

**2010 FINANCIAL REPORTS OF  
FIRSTONTARIO CREDIT UNION LIMITED**

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## REPORT ON MANAGEMENT RESPONSIBILITY

The accompanying Consolidated Financial Statements and all information contained in this Annual Report are the responsibility of the Management of FirstOntario Credit Union Limited, which is responsible for the integrity and fairness of the information presented. The financial statements, in the opinion of Management, have been prepared using appropriate accounting policies that are in accordance with Canadian generally accepted accounting principles and the Credit Unions and Caisses Populaires Act, 1994 (Ontario) and are based on informed judgments and estimates of the expected effects of current events and transactions.

To meet its responsibility for the integrity and objectivity of data in the financial statements, Management has developed and maintains a system of internal accounting controls. Management believes that this system of internal controls provides reasonable assurance that the financial records are reliable and form a proper basis for preparation of financial statements and that assets are properly accounted for and are safeguarded.

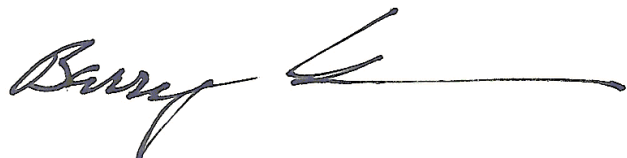
The Board of Directors is responsible for reviewing and approving the Consolidated Financial Statements and for overseeing Management's performance of its financial reporting responsibilities. The Board of Directors carried out its responsibility for the financial statements through its regular review of financial results and operations and through its Audit Committee. The Member-appointed auditors have full and free access to, and meet periodically with, the Audit Committee and may meet with the Board of Directors, with or without Management present, to discuss their audit and matters relating to financial statement presentation, internal controls and audit procedures.

The Deposit Insurance Corporation of Ontario conducts periodic examination of the financial conditions and affairs of FirstOntario. The examination includes review of FirstOntario's compliance with the provisions of the Act.

KPMG LLP, Member-appointed external auditors, has examined the Consolidated Financial Statements in accordance with Canadian generally accepted auditing standards and their report is shown as part of the Consolidated Financial Statements.



Kelly McGiffin  
President and Chief Executive Officer  
October 12, 2010



Barry Doan, CA  
Executive Vice President and Chief Financial Officer

## Loan Statistics

For the year ended August 31, 2010

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Total retail loan applications received	9,863
Total retail loans declined	3,510

### Retail loans granted include:

Personal loans	3,734 for	\$ 47,189,525
Mortgages	1,214 for	\$ 157,192,182
Lines of Credit	913 for	\$ 9,237,292
MeritLines	492 for	\$ 48,583,850

### Commercial loans granted include:

Demand term loans	5 for	\$ 3,758,995
Demand operating loans	4 for	\$ 700,000
Commercial mortgages	30 for	\$ 54,878,038

### Delinquent loans:

Total loans delinquent, 90 days and over	48 loans
Value of loans delinquent, 90 days and over	\$2,223,102

## REPORT OF THE AUDIT COMMITTEE

FirstOntario Credit Union Limited's Audit Committee is a committee of the Board of Directors pursuant to Section 125 of the Credit Unions and Caisses Populaires Act, 1994 (Ontario) and Section 27 of Ontario Regulation 237/09 . The Committee, which consists of four directors, has a mandate to cover all of the duties, which are specified to be performed by audit committees in the Regulations of the Act.

The Audit Committee is pleased to report to the Members of FirstOntario that it has fulfilled its annual mandate. During the year the Committee held five meetings and completed the following significant activities:

- Served as the principal communication link between the external auditors and the Board of Directors and, in particular, reviewed the terms of engagement and scope of the audit, and reviewed FirstOntario's annual financial statements prior to Board approval for issuance to the Members.
- Obtained a reasonable understanding of the important elements of internal controls that are important to safeguarding the assets of FirstOntario, ensuring the accuracy of financial reports and ensuring compliance with policies and procedures.
- Served as the Board's liaison with the internal auditor and reviewed the internal audit mandate, work plan and reports.
- Reviewed the policies, procedures and controls, which relate to legislative compliance, with a particular focus on requirements for liquidity, capital adequacy and interest rate management.

There are no significant recommendations made by the Audit Committee that have not been either implemented or are in the process of being implemented. In addition, there are no matters which the Audit Committee believes should be reported to the Members, other than as described above, nor are there any further matters that are required to be disclosed pursuant to the Act or the Regulations thereto.

Based on its findings, the Audit Committee issues reports and makes recommendations to the Board of Directors or senior management, as appropriate, with respect to the matters outlined above and follows up to ensure that the recommendations are considered and implemented. During the year, the Committee received full co-operation and support from management to enable it to play an effective role in maintaining the quality of financial reporting to the Members and enhancing the overall control structure of the Credit Union.



Catherine Rogers

Chair, Audit Committee

October 12, 2010

## AUDITORS' REPORT

To the Members of  
FirstOntario Credit Union Limited

We have audited the consolidated balance sheet of FirstOntario Credit Union Limited as at August 31, 2010 and the consolidated statements of earnings, changes in member's equity, comprehensive income and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Credit Union's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of the Credit Union as at August 31, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, slightly slanted style. Below the signature is a single horizontal line that starts under the 'K' and ends under the 'P'.

Chartered Accountants, Licensed Public Accountants

Hamilton, Ontario

October 12, 2010

# FIRSTONTARIO CREDIT UNION LIMITED

## Consolidated Balance Sheet

August 31, 2010 with comparative figures for August 31, 2009

(In thousands of dollars)

	2010	2009
<b>Assets</b>		
<b>Loans Receivable from Members</b>		
Residential mortgage loans (note 3)	\$ 566,613	\$ 396,138
Personal loans (note 3)	128,858	126,025
Commercial loans (note 3)	367,749	382,530
Accrued interest receivable	4,901	4,222
	<b>1,068,121</b>	<b>908,915</b>
<b>Other</b>		
Cash	18,259	35,477
Investments (note 6)	109,837	106,580
Fixed assets (note 7)	12,346	11,647
Derivative financial instruments (note 12)	778	1,005
Other assets	9,636	9,873
	<b>\$ 1,218,977</b>	<b>\$ 1,073,497</b>
<b>Liabilities</b>		
<b>Members' Deposits and Shares</b>		
Deposits (note 8)	\$ 1,009,454	\$ 943,956
Membership shares (note 9)	5,306	5,037
Investment shares (note 9)	12,155	12,817
Accrued interest on deposits and shares	8,701	12,008
	<b>1,035,616</b>	<b>973,818</b>
<b>Other</b>		
Loans payable (note 11)	79,000	35,000
Accounts payable and accrued liabilities	19,332	15,008
Derivative financial instruments (note 12)	7,314	8,193
	<b>1,141,262</b>	<b>1,032,019</b>
<b>Members' Equity</b>		
Investment shares (note 9)	32,405	-
Retained earnings	47,276	44,156
Accumulated other comprehensive loss	(1,966)	(2,678)
	<b>77,715</b>	<b>41,478</b>
	<b>\$ 1,218,977</b>	<b>\$ 1,073,497</b>

Commitments (note 17)

See accompanying notes to Consolidated Financial Statements.

On behalf of the Board:



Director



Director

# FIRSTONTARIO CREDIT UNION LIMITED

## Consolidated Statement of Earnings

For the year ended August 31, 2010 with comparative figures for the year ended August 31, 2009

(In thousands of dollars)	2010	2009
<b>Interest and Investment Income</b>		
Residential mortgage loans (note 3)	\$ 17,585	\$ 17,768
Personal loans (note 3)	8,997	7,984
Commercial loans (note 3)	24,428	24,183
Other	4,067	2,377
	<b>55,077</b>	<b>52,312</b>
<b>Interest Expense</b>		
Members' deposits (note 8)	19,873	23,716
Dividends on membership and investment shares (note 9)	543	658
Derivative instruments	5,002	3,431
Other	279	732
	<b>25,697</b>	<b>28,537</b>
<b>Operating Margin Before the Following</b>		
Provision for impaired loans (note 4)	(789)	(1,834)
Other income	8,382	16,678
<b>Operating Margin</b>	<b>36,973</b>	<b>38,619</b>
<b>Operating Expenses</b>		
Salaries and employee benefits	18,533	17,023
Administrative	11,423	10,546
Occupancy	2,701	2,729
Members' deposit insurance protection (note 1)	826	781
Life insurance on life savings deposits	63	126
	<b>33,546</b>	<b>31,205</b>
<b>Operating Income</b>	<b>3,427</b>	<b>7,414</b>
<b>Unrealized Gains (Losses)</b>		
Investments	(150)	(1,356)
Net gains (losses) on derivative financial instruments	375	(262)
	<b>225</b>	<b>(1,618)</b>
<b>Earnings Before Income Taxes</b>	<b>3,652</b>	<b>5,796</b>
Income taxes (note 16)	532	768
<b>Net earnings for the year</b>	<b>\$ 3,120</b>	<b>\$ 5,028</b>

See accompanying notes to Consolidated Financial Statements.

