




kawartha
CREDIT UNION

2012
ANNUAL REPORT





“We are what we repeatedly do;
excellence, then, is not an act
but a habit.” - Aristotle.

Table of Contents

Report to the Members	2
Report from the Governance Committee.....	8
Commercial Development.....	9
Credit Statistics	9
Community Involvement Program.....	10
Staff Recognition Awards.....	11
Auditors' Report	12
Report from the Audit Committee	13
Summary Financial Statements	14

Report to the Members

We are pleased to provide this report to our members on the results of our activities in the past year and highlights of initiatives we are working on for the future. As in the past, this is a combined report from your Board of Directors and management.

We entered fiscal 2012 in discussions to merge Unity Savings and Credit Union (Unity) and Kawartha. A highlight of the year had to be the successful amalgamation of the two companies on March 31, 2012, creating a twenty-five branch operation serving small urban and rural communities throughout eastern Ontario. We are thrilled to report that at December 31, 2012, we exceeded our long-standing goal of \$1 billion in assets. As there were a number of operational differences between Kawartha and Unity, integration of the two companies has been on-going since April and will continue in 2013.

We completed our second member survey in the fall of 2012 with very encouraging results and the Best Small and Medium Employers in Canada® survey results were released in early 2012 showing our employees' engagement increased for the fourth consecutive time.

The financial results remained solid with continuing organic growth in addition to the merger. Operating income was down in relation to average assets but was still sufficient to allow the Board to return \$1.7 million in profit sharing to members in the form of Affinity Shares and to declare over \$2 million in cash dividends. Your Board strives to provide the best governance possible and to that end both the Governance and Nominating Committees were very active this year, implementing new requirements for Director competencies for both existing Directors and candidates for the Board.

As we enter 2013, we have a number of initiatives underway to complete the post-merger integration, to enhance our member service offering, to build upon our strong employee engagement results, to build our brand throughout our territory, and to ensure continuing sound governance.



*Senior Management Team - Left to Right:
Robert Wellstood, Crystal Dayman, Julian Sellers,
Jennifer Mowry, Louise Coleman, Cheryl Pearce.*

In Memoriam



This year, Kawartha Credit Union lost our friend, colleague and leader Stuart Forsyth. Stuart introduced a number of changes to the way we do things, and was instrumental in creating our Contact Center. It was really Stuart who coined our definition of Member Service Excellence. He was a strong believer in the need for Kawartha to grow, and he worked tirelessly to help us move from \$500 million in assets to \$1 billion.



In February 2012, we lost Janice O'Neill, a dedicated Kawartha employee for 23 years. Janice was the Assistant Branch Manager at our Lindsay Branch, and was much loved by her members and co-workers. Known as a hard worker, dedicated to doing her best and committed to Kawartha's success, Janice received the Glen Davies award in 2006.

Strategic Direction

Financial Services is a people business. Kawartha's formula for success is to leverage above average member and employee engagement to produce superior financial performance for the benefit of our members - the owners of the credit union. Consequently, we have a number of strategies aimed at earning our members' trust with the goal of making you proud to belong to Kawartha. We also have strategies to promote our employees' commitment to company success. We measure progress against these strategies regularly, and report to the Board quarterly through our Key Performance Indicators.

Our primary strategy for building member engagement is Member Service Excellence – providing our members with needs-based financial advice and solutions. We measure progress through periodic third-party surveys of our membership. In late 2012, Ipsos surveyed 751 members drawn from across all 25 branches. Overall, member satisfaction was 95% (2009 – 94%) and “likelihood to recommend” / “have recommended” were unchanged from 2009 at 86% and 69% respectively. Kawartha outperforms “All Financial Institutions in Ontario” on three main performance metrics from Ipsos' proprietary Customer Service Index for the financial services industry in Canada and outperforms “All credit unions in Ontario” on Overall Quality of Service as well. Finally, the survey shows improved scores in a number of areas in relation to perceptions of Kawartha. To continue to improve in these important areas, in 2012 we quietly launched a new multi-year program entitled Creating Member Loyalty, headed by a long time Kawartha employee in a new role: Manager, Service Excellence. This program will really start to make an impact in 2013.

