit or market risk exposure. Notional amounts are not exchanged.

The Credit Union has credit risk which arises from the possibility that a counterparty to a derivative contract could default on their obligation to the Credit Union. However, credit risk associated with derivative contracts is normally a small fraction of the notional principal amount of the contract. Derivative contracts expose the Credit Union to loss where there is a favourable change in market rates from the Credit Union's perspective and the counterparty fails to perform. The Credit Union only enters into derivative contracts with a counterparty that the Credit Union has determined to be creditworthy.

Interest Rate Swaps

As part of its interest rate risk management process, the Credit Union utilizes interest rate contracts in the form of interest rate swaps to maintain its interest rate exposure within the preset limits defined by the Board approved policy.

As at September 30, 2010, the Credit Union had entered into 6 receive fixed interest rate swaps, 4 of which are delayed start, with a total notional amount of $105,000,000 and maturing between December 2010 and January 2012. Under the terms of these agreements, the counterparty to the swap is obligated to pay the Credit Union a fixed rate and the Credit Union is obligated to pay the counterparty a variable rate, with both payments based upon the notional amount of the underlying swap. The variable rate paid by the Credit Union is equivalent to the one month bankers' acceptance rate and is repriced monthly. The Credit Union is currently receiving or will receive fixed rates on these swaps ranging from 0.76% to 2.480% and is paying variable rates as at September 30, 2010 ranging from 1.091% to 1.289%.

As at September 30, 2010, the Credit Union had 8 pay fixed interest rate swaps outstanding with a notional amount of $66,218,464 and maturing from July 2011 to October 2014. Under the terms of these agreements, the counterparty to the swap is obligated to pay the Credit Union a variable rate and the Credit Union is obligated to pay the counterparty a fixed rate, with both payments based upon the notional amount of the underlying swap. The variable rate received by the Credit Union is equivalent to the one month bankers' acceptance rate and is repriced monthly. The Credit Union is currently paying a fixed rate on these swaps ranging from 1.14% to 2.90% and is receiving a variable as at September 30, 2010 ranging from 1.091% to 1.177%.

Equity Index-Linked Deposits

The Credit Union has $3,347,742 (2009 - nil) of equity index-linked deposit products outstanding to its Members. These term deposits have maturities of 3 and 5 years and pay interest to depositors, at the end of the term, based on the performance of various market indices. The Credit Union has purchased equity index-linked option agreements with Central 1 to offset the exposure to the indices associated with these products. The Credit Union pays a fixed amount based on the notional amount at the inception of the equity index-linked purchase option contract. At the end of the term the Credit Union receives from Central 1 payments equal to the amount that will be paid to the depositors based on the performance of the respective indices.

The purpose of these agreements is to provide an economic hedge against market fluctuations. These agreements have fair values that vary based on the particular contract and changes in equity indices. Although hedge accounting is not applied, these agreements continue to be effective as economic hedges.

16. 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, 2010 was as follows:

	2010
Loans that are not past due	$ 576,865,462
Loans that are past due	
under 30 days	4,283,299
30 to 89 days	4,165,909
90 -179 days	839,774
180 - 365 days	556,696
over 365 days	1,193,811
	$ 587,904,951

At a minimum all loans that are over 90 days past due are considered impaired. There are 268 loans with a combined principal of $6,478,751 considered to be impaired. The security shortfall on these loans totalled $1,550,882.

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	$ 189,476	$ 161,323	$ 28,153
< 6 months	75,868	153,718	(77,850)
1 year	54,287	111,081	(56,794)
2 years	109,892	81,547	28,345
3 years	84,986	60,005	24,981
4 years	75,534	41,247	34,287
5 years	54,860	36,425	18,435
> 5 years	-	-	-
	644,903	645,346	(443)
Non-interest sensitive items	21,762	21,319	443
	$ 666,665	**$ 666,665**	**$ -**

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, 2010, the weighted average rate for interest-bearing assets is 5.18% and for interest-bearing liabilities is 1.91%.

Based on the Credit Union's interest rate positions at September 30, 2010 the following table shows the potential before tax impact of an increase or decrease in interest rates on the Credit Union's net income.