# FIRSTONTARIO CREDIT UNION LIMITED

## Consolidated Statement of Comprehensive Income

For the year ended August 31, 2010 with comparative figures for the year ended August 31, 2009

(In thousands of dollars)	2010	2009
Net earnings for the year	\$ 3,120	\$ 5,028
<b>Other Comprehensive Income (Loss), net of tax</b>		
Net change in unrealized losses on derivatives designated as cash flow hedges (net of income tax expense of \$46,000, 2009 – recovery of \$28,000)	232	(140)
Net change in unrealized losses on available-for-sale investments (net of income tax expense of \$95,000, 2009 – recovery of \$164,000)	480	(832)
<b>Comprehensive Income</b>	<b>\$ 3,832</b>	<b>\$ 4,056</b>

## Consolidated Statement of Changes in Members' Equity

For the year ended August 31, 2010 with comparative figures for the year ended August 31, 2009

(In thousands of dollars)	2010	2009
<b>Investment Shares (Note 9):</b>		
Balance at beginning of year	\$ -	\$ -
Shares issued during year, net of issuance costs	32,405	-
<b>Balance, end of year</b>	<b>32,405</b>	<b>-</b>
<b>Retained Earnings:</b>		
Balance at beginning of year	44,156	39,128
Net earnings for the year	3,120	5,028
<b>Balance, end of year</b>	<b>47,276</b>	<b>44,156</b>
<b>Accumulated Other Comprehensive Loss:</b>		
Balance at beginning of year, net of tax	(2,678)	(1,706)
Other comprehensive income (loss), net of tax	712	(972)
<b>Balance, end of year</b>	<b>(1,966)</b>	<b>(2,678)</b>
<b>Total Member's Equity</b>	<b>\$ 77,715</b>	<b>\$ 41,478</b>

See accompanying notes to Consolidated Financial Statements.

# FIRSTONTARIO CREDIT UNION LIMITED

## Consolidated Statement of Cash Flows

For the year ended August 31, 2010 with comparative figures for the year ended August 31, 2009

(In thousands of dollars)	2010	2009
<b>Cash Flows from Operating Activities</b>		
Net earnings for the year	\$ 3,120	\$ 5,028
Adjustments for:		
Amortization of fixed assets	2,659	2,671
Impairments recorded on investments	150	2,187
Net changes in accrued interest receivable and payable	(4,059)	1,933
Net changes in employee retirement benefits accrued benefit liabilities	394	(1,275)
Other non-cash items, net	4,026	3,592
Net change in derivative financial instruments, other than derivatives designated as cash flow hedges	(374)	3,348
<b>Cash flows from operating activities</b>	<b>5,916</b>	<b>17,484</b>
<b>Cash Flows from Financing Activities</b>		
Net change in deposits	65,498	77,548
Net change in membership shares	269	161
Net change in investment shares	31,743	235
Net change in loans payable	44,000	(12,000)
<b>Cash flows from financing activities</b>	<b>141,510</b>	<b>65,944</b>
<b>Cash Flows used in Investing Activities</b>		
Net change in loans	(158,527)	(44,940)
Net investment purchases	(2,759)	(14,413)
Purchase of fixed assets, net of disposals	(3,358)	(441)
<b>Cash flows used in investing activities</b>	<b>(164,644)</b>	<b>(59,794)</b>
<b>Cash</b>		
Net increase (decrease) during year	(17,218)	23,634
Balance at beginning of year	35,477	11,843
<b>Balance at end of year</b>	<b>\$ 18,259</b>	<b>\$ 35,477</b>
<b>Supplementary Cash Flow Information</b>		
Interest received during the year	\$ 54,457	\$ 53,026
Interest paid during the year	\$ 29,004	\$ 27,323
Income taxes paid (recovered) during the year	\$ (24)	\$ 424

See accompanying notes to Consolidated Financial Statements.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 1. Significant Accounting Policies:

FirstOntario Credit Union Limited ("FirstOntario") is incorporated under and operates in compliance with the Credit Unions and Caisses Populaires Act of Ontario (the "Act") and is a member of Central 1 Credit Union ("Central 1"). FirstOntario's Member deposits are insured by the Deposit Insurance Corporation of Ontario ("DICO") under a mandatory program, the expense for which amounted to \$826,000 in 2010 and \$781,000 in 2009. At August 31, 2010 there were 76,226 Members (2009 – 71,718).

The Consolidated Financial Statements of FirstOntario have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of Consolidated Financial Statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the Consolidated Balance Sheet date and the reported amounts in revenue and expenses during the reporting period. Actual results could differ from those estimates.

The significant accounting policies used in the preparation of these Consolidated Financial Statements are summarized below. These accounting policies conform, in all material respects, to Canadian generally accepted accounting principles.

#### (a) Basis of consolidation:

The Consolidated Financial Statements include the assets, liabilities and results of the operations of FirstOntario and its wholly owned subsidiary 1320818 Ontario Limited which supplies information technology services and operates the banking system for FirstOntario. All intercompany transactions and balances have been eliminated.

Investments in which FirstOntario exercises joint control are accounted for using the proportionate consolidation method, whereby FirstOntario's share of assets, liabilities, revenue and expenses of the joint venture are included in the Consolidated Financial Statements. Investments are considered to be jointly controlled if there is a contractual agreement to share authority over determining the investments' operating, investment and financing policies. The joint ventures in which FirstOntario participates consist of investments in retail complexes which generate income from the leasing of space for commercial use.

#### (b) Financial instruments - recognition and measurement:

Financial assets and liabilities, including derivatives, are recognized on the Consolidated Balance Sheet of FirstOntario at the time that FirstOntario becomes party to the contractual provisions of the instrument. FirstOntario recognizes financial instruments at the trade date.

All financial assets and liabilities are measured at fair value upon initial recognition, except for certain related party transactions. Subsequent measurement is dependent upon the financial instrument's classification.

Financial instruments comprise cash, derivatives, investments, loans receivable from Members, Member's deposits and shares, loans payable and accounts payable and accrued liabilities.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 1. Significant Accounting Policies (continued):

#### (b) Financial instruments - recognition and measurement (continued):

##### Classification of financial instruments

Held for trading ("HFT") financial assets and liabilities are acquired or incurred principally for resale, generally within a short period of time. They are measured at fair value at each balance sheet date. Gains and losses realized on disposal together with dividends and interest earned on these instruments are reported in interest and investment income. Unrealized gains and losses from market fluctuations are reported separately in the Consolidated Statement of Earnings. There are regulatory restrictions imposed by the Financial Services Commission of Ontario on the use of this designation including that loan financial assets are precluded from being designated HFT and that the fair value designated financial instruments are managed on a fair value basis.

Held to maturity ("HTM") financial assets are non-derivative financial assets with fixed or determinable payments, other than Loans and Receivables that FirstOntario has the positive intention and ability to hold to maturity. These financial assets are accounted for at amortized cost using the effective interest method of amortization.

Available for sale ("AFS") financial assets are those non-derivative financial assets that are not designated as HFT, HTM or Loans and Receivables. AFS instruments are carried at fair value whereby the unrealized gains and losses are included in accumulated other comprehensive income ("AOCI"), as discussed below, until sale or other-than-temporary impairment when the cumulative gain or loss is transferred to the Consolidated Statement of Earnings. AFS equity instruments that do not have quoted market values in active markets are carried at cost. Realized gains and losses on sale are recorded in other income. Write downs to reflect other-than-temporary impairment in value are recorded in unrealized gains (losses).

Financial assets classified as Loans and Receivables are accounted for at amortized cost using the effective interest method of amortization.

Financial liabilities designated as Other Liabilities are recorded at amortized cost.

Designation of investment instruments is outlined in note 6. Designation of all financial instruments is outlined in note 14.

##### Effective interest method

Interest income and expense are recognized in the Consolidated Statement of Earnings using the effective interest method. The effective interest rate is the rate that discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability to its fair value at inception. The effective interest rate is established on initial recognition of the financial asset or liability and is not revised subsequently. The calculation of the effective interest rate includes transaction costs, fees and discounts or premiums that are an integral part of the interest rate.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 1. Significant Accounting Policies (continued):

#### (b) Financial instruments - recognition and measurement (continued):

##### Transaction costs

Transaction costs are incremental costs that are directly attributable to the acquisition, issuance or disposal of a financial asset or liability. Transaction costs related to HFT financial assets and liabilities are expensed as incurred. Transaction costs relating to AFS and HTM assets and loans and receivables are capitalized and amortized over the expected life of the instrument using the effective interest method.