At Kawartha we want every employee to be committed with their heart and their mind to the success of the credit union. We call this employee engagement and it is measured through bi-annual participation in the Best Small and Medium Employers in Canada® survey conducted by Queens University and AON Hewitt. In 2012 Kawartha was again designated a Best Employer, ranking in the top 20 nationally. Kawartha was also honoured with the Employer of the Year award at the Peterborough Chamber of Commerce 2012 Business Excellence Awards. Career development is an important contributor to employee engagement and we are pleased to report that during the past year, thirty-three employees were promoted while another sixty-nine participated in temporary transfers to different positions as part of our employee development initiatives. We also had thirteen employees receive accreditations in their area of expertise.

Effective governance provides oversight and is a critical element of the sound management of the company. For the past two years, the Governance Committee has been very active in reviewing and making recommendations for changes to our Governance policies. The Governance Committee Report found on page 8 of this Annual Report provides a summary of the activities and outcomes in 2012. The introduction of nine Director competencies, minimum competency levels, Director assessments and training plans has been approved by the Board and overseen by the Governance Committee. The Nominating Committee has imbedded the nine competencies into the candidate assessment process, providing a link between Board needs and candidate recruitment.

As reported last year, the credit union has contracted for a new computer system and commenced the implementation process. This project has deviated from the project plan and consequently the Board has increased oversight, with management providing monthly reporting. Management expects to resolve the issues delaying implementation during 2013.

Financial Results

There are two significant changes affecting financial reporting in 2012. Firstly, this was the year of transition from Canadian Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS). Comparative numbers for fiscal 2011 have been restated to comply with IFRS, with changes resulting from that restatement explained in Note 25 to the audited financial statements. Secondly, as a result of the amalgamation with Unity, Kawartha was required by statute to adopt a December 31 year end. To accomplish this we have chosen to present the results for a fifteen month period from October 1, 2011 to December 31, 2012. The amalgamation with Unity was effective March 31, 2012, and was accounted for prospectively from that date. Consequently, comparisons between 2012 and 2011 need to be made with care.

In 2012, total assets under management grew by \$249 million or 32% to end the year at \$1.015 billion. Balance sheet assets grew by \$237 million or 33% to \$966 million and off-balance sheet assets grew by \$11 million to \$49 million. Unity's assets contributed \$168 million to balance sheet growth, while \$69 million or 9.5% was internal growth. The total consumer lending portfolios grew by \$179 million or 36%. Commercial lending growth of \$43 million or 23% brought the portfolio to 26% of total loan portfolios under management. Deposit growth of \$197 million or 33% was composed of \$157 million from Unity and \$40 million or 6.6% from internal growth. Members'

Equity grew by \$20 million or 40%, with \$10 million from a Class A Investment Share offering in 2012, \$3.4 million from Unity's Investment Shares and the balance of \$6.6 million primarily due to earnings, net of returns to members. Once again, Kawartha maintained its healthy financial position with regulatory capital of 7.97% on a leverage basis or 14.56% on a risk weighted basis and liquidity of 8.8% at year end, all well in excess of statutory and Board policy requirements.

Under IFRS, patronage distributions are a deduction from income, whereas previously we reported them as a distribution from retained earnings. Consequently, net income figures will be lower than would otherwise have been reported. In 2012, this has been mitigated to some extent because the figures are for a fifteen month period ended December 31, 2012. Net income of \$7.3 million or 0.69% of average assets was up 69% from 2011. Operating income plus changes in fair values of investments totaled \$8.4 million or 0.80% of average assets annualized (2011 - \$7.0 million or 1.0%). This provided a pre-tax return on average equity of 11.0%, slightly below our target range of 13% - 16% and supported the payment of a 5% dividend on Class A Investment Shares and a 4.5% dividend on Class B Affinity Shares. As the interest rate environment has remained low and fairly stable and the economic recovery remained sluggish, the financial services industry has grown even more competitive. Consequently, the financial margin has been compressed due to price competition, from 3.12% of average assets in 2011 to 3.04% (annualized) in 2012. Similarly, other income has

come under pressure with the elimination of securitization income under IFRS and price competition on service charges. In November, 2012, Kawartha made a number of adjustments to our service fees based on a review of the market in order to bring Kawartha's and Unity's fees into alignment. Some fees increased but the more significant changes were decreases and we project a net reduction in service fee revenue going forward. Operating expenses increased 45% (annualized) over 2011, due primarily to the amalgamation. The business case supporting the amalgamation called for overheads to increase initially due to costs of integration, but they are projected to reduce by the third year post-merger to a level below which either of the predecessor credit unions could achieve on their own.