	2010	2009
100 bp increase	$ (457,000)	$ 161,000
25 bp decrease	$ 189,000	$ (41,000)

The interest rate risk policy has been approved by the Board of Directors and for the year ended September 30, 2010 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 members 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 Unions and Caisses Populaires Act, 1994 and Regulation 237/09 requires the Credit Union to establish and maintain prudent levels and forms of liquidity that are sufficient to meet its cash flow needs, including depositor withdrawals and all other obligations as they come due.

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 table below summarizes the contractual maturities of the Credit Union's member deposits and existing loan commitments as at September 30, 2010:

	on demand	less than one year	one to five years
Member deposits (Note 6)	$ 166,183,085	$ 202,512,120	$ 182,245,873
Loan commitments (Note 8)	61,506,307	15,082,621	-
	$ 227,689,392	**$ 217,594,741**	**$ 182,245,873**

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.

17. SUBSEQUENT EVENT

On October 20, 2010, 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, 2010. The amount of the dividend will be $886,955, with a corresponding tax saving of $282,000.

On October 20, 2010, 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, 2010. The amount of the dividend will be $225,434, with a corresponding tax saving of $72,000.

18. MORTGAGE SECURITIZATIONS

During the year Kawartha Credit Union securitized residential mortgages of $20,910,998 (2009 - $19,274,206). 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, 2010 was $50,182,898 (2009 – $39,473,218)

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

	2010	2009
Net cash proceeds received	$ 21,011,228	$ 19,332,989
Premium	186,834	142,931

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

	2010	2009
Prepayment rate	8%	8%
Weighted-average term to maturity	4.64 years	4.50 years
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:

	2010	2009
Carrying value of retained interests	$ 1,491,377	$ 1,903,730
Weighted-average term to maturity	3.12 years	3.58 years
Prepayment rate assumption	8%	8%
Impact of a 10% prepayment	$ (65,989)	$ (112,355)
Impact of a 20% prepayment	$ (373,600)	$ (323,183)

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.

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:

	2010	2009
Employee future benefits	$ 591,000	$ 655,000
Allowance for impaired loans	397,000	252,000
Capital assets	117,000	140,000
Other	40,000	60,000
	$ 1,145,000	**$ 1,107,000**

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:

	2010	2009
Income before income taxes	$ 7,293,915	$ 4,266,201
Statutory income tax rate	32.25%	33.13%
Expected income tax expense	2,352,288	1,413,392
Increase (decrease) in taxes resulting from:		
Available credit union small business deduction	(844,809)	(1,225,974)
General tax reduction unavailable	309,737	416,678
Non-deductible expenses and other reconciling items	38,784	230,904
Income tax expense	**$ 1,856,000**	**$ 835,000**

The income tax expense consists of the following:

	2010	2009
Current provision	$ 1,895,000	$ 880,000
Future provision	(39,000)	(45,000)
	$ 1,856,000	**$ 835,000**

KAWARTHA CREDIT UNION
STAFF RECOGNITION AWARDS

	2006	2007	2008	2009	2010
BRANCH AWARDS					
Highest Overall Growth %	Huntsville	Huntsville	Little Britain	Keene	Huntsville
Highest Overall Growth $	Trenton	Monaghan	Monaghan	Monaghan	Huntsville
100% Club	South River	Kinmount	*No Entry*	*No Entry*	*No Entry*
Community Commitment Award			Emsdale	Bancroft	Cobourg
INDIVIDUAL AWARDS					
Manager of the Year	Connie White	Dana Farrell	Connie White	Karen Woodman	Susan Wakeford
Extra Mile Award	Eon Dalzell	Janice Barber Francine Currie	Carol Davis Linden Gage Lana Koch	Diana Andrews Susie Lodge Bonnie Rickward	Stefanie Kubica Betty Dickson Arlene McKee
Glen Davies Award	Janice O'Neill	Steve Olmstead	Kristy Tremblett	Suzanne Shannon	Dan MacNamee

OUR BRANCH COMMUNITIES:

Bracebridge • Burk's Falls • Bancroft • Cobourg • Coe Hill • Emsdale

Huntsville • Kinmount • Keene • Lindsay • Little Britain

Magnetawan • Parry Sound • Peterborough • South River • Trenton

PHOTOS:

Trenton, Ontario

Trenton Branch located at 107 Dundas Street West, Trenton

kawartha
CREDIT UNION

www.kawarthacu.com