##### Derivative financial instruments

Derivative financial instruments are financial contracts whose value is derived from interest rates or other financial indices in the equity markets. In the ordinary course of business, FirstOntario enters into various derivative contracts, including interest rate swaps, equity-linked options and foreign exchange forwards. FirstOntario enters into such contracts to manage interest rate fluctuations and foreign exchange risk as part of FirstOntario's asset/liability management program.

Derivatives are carried at fair value and are reported as assets where they have a positive fair value and as liabilities where they have a negative fair value. In both cases they are reported as derivative financial instruments in the financial statements.

Derivatives embedded in other financial instruments are valued as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivatives would meet the definition of a derivative if it was a free standing instrument, and the combined contract is not designated as HFT and recorded at fair value. These embedded derivatives are classified as part of the host instrument and measured at fair value with changes therein recognized on the Consolidated Statement of Earnings.

Interest rate swaps involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based. Equity-linked options are purchased to hedge deposit products whose interest is linked to various equity indices or a specific bundle of equities. These contracts pay returns based on the change in value of equity indices or a specific bundle of equities.

Foreign exchange contracts are used to hedge FirstOntario's net US dollar liability position.

##### Hedges

FirstOntario formally documents all relationships between hedging instruments and hedged items; as well as risk management objectives and strategies for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the Consolidated Balance Sheet or specific firm commitments or forecasted transactions. FirstOntario also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. FirstOntario designates its interest rate hedge agreements as hedges of the underlying financial instrument.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 1. Significant Accounting Policies (continued):

#### (b) Financial instruments - recognition and measurement (continued):

##### Hedges (continued)

CICA Handbook section 3865 specifies the criteria that must be satisfied in order for hedge accounting to be applied and prescribes the accounting treatment for those permitted hedging strategies applicable to FirstOntario - fair value hedges and cash flow hedges.

In a fair value hedge, the change in fair value of the hedging derivative is offset on the Consolidated Statement of Earnings by the change in fair value of the hedged item relating to the hedged risk. FirstOntario utilizes fair value hedges primarily to convert fixed rate financial assets and liabilities to floating rate. The main financial instruments designated in fair value hedging relationships are loans. If the derivative expires or is sold, terminated or exercised, no longer meets the criteria for fair value hedge accounting, or the designation is revoked, hedge accounting is discontinued. The fair value of the hedged item related to the hedged risk is reported as other assets.

In a cash flow hedge, the effective portion of changes in fair value of the derivative is recognized in other comprehensive income ("OCI"). The amount recognized in OCI is reclassified and included on the Consolidated Statement of Earnings in the same period that the hedged cash flows affect income. The amount of other comprehensive loss that is expected to be reclassified to the Consolidated Statement of Earnings over the next 12 months is \$941,694 (2009 – \$1,535,000). This will be offset by increased net interest income on assets and liabilities that are hedged. FirstOntario utilizes cash flow hedges primarily to convert floating rate assets and liabilities to fixed rate. Any hedge ineffectiveness is measured and recorded in the Consolidated Statement of Earnings.

When either a fair value or cash flow hedge is discontinued, any cumulative adjustment to either the hedged item or other comprehensive income (loss) is recognized in income over the remaining term of the original hedge (fair value hedge) and as the hedged item impacts earnings (cash flow hedge) or immediately if the hedged item is derecognized.

Accrued interest receivable is recorded in other assets and accrued interest payable is recorded in accounts payable and accrued liabilities. Interest income or expense is recorded in interest income or interest expense, as applicable.

#### (c) Loans receivable from Members:

Loans are initially measured at fair value net of direct transaction costs and revenues and are subsequently re-measured at their amortized cost (net of an allowance for impaired loans) using the effective interest method.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 1. Significant Accounting Policies (continued):

#### (c) Loans receivable from Members (continued):

FirstOntario maintains an allowance for impaired loans, which in management's opinion, is considered adequate to absorb all loan-related losses. The allowance for impaired loans represents specific and non-specific provisions. Specific allowances are calculated on individual loans when they become impaired. A loan is impaired at the earlier when, in the opinion of management, there is reasonable doubt as to the collectability of principal and interest, or when loan payments are 90 days past due. Non-specific allowances are established to absorb probable loan losses not yet specifically identified on a loan-by-loan basis. The non-specific allowance is based on portfolio quality, past experience, current economic conditions and management's judgment.

#### (d) Loan securitizations:

FirstOntario periodically securitizes personal loans, residential mortgages and commercial loans by selling them to Central 1 or other funding partners. These transactions are accounted for as a sale when control over the loans and mortgages has been surrendered and FirstOntario has received consideration in exchange.

Revenue from servicing loans and mortgages is recorded as the services are provided.

Gains on these transactions are reported as other income on the Consolidated Statement of Earnings. The amount of these gains is based on the present value of expected future cash flows using management's best estimates of key assumptions such as prepayment rates, excess spread, credit losses and discount rates.

FirstOntario typically retains interests in the transferred loans and mortgages, such as excess interest spread and servicing rights. Retained interests are designated as AFS and are measured at fair value. The fair value of the retained interests is estimated using the same present value methodology described above for gains or losses on securitization. The carrying value of retained interests are reviewed annually for impairment and adjusted as required.

#### (e) Cash:

Cash includes cash on hand, current accounts, short term deposits with other financial institutions, cheques and other items in transit. Given their short term nature, the carrying value of cash equals fair value.

#### (f) Investments:

Investments are recorded at fair value unless designated as loans and receivables or AFS investments where there is no active market. Any gains and losses on disposal of investments are recorded in the year they occur and are included in other investment income in the Consolidated Statement of Earnings.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 1. Significant Accounting Policies (continued):

(g) Intangible assets:

Computer software that is not an integral part of other property is accounted for as intangible assets. Computer software is stated at cost less accumulated amortization and is presented as part of fixed assets in the Consolidated Balance Sheet. Amortization of computer software is calculated by applying the straight-line method at rates based on estimated useful lives between 3 and 7 years.

(h) Fixed assets:

Fixed assets are stated at cost less accumulated amortization. Amortization on buildings and equipment is provided using the straight-line method at rates based on the estimated useful lives of the related assets as follows:

Asset	
Buildings	20 – 40 years
Parking lots and site improvements	10 – 25 years
Equipment	3 – 10 years
Leasehold improvements	term of lease

(i) Shares:

Membership and investment shares are classified either as liabilities or Member's Equity. Where shares are redeemable at the option of the Member, either on demand or on withdrawal from membership, the shares are classified as other liabilities and carried at amortized cost. Shares that are redeemable at the discretion of FirstOntario's Board of Directors are classified as equity.

Dividends on shares classified as other liabilities are reported as interest expense. Dividends on shares classified as equity are charged to retained earnings on the date at which distributions are declared payable by the Board of Directors.

(j) Revenue recognition:

Loan interest and revenue is recognized on the effective yield basis except when interest is ninety days past due or earlier when, in the opinion of management, there is doubt as to the collectability of principal or interest.

(k) Foreign exchange:

Financial assets and liabilities denominated in foreign currencies, primarily US dollars, are translated into Canadian dollars at rates prevailing at the year-end. Fixed assets are carried at the historical Canadian dollar cost. Income and expenses are translated at the exchange rates in effect on the date of the transactions. Exchange gains and losses arising on the translation of financial assets and liabilities are included in other income.

(l) Employee retirement benefits:

FirstOntario provides retirement benefits to certain employees. These benefits include registered pension plans, medical benefits, dental care and life insurance.

Defined contribution pension plan contributions are expensed in the year earned.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 1. Significant Accounting Policies (continued):

#### (l) Employee retirement benefits (continued):

The costs of defined benefit post-employment benefits (including medical benefits, dental care, life insurance, and defined benefit pension plans) related to the employees' current service is charged to income annually. The cost is computed on an actuarial basis using the projected benefit method estimating the usage frequency and cost of services covered and management's best estimates of investment yields, salary escalation, and other factors. Transitional obligations are being expensed over the average remaining service period of the employees.

FirstOntario uses the corridor method to amortize actuarial gains or losses (such as changes in actuarial assumptions and experience gains or losses) over the average remaining service life of active employees. Under the corridor method, amortization is recorded only if the accumulated net actuarial gains or losses exceed 10% of the greater of the accrued benefit obligation and the value of the plan assets. The average remaining service period of the active employees covered by the defined benefit pension plans is 18 years. The average remaining service period of the active employees covered by the other post-employment benefit plan is 9 years.

When the restructuring of a benefit plan gives rise to a curtailment, the curtailment is accounted for at the time of restructuring.

#### (m) Income taxes:

FirstOntario follows the asset and liability method of accounting for income taxes, whereby FirstOntario recognizes both the current and future income tax consequences of all transactions that have been recorded in the financial statements. Future income tax assets and liabilities are determined based on the tax rates that are expected to apply when the assets or liabilities are reported for tax purposes.