During fiscal 2012 Kawartha distributed \$1.7 million to our members, in the form of Affinity Shares, as a reward for doing business with Kawartha. Cumulatively, we have distributed \$7.4 million of profits back to our members during the four years this program has been in place. This is an ongoing program with distributions to members every year, subject to financial constraints. The more business you do with Kawartha, the more shares you receive.

Overall, the Board and management are satisfied with the financial results of 2012, particularly in light of the economy, low interest rate environment and additional workload and costs of integration. We are proud to have reached our goal of \$1 billion in assets in 2012. Profitability is expected to gradually improve as we realize some of the benefits of the merger.

\$1 BILLION

We are proud to have reached our goal of \$1 billion in assets in 2012!

Looking Ahead

Your Board of Directors and management firmly believe that Kawartha Credit Union needs to continue to grow quickly. The merger with Unity was but one step towards building a sustainable credit union capable of competing successfully in the future. Longer term, we have a number of initiatives underway to lay the foundation for that growth.

In the short term, we need to complete the merger integration activities to truly bring the Unity and Kawartha operations together as one and to fully realize the potential of this merger. This includes a computer banking system conversion onto Kawartha's existing system, planned for the first weekend of April 2013. We have some new product introductions planned, including Interac e-transfer®, US \$ chequing, and Life Income Funds. We will continue to roll out our Creating Member Loyalty program, in order to further improve our member service and give you more reasons to do business with Kawartha.



On behalf of the Board and management team, we offer our sincere thanks to our dedicated employees for your commitment to Kawartha's success. Through your efforts the company has enjoyed another successful year. To our members, we thank you for your ongoing support. We will continue to do our best to warrant your trust, to make you proud to be a member of Kawartha, and to earn your business.

Respectfully,

A handwritten signature in black ink, appearing to read "R Wellstood".

Robert Wellstood
Chief Executive Officer

A handwritten signature in black ink, appearing to read "Carl J. Silvestri".

Carl Silvestri
Chair of the Board



Board of Directors



*Carl
Silvestri
(Chair)*



*Ken
Stickle
(Vice Chair)*



*Michael
Minicola
(Corporate
Secretary)*



*Robert
Lake
(Audit
Committee
Chair)*



*Earl
Robbins
(Governance
Committee
Chair)*



*Dave
Standen
(Nominating
Committee
Chair)*



*Lloyd
Churchill*



*Robert
George*



*Harvey
Spry*



*Beverley
Carty*



*Janice
James*



*Ellen
Menzies
(Recording
Secretary)*

Report from the Governance Committee

One of the goals of the Board of Directors is to provide the best governance possible for Kawartha Credit Union. The Governance Committee's role is to assist in achieving that goal, by making recommendations to create, promote and enhance policies and programs for:

- a. Corporate governance;
- b. Board and committee composition; and
- c. Director education, knowledge, skills and abilities

The Governance Committee met seven times in 2012.

Key activities included:

1. Considered the Governance policy implications of the merger with Unity Savings and Credit Union in conjunction with a review of existing governance policies and made recommendations for improvement.
2. Recommended to the Board policy changes to implement the DICO Guidance Note: Director Training and Qualifications. This resulted in the introduction of Director competency requirements, a new assessment process, and Director training plans.
3. Recommended to the Board of Directors updated qualifications and selection criteria for Directors.

4. Reviewed and made a recommendation to the Board regarding the adequacy of Director compensation.
5. Monitored compliance with the mandatory Director education program.

The Board has approved all Committee recommendations.

Respectfully submitted,



Earl Robbins, Governance Committee Chair
Committee: Beverley Carty, Lloyd Churchill, Dave Standen,
Ken Stickle

Commercial Development 2012

COMMERCIAL LOANS BY TYPE OF BUSINESS

Type of Business	# of Loans	Disbursed
Agriculture, Forestry, Fishing & Hunting	9	\$ 3,135,500
Utilities	8	3,144,684
Construction	6	1,702,298
Manufacturing	2	645,000
Wholesale Trade	4	540,000
Retail Trade	14	3,878,991
Information	1	1,000
Transportation & Warehousing	1	109,000
Real Estate - Rental & Leasing	21	7,079,709
Administrative, Support, Waste Management	3	51,400
Education Services	1	1,000
Health Care & Social Assistance	3	7,974,773
Arts, Entertainment & Recreation	5	993,428
Accommodation & Food Services	30	13,784,764
Other Services (except public administration)	7	923,634
TOTAL	115	43,965,181