Future tax assets and liabilities are included either in other assets or accounts payable and accrued liabilities, as applicable, in the Consolidated Balance Sheet.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 2. Change in Accounting Policies:

#### Current year changes

Effective September 1, 2009, FirstOntario adopted the following new accounting pronouncements issued by the Canadian Institute of Chartered Accountants (“CICA”):

- (a) CICA Handbook Section 1582 “Business Combinations” replaces Section 1581 “Business Combinations” if early application is elected. Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under International Financial Reporting Standards (“IFRS”). FirstOntario chose to apply the section prospectively from the beginning of its fiscal year, September 1, 2009, and therefore was also required to adopt Section 1601, “Consolidated Financial Statements”. As a result of this adoption, FirstOntario is required to account for business combinations by applying the acquisition method. Refer to Note 19 for disclosures related to the acquisition of Canal City Savings and Credit Union Limited.
- (b) Amendments to Section 3855 “Financial Instruments – Recognition and Measurement” provide enhanced guidance on the reassessment of embedded derivatives upon reclassifications out of the held-for-trading category under specific circumstances, an expanded definition of loans and receivables, an impairment model for HTM assets that is aligned with the credit loss model in Section 3025, “Impaired Loans”, and additional specific requirements for reclassifications from the HFT and AFS categories to Loans and Receivables. The adoption of the above changes did not have a significant impact on FirstOntario’s Consolidated Financial Statements.
- (c) Amendments to Section 3862 “Financial Instruments – Disclosures” require FirstOntario to provide disclosure on financial instruments measured at fair value on its balance sheet using a fair value hierarchy that reflects the extent to which quoted prices or other market or non-market inputs are used in the valuation of those financial instruments. Refer to Note 14 – Fair Values of Financial Instruments for disclosures relating to fair value measurement. The amendments also enhance existing liquidity risk management disclosure requirements and require a maturity analysis for any derivative and non financial liabilities based on expected maturities. Refer to Note 13 – Financial Risk Management for disclosures relating to liquidity risk management.
- (d) Amendments to Section 1506 “Accounting Changes” excludes from its scope changes in accounting policies upon the complete replacement of an entity’s primary basis of accounting. As a result, FirstOntario is no longer required to disclose the progress of its implementation of International Financial Reporting Standards (“IFRS”) in the notes to the Consolidated Financial Statements.
- (e) CICA Handbook Section 3064, “Goodwill and Intangible Assets,” which replaces Section 3062, “Goodwill and Other Intangible Assets,” and Section 3450, “Research and Development Costs,” establishes standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. The adoption of this new standard did not have a significant impact on FirstOntario’s Consolidated Financial Statements.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 2. Change in Accounting Policies (continued):

#### Regulatory changes

Amendments to the Act came into effect on October 1, 2009. As part of these amendments, additional disclosures were required to be included in these financial statements. These disclosures include information relating to remuneration paid to officers and employees, regulatory capital, liquidity, outstanding loans, and impaired loans.

### 3. Loans Receivable from Members:

Loans receivable from Members, which have been designated as loans and receivables, are as follows:

(In thousands of dollars)	2010	2009
Residential Mortgage Loans	\$ 566,778	\$ 396,141
Allowance for impaired loans	(165)	(3)
	<b>566,613</b>	396,138
Personal Loans	130,779	127,852
Allowance for impaired loans	(1,921)	(1,827)
	<b>128,858</b>	126,025
Commercial Loans	369,486	384,338
Allowance for impaired loans	(1,737)	(1,808)
	<b>367,749</b>	382,530
	<b>\$1,063,220</b>	\$ 904,693

Interest income for the year is as follows:

(In thousands of dollars)	Year Ended August 31 2010	Year ended August 31 2009
Residential Mortgage Loans	\$ 17,585	\$ 17,768
Personal Loans	8,997	7,984
Commercial Loans	24,428	24,183
	<b>\$ 51,010</b>	\$ 49,935

Total fees from third parties associated with lending activities capitalized in other assets were \$2,886,000 as at August 31, 2010 (2009 – \$2,364,000). Charges amortized into interest expense in respect of these fees was \$1,440,000 during 2010 (2009 - \$1,464,000).

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 3. Loans Receivable from Members (continued):

The following summarizes FirstOntario's loan portfolio by the contractual repricing or maturity date, whichever is earlier:

(In thousands of dollars)	2010		2009	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Floating	\$ 313,739	4.06%	\$ 257,534	3.90%
Within 1 year	105,370	5.81%	82,739	6.30%
Over 1 year	647,934	5.83%	568,058	6.23%
	1,067,043	5.31%	908,331	5.57%
Provision for loan losses	(3,823)		(3,638)	
	\$ 1,063,220		\$ 904,693	

### 4. Allowance for Impaired Loans:

A summary of the allowance for impaired loans is as follows:

(In thousands of dollars)					2010	2009
	Residential Mortgage Loans	Personal Loans	Commercial Loans	General Allowance	Total	Total
Balance at beginning of year	\$ 3	\$ 560	\$ -	\$ 3,075	\$ 3,638	\$ 2,494
Loans written off	-	(687)	-	-	(687)	(833)
Recoveries	-	83	-	-	83	143
Net provision for impaired loans	162	666	-	(39)	789	1,834
Balance at end of year	\$ 165	\$ 622	\$ -	\$ 3,036	\$ 3,823	\$ 3,638

A summary of loans past due but not impaired are as follows:

(In thousands of dollars)				2010	2009
	< 30 days	30-59 days	60-89 days	Total	Total
Residential mortgage loans	\$ 4,865	\$ 548	\$ 1,035	\$ 6,448	\$ 6,254
Personal loans	3,011	863	63	3,937	4,081
Commercial loans	-	-	-	-	-
Balance at end of year	\$ 7,876	\$ 1,411	\$ 1,098	\$ 10,385	\$ 10,335

Impaired loans on which interest was not accruing totaled \$2,939,000 at August 31, 2010 (2009 - \$1,954,000).

FirstOntario's commercial loan portfolio contains Member concentration risk, whereby a large amount of the loans are connected to certain individuals. Collectively, the largest five commercial Members by loan dollar value are associated with approximately 30% (2009 - 47%) of the commercial loan portfolio.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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#### 4. Allowance for Impaired Loans (continued):

FirstOntario's commercial loan portfolio consists of the following industry sectors:

	2010	2009
Hospitality	30%	36%
Retail & Commercial Buildings	42%	42%
Other	28%	22%

#### Collateral

There are documented policies and procedures in place for the valuation of financial and non-financial collateral. The fair valuation exercise of non-financial collateral is performed if there has been a significant change in the terms and conditions of the loan and (or) the loan is considered impaired. For impaired loans, an assessment of the collateral is taken into consideration when estimating the net realizable amount of the loan.

The amount and type of collateral and other credit enhancements required depend upon FirstOntario's assessment of counterparty credit quality and repayment capacity. FirstOntario complies with industry standards for collateral valuation, frequency of recalculation of the collateral requirements, documentation, registration and perfection procedures and monitoring. Non-financial assets accepted by FirstOntario as collateral include vehicles, residential real estate, real estate under development, commercial real estate and certain business assets (accounts receivable, inventory, fixed assets). Financial collateral includes cash and negotiable securities issued by governments and investment grade issuers. Guarantees are also accepted to reduce credit risk.

The fair value of collateral held with respect to assets that are either past due greater than 30 days or impaired is \$11,042,000 as at August 31, 2010 (2009 - \$11,384,000).

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 4. Allowance for Impaired Loans (continued):

The following tables illustrate the credit quality of loans that are neither past due nor impaired:

<u>Credit quality of loans – August 31, 2010</u>			
Retail Mortgage and Personal Loans		Commercial Loans	
Rating	% of Portfolio	Rating	% of Portfolio
Unscored	6%	Undoubted	0%
A+	3%	Superior	18%
A	49%	Satisfactory	81%
B	20%	Watch List	1%
C	11%		
D	6%		
E	5%		

<u>Credit quality of loans – August 31, 2009</u>			
Retail Mortgage and Personal Loans		Commercial Loans	
Rating	% of Portfolio	Rating	% of Portfolio
Unscored	7%	Undoubted	0%
A+	5%	Superior	6%
A	51%	Satisfactory	90%
B	18%	Watch List	4%
C	10%		
D	5%		
E	4%		

Refer to Note 13 – Financial Risk Management for a detailed explanation of the credit risk rating process of both portfolios.

### 5. Loan Securitizations:

The following table summarizes FirstOntario's securitization activity during the year ended August 31, 2010:

(In thousands of dollars)	2010			2009		
	Residential mortgages	Personal loans	Commercial mortgages	Residential mortgages	Personal loans	Commercial mortgages
Amount securitized/sold	\$ 26,710	\$ -	\$ 45,895	\$ 246,482	\$ 9,960	\$ 12,700
Net cash proceeds received	26,830	-	45,895	249,100	9,710	12,700
Retained rights to cash reserves	-	-	-	-	249	-
Retained rights to future excess spread	1,638	-	-	10,902	-	-
Pre-tax gain on sale	1,580	-	-	11,275	246	-
Outstanding balances of securitized loans	187,382	-	137,067	231,816	-	94,308

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 5. Loan Securitizations (continued):

Retained rights are reported as investments on the Consolidated Balance Sheet (note 6). The following table summarizes the weighted average key assumptions at the date of securitization for retained rights related to mortgage pools sold in the current year:

	2010			2009		
	Residential mortgages	Personal loans	Commercial mortgages	Residential mortgages	Personal loans	Commercial mortgages
Average life	4.6 years	na	na	3.9 years	2.1 years	na
Prepayment rate	22.32%	na	na	22.32%	18.02%	na
Excess spread	3.29%	na	na	2.80%	5.00%	na
Discount rate	3.97%	na	na	3.59%	1.85%	na
Expected credit losses	0.00%	na	na	0.00%	0.14%	na

The residential mortgage discount rate includes an allowance for expected credit losses.

At year end, the key economic assumptions and the sensitivity of the current fair value of retained interests related to excess spread receivables of two different adverse changes in those assumptions are as follows:

Prepayment rate:

Impact of a 5% increase in prepayment rate (annual %) \$ (498,000)

Impact of a 10 % increase in prepayment rate (annual %) \$ (946,000)

Excess spread:

Impact of a 0.5% point adverse change \$ (1,087,000)

Impact of a 1% point adverse change \$ (2,173,000)

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 6. Investments:

Investments are as follows:

(In thousands of dollars)	2010	2009
Investments held as loans and receivables, amortized cost		
Liquidity reserve deposits – Central 1	\$ 82,328	\$ 73,684
Accrued interest	494	421
Investments available for sale, fair value, liquid		
Preferred shares (a)	13	14
Common shares (a)	2,544	5,043
Income trusts and limited partnerships (a)	284	412
Total liquid investments	85,663	79,574
Investments available for sale, non-liquid		
Amortized cost		
ABCP 2008 Limited Partnership (b)	3,815	4,107
Shares – Central 1/CUCO (c)	7,258	7,234
Fair value		
Retained rights – loan securitizations	6,290	9,409
Real Estate Ventures (d)	6,392	5,994
Other investments	419	262
	\$ 109,837	\$ 106,580

The following summarizes FirstOntario's investments by the contractual repricing or maturity date, whichever is earlier:

(In thousands of dollars)	2010		2009	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Within 1 year	\$ 30,372	1.02%	\$ 67,437	1.08%
Over 1 year	51,956	1.96%	6,247	1.30%
	82,328	1.61%	73,684	1.10%
Non-rate sensitive	27,015		32,475	
Accrued interest	494		421	
	\$109,837		\$106,580	

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 6. Investments (continued):

#### (a) Reclassification of Financial Instruments

As a result of the unprecedented extent of the deterioration in global financial market conditions, FirstOntario's intention changed from actively trading its HFT investments to holding them for an extended period of time. Therefore, these investments were reclassified from HFT to AFS as of September 1, 2008. Subsequent changes in fair value of these assets have been charged to OCI except when other-than-temporary impairment exists.

The tables below present the carrying values, income and losses of the reclassified financial assets.

(In thousands of dollars)	August 31 2010	August 31 2009	September 1 2008
Bonds, debentures and other indebtedness			
of Canada, provinces and corporations	\$ -	\$ -	\$ 150
Preferred shares	13	14	2,008
Common shares	2,544	5,043	7,425
Income trusts and limited partnerships	284	412	543
Total financial assets reclassified to AFS	\$ 2,841	\$ 5,469	\$ 10,126

(In thousands of dollars)	Year Ended August 31, 2010	Year Ended August 31, 2009
Interest and investment income	\$ 518	\$ 551
Other-than-temporary impairment loss recorded on common shares	\$ (150)	\$ (756)
Unrealized pre-tax income (loss) recognized in OCI	\$ 575	\$ (996)

#### (b) ABCP 2008 Limited Partnership:

As a result of the merger between Credit Union Central of Ontario Limited ("CUCO") and Credit Union Central of British Columbia ("CUCBC") to form Central 1 in 2008, member credit unions were required to invest in a limited partnership ("ABCP LP") in order to acquire third-party asset-backed commercial paper ("ABCP"). Members of CUCO were required to purchase units in the ABCP LP based on their proportionate asset size. FirstOntario was required to purchase 6,667,059 units in the ABCP LP.

The fair value of these units is directly related to the ABCP investments held by the ABCP LP. As there is no active market for the underlying ABCP investments, this investment is being carried at cost. During the year, FirstOntario received \$292,011 (2009 - \$1,414,941) capital distributions from ABCP LP that were recorded as a reduction in the original investment.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 6. Investments (continued):

#### (b) ABCP 2008 Limited Partnership (continued):

During 2009, there was an other-than-temporary deterioration in the quality of the underlying ABCP assets in the investment. Accordingly, a \$1,145,000 impairment charge was recorded against the carrying value of the investment. The impairment charge was calculated as the carrying amount of the ABCP investment less its fair value as at August 31, 2009. Fair value of the underlying ABCP in the investment is determined by ABCP LP's independent valuator, Edenbrook Hill Capital Ltd. No further impairment was recorded during 2010.

The ABCP LP is governed by a Board of Directors that was elected by Ontario member credit unions and each limited partner records its proportionate share of net income or loss in the ABCP LP as determined by Canadian generally accepted accounting principles.

#### (c) Central 1/CUCO Shares:

As a member of Central 1, FirstOntario is required to maintain an investment in Central 1 shares equal to its share of the level of capital required by Central 1. FirstOntario's share of Central 1 capital requirements is based on asset size relative to other Class "A" members. Central 1 rebalances the investment annually.

When CUCO and CUCBC merged to form Central 1, CUCO sold substantially all of its assets to Central 1 in exchange for Class A and Class E shares. The final number of shares was subject to future price adjustments. During 2010, FirstOntario was required to purchase 23,924 Central 1 Class A shares and received \$408,000 in dividends from the investment. Central 1 also distributed 1,235,600 Class E shares in exchange for the balance of CUCO shares.

The following table summarizes shares invested in CUCO/Central 1 Shares as at August 31, 2010:

(In thousands of dollars)	2010	2009
2,490,554 Central 1 Class "A" Shares (2009 – 2,466,630)	\$ 2,490	\$ 2,466
4,767,600 Central 1 Class "E" Shares (2009 – 3,532,000)	4,768	3,532
nil CUCO Shares (2009 – 1,681,699)	-	1,236
	\$ 7,258	\$ 7,234

As there is no market for these shares classified as available for sale, these shares are carried at cost.

Central 1 requires that member credit unions maintain with them liquidity and secondary liquidity reserve deposits equal to 7% of the member credit union's assets. These reserve deposits are determined on a quarterly basis.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 6. Investments (continued):

#### (d) Real Estate Ventures

FirstOntario periodically enters into agreements with third parties to jointly control retail complexes. FirstOntario's portion of the revenue and expenses from participation in the ventures has been included in investment income as follows:

(In thousands of dollars)	2010	2009
Revenues	\$ 1,240	\$ 348
Expenses	(658)	(183)
Earnings from joint ventures	\$ 582	\$ 165

The ventures expenses included amortization in the amount of \$124,000 (2009 - \$30,000). Operating cash flow generated by the ventures was \$886,000 (2009 - \$138,000). During the year, FirstOntario received \$684,000 (2009 - \$171,000) in distributions from the ventures.

Real estate investments are stated at cost. Costs include initial acquisition costs and certain other costs incurred prior to substantial occupancy. Real estate held under the ventures is as follows:

(In thousands of dollars)	2010	2009
Real estate held for investment purposes	\$ 6,399	\$ 5,887
Accumulated amortization	(154)	(30)
Balance, August 31	\$ 6,245	\$ 5,857

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 7. Fixed Assets:

(In thousands of dollars)		2010	2009
	Cost	Accumulated amortization	Net book value
Land	\$ 1,829	\$ -	\$ 1,829
Parking lots/ Site improvements	611	401	210
Buildings	10,828	6,012	4,816
Equipment	11,387	9,294	2,093
Leasehold improvements	4,603	1,945	2,658
Tangible assets	29,258	17,652	11,606
Intangible assets (software)	11,400	10,660	740
Total fixed assets	\$ 40,658	\$ 28,312	\$ 12,346

Amortization in respect of the above assets for the year amounts to \$2,659,000 (2009 - \$2,671,000).

### 8. Members' Deposits:

Members' deposits, which are designated as other liabilities, are as follows:

(In thousands of dollars)		2010	2009
Chequing		\$ 127,497	\$ 110,323
Savings		247,254	242,117
Term Deposits		287,236	248,189
Registered Plans		347,467	343,327
		\$ 1,009,454	\$ 943,956

Included in registered retirement plans and term deposits are \$14,683,000 in Equity-Linked Deposits at August 31, 2010 (2009 - \$7,128,000). See note 12 for the related derivatives used to hedge exposure to equity market risk.