COMMERCIAL LOANS BY SIZE

Size	# of Loans	Disbursed
Less than \$25,000	29	\$ 336,829
\$25,000 to \$99,999	20	1,389,643
\$100,000 to \$499,999	44	12,077,680
Over \$500,000	22	30,161,029
TOTAL	115	\$ 43,965,181

Credit Statistics 2012

Total interviews for consumer and commercial credit:

Consumer	8,251	
Commercial	925	
Total declined requests for consumer and commercial credit:	2,141	
Accounts in arrears greater than 90 days:	115	\$ 7,056,651

APPROVED CREDIT

Consumer Loans	2,266	\$ 33,712,567
Consumer Lines of Credit	2,059	\$ 55,107,857
Consumer Overdrafts	381	\$ 212,235
Residential Mortgages	884	\$ 138,491,810
Commercial Mortgages	54	\$ 39,019,447
Agricultural Mortgages	4	\$ 1,445,500
Commercial Loans	7	\$ 253,934
Agricultural Loans	1	\$ 30,000
Commercial Lines of Credit	35	\$ 3,199,500
Commercial Overdrafts	14	\$ 16,800
Total Approved Credit	5,705	\$ 271,489,650

Community Involvement Program

Supporting the well-being of the communities we serve is one of our credit union's guiding principles. Kawartha Credit Union distributes funds and gifts-in-kind to causes that affect the most positive community advantage. We strive to remain a vital contributor through corporate donations and sponsorships, and in 2012 we invested \$200,000 (2.7% of our after-tax net earnings) to causes that matter most to our members in the regions that encompass our 25 branches. These causes include:

HEALTHCARE

We strive to benefit the greatest number of people in the communities we serve by supporting health centres and broader health concerns.

YOUTH AND EDUCATION

Literacy and learning improve quality of life, enhance prosperity and encourage the development of critical skills to contribute to economic viability.

ENVIRONMENT

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

COMMUNITY SUPPORT AND DEVELOPMENT

From shelters to community centres, our contributions help to strengthen the infrastructures that support independence.

Our dedicated employees also lend their time and talents to a variety of causes and make important contributions. They build solid relationships with our community partners, and participate in initiatives above and beyond those we support through our corporate Community Involvement Program.

Giving Back



Jane Fullarton (l) and Lindsay Butcher-Dodds (r) from Brockville Big Brothers, Big Sisters accept a donation from Mary Haddow, Brockville Branch Manager.

Photo: Andy Wheeler, SNAP Brockville



Al Mackay, Lansdowne Place Branch Manager presents a cheque to Camp Kawartha's Executive Director, Jacob Rodenburg.



Left to right: Rosann Carr from Cornwall Hospice accepts a cheque from Lynn Healey FSR and Joanne Montford, Branch Manager.

Staff Recognition Awards

	2008	2009	2010	2011	2012
Branch Awards					
Highest Overall Growth %	Little Britain	Keene	Huntsville	Huntsville	Kinmount
Highest Overall Growth \$	Monaghan	Monaghan	Huntsville	Huntsville	Monaghan
100% Club	No entry	No entry	No entry	No entry	Bancroft
Community Commitment Award	Emsdale	Bancroft	Cobourg	Administration Department	Lindsay
Individual Awards					
Manager of the Year	Connie White	Karen Woodman	Susan Wakeford	Karen Munro	Andrew Smith
Extra Mile Award	Carol Davis	Diana Andrews	Stefanie DiMarco	Paige Harris	Christine Cassidy
	Linden Gage	Susie Lodge	Betty Dickson	Amie Keech	Fred Maynard
	Lana Koch	Bonnie Rickward	Arlene McKee	Jessica Harnum	Nicole McArthur
Glen Davies	Kristy DiMarco	Suzanne Shannon	Dan MacNamee	Deb Elacqua	Steve Self

Independent Auditors' Report

To the Members of Kawartha Credit Union Limited

Report on the Summary Financial Statements

The accompanying summary financial statements, which comprise the summary statements of financial position as at December 31, 2012, September 30, 2011 and October 1, 2010, and the summary statements of comprehensive income for the 15 month period ended December 31, 2012 and for the year ended September 30, 2011 (the "Summary Financial Statements"), are derived from the audited financial statements of Kawartha Credit Union Limited for the 15 month period ended December 31, 2012 and for the year ended September 30, 2011. We expressed an unmodified audit opinion on those financial statements in our report dated February 20, 2013.

The Summary Financial Statements do not contain all disclosures required by International Financial Reporting Standards. Reading the Summary Financial Statements, therefore, is not a substitute for reading the audited financial statements of Kawartha Credit Union Limited.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of Summary Financial Statements based on the audited financial statements of Kawartha Credit Union Limited for the 15 month period ended December 31, 2012.

Auditors' Responsibility

Our responsibility is to express an opinion on the Summary Financial Statements based on our procedures, which were conducted in accordance with Canadian Audit Standards (CAS) 810, 'Engagements to Report on Summary Financial Statements.'

Opinion

In our opinion, the Summary Financial Statements derived from the audited financial statements of Kawartha Credit Union Limited for the 15 month period ended December 31, 2011 and for the year ended September 30, 2011 are a fair summary of those financial statements.

BDO Canada LLP

Chartered Accountants, Licensed Public Accountants

Peterborough, Ontario

March 4, 2013

Report from the Audit Committee

The Audit Committee's function is to assist the Board of Directors in fulfilling 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 comprised 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 2012 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;
- Review risk management issues;
- Review internal audit activities; and
- Complete a self-assessment on the effectiveness of the Committee and take the necessary steps to ensure effectiveness.

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,



Robert Lake, Audit Committee Chair
Committee: Harvey Spry, Robert George, Michael Minicola

Statement of Financial Position

(thousands of Canadian dollars)

December 31, 2012

September 30, 2011

October 1, 2010

Assets

Cash resources	\$ 19,173	\$ 16,811	\$ 18,570
Liquidity deposits	57,144	40,771	45,939
Investments	10,028	6,611	6,331
Derivative financial instruments	692	1,694	1,008
Loans to members	858,506	650,850	586,027
Other assets	8,268	6,972	4,786
Property and equipment	12,118	4,740	4,938
	\$ 965,929	\$ 728,449	\$ 667,599

Liabilities

Term loans	\$ 39,000	\$ 25,000	\$ 53,000
Member deposits	802,101	604,912	557,835
Accounts payable and accrued liabilities	4,037	5,263	4,628
Derivative financial instruments	978	2,056	1,166
Securitized mortgages under administration	42,301	34,714	-
Members' shares	1,137	866	845
Employee future benefits	4,388	4,055	3,576
	893,942	676,866	621,050

Members' Equity

Class A Investment Shares	25,830	12,495	12,495
Class B Affinity Shares	7,368	5,746	3,757
Contributed surplus	258	230	210
Retained earnings	39,061	33,650	30,094
Accumulated other comprehensive income	(530)	(538)	(7)
	71,987	51,583	46,549
	\$ 965,929	\$ 728,449	\$ 667,599

Approved by the Board:

Carl J. Silvestri

Director

Robert F. Baker

Director

Please see full financial statement
for accompanying notes.

Statement of Comprehensive Income

(thousands of Canadian dollars)	15 month period ended December 31, 2012	Year ended September 30, 2011
Financial Revenue		
Interest on loans to members	\$ 48,334	\$ 32,249
Investment income	1,075	787
	49,409	33,036
Financial Expense		
Interest on deposits	16,679	10,726
Interest on borrowings	595	538
	17,274	11,264
Financial Margin	32,135	21,772
Other Income	6,512	4,897
	38,647	26,669
Operating Expenses		
Salaries and employee benefits	16,582	10,969
Loan loss expense	970	767
Occupancy	3,647	2,067
Banking costs	1,077	741
Other expenses	3,974	2,428
Data costs	2,307	1,145
Deposit insurance	804	462
Promotion	1,422	1,207
Directors' expenses	230	136
	31,013	19,922
Operating Income	7,634	6,747
Increase in fair value of investments	848	219
Gain on amalgamation	1,273	-
Patronage distributions	(1,724)	(2,069)
Income before income taxes	8,031	4,897
Income tax expense	756	584
Net Income	7,275	4,313
Other comprehensive income (loss)		
Unrealized gains (losses) on financial derivatives designated as cash flow hedges net of tax effect	8	(531)
Comprehensive income	\$ 7,283	\$ 3,782

Our Newest Branch Communities



Kingston, Ontario



Napanee, Ontario*



Brockville, Ontario*



Cornwall, Ontario

OUR BRANCH COMMUNITIES:

Bancroft • Brockville • Bracebridge • Burk's Falls • Cobourg
Coe Hill • Cornwall Emsdale • Huntsville • Keene • Kingston
Kinmount • Lindsay • Little Britain • Magnetawan • Napanee
Parry Sound • Peterborough • South River • Trenton



www.kawarthacu.com