Interest expense for the year is as follows:

(In thousands of dollars)		Year Ended August 31 2010	Year ended August 31 2009
Chequing		\$ -	\$ 21
Savings		1,469	3,004
Term Deposits		8,187	8,563
Registered Plans		10,217	12,128
		\$ 19,873	\$ 23,716

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 8. Members' Deposits (continued):

The following summarizes FirstOntario's Members' deposits by the contractual repricing or maturity date, whichever is earlier:

(In thousands of dollars)	2010		2009	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Floating	\$ 208,449	0.82%	\$ 207,661	0.71%
Within 1 year	249,257	3.01%	270,914	3.78%
Over 1 year	356,962	2.52%	299,420	3.38%
	814,668	2.24%	777,995	2.81%
Non-rate sensitive	194,786		165,961	
	\$ 1,009,454		\$ 943,956	

Members' deposits held in registered plans are as follows:

(In thousands of dollars)	2010	2009
Registered savings plans	\$ 247,174	\$ 243,870
Registered income funds	100,293	99,457
	\$ 347,467	\$ 343,327

Concentra Financial Services Association acts as the trustee for the majority of FirstOntario's tax deferred savings plans (registered retirement savings plans and registered retirement income funds). FirstOntario accepts deposits on behalf of the trustee and retains the funds deposited.

### 9. Membership and Investment Shares:

#### Authorized Share Capital

An unlimited number of membership shares. Such shares are issued for \$5 each and Members under the age of twenty-one must hold one membership share while those twenty-one and over are required to hold at least five shares and increase their holdings of membership shares to thirty shares over a twenty-five year period. Membership shares are redeemable, on withdrawal from membership, at the amount paid thereon provided the credit union is meeting the "capital adequacy" requirements (see note 10) and they rank junior to Class A and Class B special shares for priority in the payment of dividends.

An unlimited number of Class A and Class B special shares. Such shares are generally non-voting and non-participating with non-cumulative dividend entitlements. In respect of dividends, both classes rank senior to the membership shares and the Class B special shares rank ahead of the Class A special shares.

The Board of Directors has authorized a Series 1, Series 2, and Series 2010 for Class B special shares ("investment shares"). The investment shares have an issue price of \$1 each and are entitled to receive dividends if, as and when declared by the Board of Directors. Series 1 and Series 2 investment shares are redeemable at the holder's request. Series 2010 investment shares are redeemable at the sole and absolute discretion of the Board of Directors.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 9. Membership and Investment Shares (continued):

#### Issued and Outstanding

Membership shares and Series 1 and 2 investment shares are designated as other liabilities. Series 2010 investment shares are classified as equity as these shares are redeemable at the sole and absolute discretion of the Board of Directors.

On May 14, 2010, 32,651,394 Series 2010 shares were issued and recorded on the Consolidated Balance Sheet net of issuance costs in the amount of \$32,405,000. Five years subsequent to the initial offering, requests for redemption are considered for approval by the Board of Directors for Series 2010 shares. In any fiscal year, redemptions are restricted to 10% of the respective series of the outstanding investment shares.

(In thousands of dollars)	2010	2009
Membership shares:		
1,061,124 (2009 – 1,007,426) Membership Shares	\$ 5,306	\$ 5,037
Investment shares:		
5,371,959 (2009 – 5,478,488) Class B, Series 1, Special Shares	\$ 5,372	\$ 5,478
6,782,653 (2009 – 7,338,672) Class B, Series 2, Special Shares	6,783	7,339
Investment shares designated as other liabilities	\$ 12,155	\$ 12,817
32,651,394 (2009 – nil) Class B, Series 2010, Special Shares	\$ 32,405	\$ -
	\$ 44,560	\$ 12,817

#### Dividends

Dividends earned by membership and investment shares classified as liabilities and expensed on the Consolidated Statement of Earnings were as follows:

(In thousands of dollars)	2010	2009
Membership shares	\$ 348	\$ 293
Investment shares	195	365
Dividends on membership and investment shares	\$ 543	\$ 658

On February 1, 2010, the Board of Directors approved the issue of investment shares in payment of a dividend for the year from December 1, 2008 to November 30, 2009. The table below presents the number of investment shares issued as payment of dividends and shares redeemed during the year:

(In thousands of dollars)	Shares Issued	Shares Redeemed
Class B, Series 1, Special Shares	168,543	275,072
Class B, Series 2, Special Shares	223,535	779,544
Total change in shares	392,078	1,054,616

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 10. Regulatory Reporting:

(a) Capital Management:

FirstOntario maintains policies and procedures relative to capital management so as to ensure that capital levels are sufficient to cover risks inherent in the business.

FirstOntario's objectives when managing capital are:

- (i) To ensure that the quantity, quality and composition of capital required reflects the inherent risks of FirstOntario and to support the current and planned operations and portfolio growth.
- (ii) To provide a basis for confidence among Members, depositors, creditors and regulatory agencies.
- (iii) To ensure that FirstOntario maintains a level of capital that sufficiently protects against unanticipated losses and to comply with the minimum regulatory capital requirements set out in the Act.

Regulatory capital is calculated as a percentage of total assets and of risk-weighted assets. Risk-weighted assets are calculated by applying risk weight percentages, as prescribed by the Act, to various asset categories, operational and interest rate risk criteria. The prescribed risk weights are dependent upon the degree of risk associated with the asset.

FirstOntario manages its Tier 1 and Tier 2 capital in accordance with internal policies and regulatory requirements. Tier 1 capital is the highest quality and consists of retained earnings, accumulated other comprehensive losses, membership shares and the portion of the value of Class B investment shares that are not redeemable within 12 months. Tier 2 capital is comprised of the value of Class B investment shares ineligible as Tier 1 capital and the eligible portion of the allowance for impaired loans.

As at August 31, 2010, the amount and composition of Tier 1 and Tier 2 capital was as follows:

(In thousands of dollars)	2010
<u>Tier 1 Capital</u>	
Retained Earnings	\$ 47,276
Accumulated Other Comprehensive Losses on AFS investments	(352)
Membership shares	5,306
Class B Investment Shares, Series 1 (90%)	4,835
Class B Investment Shares, Series 2 (90%)	6,105
Class B Investment Shares, Series 2010 (100%)	32,405
<u>Tier 2 Capital</u>	
Class B Investment Shares, Series 1 (10%)	537
Class B Investment Shares, Series 2 (10%)	678
General Allowance for Impaired Loans	3,036
<u>Total Regulatory Capital</u>	<u>\$ 99,826</u>

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 10. Regulatory Reporting (continued):

#### (a) Capital Management (continued):

Under the Regulations of the Act, FirstOntario must maintain minimum levels of regulatory capital. FirstOntario complied with these requirements as follows:

	Regulatory Capital	Leverage Ratio		Risk-Weighted Capital Ratio	
		Minimum	Actual	Minimum	Actual
2010	\$ 99,826,000	4.00%	8.19%	8.00%	13.69%
2009	\$ 62,801,000	4.00%	5.86%	8.00%	9.13%

#### (b) Remuneration of officers and employees:

The Act requires disclosure of the five highest paid officers and employees of FirstOntario where total remuneration exceeds \$150,000. The names, positions and remuneration paid during 2010 of those officers and employees are as follows:

	Salary	Bonuses*	Benefits	Total
Kelly McGiffin, President & Chief Executive Officer	\$ 210,000	\$ 168,000	\$ 45,183	\$ 423,183
Barry Doan, EVP & Chief Financial Officer	176,500	41,000	31,200	248,700
David Schurman, EVP & Chief Operating Officer	162,803	38,000	27,984	228,787
Lloyd Smith, VP Finance & Treasury	165,000	44,000	51,574	260,574
Ron Choma, VP Commercial Services	175,000	40,000	30,651	245,651

\*Bonuses paid during 2010 were earned during 2009

Remuneration is fair and competitive and is targeted to be in the 50<sup>th</sup> percentile of similar positions in credit unions of equal asset size. FirstOntario actively participates in compensation surveys to ensure alignment with the market and employs third party compensation consultants to provide more independence to the process.

Executive compensation is reviewed and approved by the Board on an annual basis. As part of this review, the Board considers market expectations and projections of changes for comparable positions using, where available, independent, competent and relevant sources.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 11. Loans Payable:

The following table details loans payable to Central 1. Security pledged is set out in note 17(c). All loans with Central 1 are designated as other liabilities.

(In thousands of dollars)	2010	2009
Term loan facilities, bearing a weighted average interest rate of 1.32%, due within one year	\$ 69,000	\$ -
Term loan facilities, bearing a weighted average interest rate of 0.78%, due within one year	-	35,000
Term loan, bearing an interest rate of 3.10%, principal and interest due April 20, 2012	10,000	-
	<b>\$ 79,000</b>	<b>\$ 35,000</b>

### 12. Derivative Financial Instruments:

#### (a) Asset liability management:

In the ordinary course of business, FirstOntario purchases derivative instruments from Central 1 in order to hedge against exposure to interest rate fluctuations.

Derivative instruments have a fair value that varies based on the particular instrument and changes in interest rates. The purpose of these instruments is to provide a hedge against interest rate fluctuations by improving FirstOntario's matching of its asset and liability position.

#### (b) Product related:

FirstOntario offers deposit products linked to changes in equity indexes or specific bundles of equities. FirstOntario hedges the underlying risk of these products by entering into equity-linked purchase option contracts. Under the terms of these contracts, FirstOntario will receive payments equal to the future payments to Members.

#### (c) Foreign exchange forward contracts:

FirstOntario offers deposit products denominated in US dollars. In order to meet liquidity reserve requirements FirstOntario sells US dollars and purchases US dollar foreign exchange forward contracts to hedge the exchange risk.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 12. Derivative Financial Instruments (continued):

The following table summarizes the notional amounts, maturities and fair values of FirstOntario's derivative portfolio:

(In thousands of dollars)						
	Within 1 year	1 to 5 years	Over 5 years	Total	Fair Value	
					Assets	Liabilities
Pay fixed interest rate swaps	\$ 88,109	\$ 122,515	\$ 10,000	\$ 220,624	\$ -	\$ (6,802)
Float pay and float						
receive interest rate swaps	3,000	6,500	-	9,500	93	-
Equity-linked options	489	14,498	-	14,987	584	(512)
Foreign exchange forward contracts	8,600	-	-	8,600	101	-
<b>2010 Total</b>	<b>\$ 100,198</b>	<b>\$ 143,513</b>	<b>\$ 10,000</b>	<b>\$ 253,711</b>	<b>\$ 778</b>	<b>\$ (7,314)</b>
2009 Total	\$ 23,631	\$ 218,024	\$ 10,000	\$ 251,655	\$ 1,005	\$ (8,193)

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.

FirstOntario has off-balance sheet credit risk which arises from the possibility that a counterparty to an interest rate contract could default on their obligation to FirstOntario. However, credit risk associated with interest rate contracts is normally a small fraction of the notional principal amount of the contract. Interest rate contracts expose FirstOntario to loss only if changes in market rates cause a material unfavourable affect on a counterparty's position, which could then lead to the counterparty defaulting on its payment. FirstOntario only enters into derivative contracts with a counterparty that FirstOntario has determined to be creditworthy.

### 13. Financial Risk Management:

The Board of Directors (the "Board") has overall responsibility for the establishment and oversight of FirstOntario's risk management framework. The Board has delegated to the Audit Committee the responsibility for the development and monitoring of risk management policies. The Audit Committee reports regularly to the Board on its activities.

All risk management policies and established limits ensure that FirstOntario is in full adherence to the regulatory requirements prescribed in the Act as well as DICO's standards of Sound Business and Financial Practices. The Board receives reports from management on FirstOntario's exposure to credit, interest rate, liquidity, foreign currency and other price risk regularly in order to monitor financial risks.

# FIRSTONTARIO CREDIT UNION LIMITED

Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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## 13. Financial Risk Management (continued):

### (a) Credit Risk:

Credit risk is the potential for financial loss to FirstOntario if a borrower or guarantor fails to meet payment obligations in accordance with agreed terms. FirstOntario's financial assets that are affected by credit risk include loans receivable from Members, investments, and derivative financial instruments. Credit risk is one of the most significant financial risks to FirstOntario.

FirstOntario's primary objective when managing credit risk is to ensure a portfolio of high quality financial assets properly diversified so as to balance the risk associated with the portfolio and return on assets.

Credit risk is managed in accordance with the Retail Credit Risk Management Policy and Commercial Credit Risk Management Policy for loans receivable from Members and the Market Risk Management Policy for investments and derivative financial instruments.

For loans receivable from Members, credit risk is managed through an infrastructure based upon:

- (i) Approval by the Board of all credit risk management policies;
- (ii) Approval by the Vice President Credit of the discretionary limits of lending officers throughout FirstOntario;
- (iii) Credit adjudication subject to compliance with established policies, exposure guidelines and discretionary limits, as well as adherence to established standards of credit assessment. Credit approvals are escalated to the Management Credit Committee and ultimately to the Board dependent upon credit exposure level and restricted party transactions;
- (iv) Credit division is charged with oversight of the following:
  - a. The establishment of guidelines to monitor and limit concentrations in the portfolios in accordance with Board approved policies governing regulatory requirements, industry risk and group exposures;
  - b. The development and implementation of credit risk models and policies for establishing borrower risk ratings to quantify and monitor the level of risk and facilitate management of retail and commercial credit;
  - c. Implementation of an ongoing monitoring process of the key risk factors used in FirstOntario credit risk models.

Management has designed and implemented an effective system to measure, monitor and report credit risk exposure. Management reports credit risk exposure to the Board regularly.

In conducting lending activities, FirstOntario diversifies its portfolio of loans receivable from Members in order to reduce overall credit risk. Residential mortgage and personal loans are diversified between authorized loan types, forms of security and certain sectoral groupings.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 13. Financial Risk Management (continued):

#### (a) Credit Risk (continued):

Commercial loans are diversified through the establishment of credit exposure limits for specific industry sectors and groups of related borrowers.

Credit exposure is assessed through the following:

- (i) Probability of default, which is an estimate of probability that an obligor with a certain borrower risk rating will default within a one year time horizon.
- (ii) Loss given default, which represents the unsecured portion expected to be lost when a borrower defaults.

Credit risk rating systems are designed to assess and quantify the risk inherent in credit activities in an accurate and consistent manner as follows:

- (i) Commercial loans are principally assessed based on the Member's ability to service debt (debt service coverage ratio) and the secured amount (loan to value ratio). Management regularly reviews the commercial loan portfolio and assesses the credit risk associated with each loan.
- (ii) Automated credit scoring systems are used in assessing credit risk associated with residential mortgage and personal loans. These loans are managed as pools of homogeneous risk exposures using internal benchmarks based upon Equifax Beacon Score's. These global standard credit scores track each individual's past credit history and, using a mathematical model, predicts how likely a person is to repay a loan.

For investments and derivative financial instruments, risk is measured by reviewing exposure to individual counterparties to ensure the assets are within the policy limit by issuer weightings and by dollar amount. The quality of the counterparties is assessed through published credit rating agencies.

Except as noted, the carrying amount of financial assets recorded in the financial statements represents FirstOntario's maximum exposure to credit risk without taking into account the value of any collateral obtained. FirstOntario is also exposed to credit risk through transactions which are not recognized in the balance sheet, such as granting financial guarantees and extending loan commitments. Refer to note 16 for further details. The risk of losses from loans undertaken is reduced by the nature and quality of collateral obtained. Refer to note 4 for a description of the nature of the security held against loans as at the balance sheet date.

#### (b) Interest Rate Risk:

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. FirstOntario is exposed to interest rate risk when entering into banking transactions with Members, primarily deposit and lending activities.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 13. Financial Risk Management (continued):

#### (b) Interest Rate Risk (continued):

FirstOntario's exposure to interest rate risk depends on the size and direction of interest rate changes, and on the size and maturity of mismatched positions. An interest-sensitive asset or liability is repriced when market interest rates change, when there is cash flow from final maturity, normal amortization, or when Members exercise prepayment, conversion or redemption options are offered for the specific product.

Interest rate risk is managed in accordance with the Structural Risk Management Policy. The Board delegates the responsibility to manage interest rate risk on a day-to-day basis to management.

FirstOntario's Structural Risk Management Policy includes:

- (i) Guidelines and limits on the structuring of the maturities, price and mix of deposits, loans, mortgages and investments and the management of cash flows derived from financial assets in relation to liabilities.
- (ii) Guidelines and limits on the use of derivative products to hedge against changes in cash flows as a result of changes in interest rates.

The following table summarizes carrying amounts of Consolidated Balance Sheet assets, liabilities and equity, and derivative instruments to arrive at FirstOntario's interest rate gap based on the earlier of contractual re-pricing and maturity dates:

(In thousands of dollars)						
	Within 3 Months	3 Months to 1 Year	1 to 5 Years	Over 5 years	Non Interest Sensitive	Total
<b>Assets</b>						
Loans receivable	\$ 327,247	\$ 88,425	\$ 576,887	\$ 75,562	\$ -	\$ 1,068,121
Cash	-	-	-	-	18,259	18,259
Investments	7,671	22,701	51,956	-	27,509	109,837
Other	116	39	623	-	21,982	22,760
	<b>335,034</b>	<b>111,165</b>	<b>629,466</b>	<b>75,562</b>	<b>67,750</b>	<b>1,218,977</b>
<b>Liabilities and equity</b>						
Deposits and shares	285,047	172,659	356,962	-	220,948	1,035,616
Loans	69,000	-	10,000	-	-	79,000
Other	161	1,061	5,150	942	97,047	104,361
	<b>354,208</b>	<b>173,720</b>	<b>372,112</b>	<b>942</b>	<b>317,995</b>	<b>1,218,977</b>
On-balance sheet gap	(19,174)	(62,555)	257,354	74,620	(250,245)	-
Off-balance sheet gap	(116,888)	(67,469)	194,357	(10,000)	-	-
<b>Interest rate gap 2010</b>	<b>\$ (136,062)</b>	<b>\$ (130,024)</b>	<b>\$ 451,711</b>	<b>\$ 64,620</b>	<b>\$ (250,245)</b>	<b>-</b>
Interest rate gap 2009	\$ 83,930	\$ (100,242)	\$ 156,308	\$ 22,420	\$ (162,416)	\$ -

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 13. Financial Risk Management (continued):

#### (b) Interest Rate Risk (continued):

Key metrics involved in management of interest rate risk include the use of Earnings at Risk ("EaR") and Economic Value of Equity at Risk ("EVEaR"). EaR is defined as the change in the net interest income from a 100 basis point ("bps") shock to interest rates. This exposure is measured over a 12 month period. EVEaR is defined as the difference in the change in the present value of the asset portfolio and the change in the present value of the liability portfolio, including off-balance sheet instruments, resulting from a 100 bps interest rate shock.

The following table summarizes the EaR and EVEaR as follows:

(In thousands of dollars)	2010	2009
EaR	\$ 617	\$ 462
EVEaR	0.3%	4.8%

#### (c) Liquidity Risk:

Liquidity risk is the risk that FirstOntario will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets.

FirstOntario engages in proper liquidity risk management practices to comply with regulatory requirements and to guarantee the funding of Member needs and obligations. FirstOntario's overall objective when managing liquidity is to ensure limited exposure to material liquidity risk.

Liquidity risk is managed in accordance with the Liquidity Risk Management Policy. Key elements of this policy include limits on the sources, quality and amount of liquid assets to meet operational requirements, regulatory requirements and contingency funding. Liquidity is monitored by management through FirstOntario's Asset/Liability Committee ("ALCO"), consisting of senior executives.

Under the Regulations, FirstOntario must establish and maintain prudent levels of liquidity that are sufficient to meet its cash flow needs, including depositor withdrawals and all other obligations as they come due. FirstOntario targets to maintain operating liquidity within the range of 8.5% to 16%. The low end of the range has been established in order to maintain a comfortable cushion beyond the statutory minimum requirements in order to meet cash needs, even during periods of market volatility. As at August 31, 2010 FirstOntario's liquidity ratio was 9.15% (2009 – 11.69%) and assets held for liquidity purposes totalled \$99,603,000, consisting of \$82,328,000 liquidity reserve deposits and \$17,275,000 cash.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 13. Financial Risk Management (continued):

#### (c) Liquidity Risk (continued):

The table below demonstrates FirstOntario's ability to pay future obligations as financial assets and liabilities mature. These cash flows include both the contractual cash flows currently exposed on the balance sheet and the cash flows that will be generated in the future. In the case of loans, the cash flows include estimated prepayments and credit losses based on experience and current economic conditions.

(In thousands of dollars)							
	Within 1 month	2 to 12 months	1 to 3 years	3 to 5 years	Over 5 years	Not Specified	Total
<b>Assets</b>							
Loans Receivable							
from Members	\$ 18,944	\$ 214,626	\$ 473,924	\$ 480,049	\$ 34,004	\$ -	\$ 1,221,547
Cash	18,259	-	-	-	-	-	18,259
Investments	6,245	24,541	49,339	5,159	-	27,015	112,299
Derivative financial instruments	102	43	165	468	-	-	778
<b>Total Cash Inflow</b>	<b>\$ 43,550</b>	<b>\$ 239,210</b>	<b>\$ 523,428</b>	<b>\$ 485,676</b>	<b>\$ 34,004</b>	<b>\$ 27,015</b>	<b>\$ 1,352,883</b>
<b>Liabilities</b>							
Members' deposits and Shares	\$ 447,732	\$ 207,720	\$ 286,650	\$ 89,779	\$ 53	\$ 17,461	\$ 1,049,395
Loans Payable	69,076	-	10,621	-	-	-	79,697
Other Liabilities	19,332	-	-	-	-	-	19,332
Derivative financial instruments	385	3,303	2,951	710	7	-	7,356
<b>Total Cash Outflow</b>	<b>\$ 536,525</b>	<b>\$ 211,023</b>	<b>\$ 300,222</b>	<b>\$ 90,489</b>	<b>\$ 60</b>	<b>\$ 17,461</b>	<b>\$ 1,155,780</b>

#### (d) Foreign Currency Risk:

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates. FirstOntario is exposed to foreign currency risk as a result of its Members' activities in US dollar currency denominated deposits and cash transactions. Activities that expose FirstOntario to currency risk are measured, monitored and controlled daily to minimize risk. At any point in time, net US dollar exposure is limited by the Market Risk Management Policy to \$500,000 through the use of foreign exchange forward contracts. As at August 31, 2010, FirstOntario does not have significant exposure to changes in foreign currency exchange rates.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 13. Financial Risk Management (continued):

#### (e) Other Price Risk:

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices other than those arising from interest rate risk or currency risk. FirstOntario is primarily exposed to other price risk through investments. However, these investments are limited to ensure diversification and quality of financial assets. As at August 31, 2010, had the value of FirstOntario's equity investments portfolio increased or decreased by 10% with all other variables remaining unchanged, the portfolio's asset value would have increased or decreased respectively by \$254,000 (2009 - \$504,000) or 0.3% (2009 - 1.2%) of total Member's Equity.

### 14. Fair Values of Financial Instruments:

The following table represents the fair values of FirstOntario's on and off-balance sheet financial instruments. The fair values disclosed do not include the value of assets that are not considered financial instruments, such as fixed assets. The value of intangibles such as long-term Member relationships are also not included in the fair value amounts, although FirstOntario considers the value of intangibles to be significant.

While the fair value amounts are intended to represent estimates of the amounts at which these instruments could be exchanged in a current transaction between willing parties, some of FirstOntario's financial instruments lack an available trading market. Consequently, the fair values presented are estimates derived using present value and other valuations techniques and may not be indicative of the net realizable values.

Due to the judgment used in applying a wide range of acceptable valuation techniques and estimates in calculating fair value amounts, fair values are not necessarily comparable among financial institutions. The calculation of estimated fair values is based on market conditions at a specific point in time and may not be reflective of future fair values.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 14. Fair Values of Financial Instruments (continued):

(In thousands of dollars)	2010			2009		
	Carrying Value	Fair Value	Fair Value Difference	Carrying Value	Fair Value	Fair Value Difference
<u>Loans and Receivables</u>						
Loans receivable	\$ 1,068,121	\$ 1,071,424	\$ 3,303	\$ 908,915	\$ 911,263	\$ 2,348
Investments	82,822	83,944	1,122	74,105	74,335	230
<u>Held for trading</u>						
Cash	18,259	18,259	-	35,477	35,477	-
Derivative financial instruments	778	778	-	1,005	1,005	-
<u>Available for Sale</u>						
Investments	20,204	20,929	725	26,219	26,219	-
<b>Total financial assets</b>	<b>\$ 1,190,184</b>	<b>\$ 1,195,334</b>	<b>\$ 5,150</b>	<b>\$1,045,721</b>	<b>\$1,048,299</b>	<b>\$ 2,578</b>
<u>Other Liabilities</u>						
Deposits and shares	\$ 1,035,616	\$ 1,037,943	\$ (2,327)	\$ 973,818	\$ 981,701	\$ (7,883)
Loans payable	79,000	79,384	(384)	35,000	35,108	(108)
Accounts payable and accrued liabilities	19,332	19,332	-	15,008	15,008	-
<u>Held for Trading</u>						
Derivative financial instruments	7,314	7,314	-	8,193	8,193	-
<b>Total financial liabilities</b>	<b>\$ 1,141,262</b>	<b>\$ 1,143,973</b>	<b>\$ (2,711)</b>	<b>\$1,032,019</b>	<b>\$1,040,010</b>	<b>\$ (7,991)</b>

Interest rate sensitivity is the main cause of change in fair values of FirstOntario's financial instruments.

The following methods and assumptions were used to estimate the fair value of financial instruments:

- The fair values of cash and accounts payable and accrued liabilities are assumed to approximate their book values, due to their short-term nature.
- The estimated fair value of floating rate loans, demand deposits and floating rate deposits are assumed to be equal to book value as the interest rates on these loans and deposits reprice to market on a periodic basis.
- The estimated fair values of fixed rate investments, fixed rate loans and fixed rate deposits are determined by discounting the expected future cash flows of these investments, loans, deposits and borrowings at current market rates for products with similar terms and credit risks.
- The estimated fair values of derivative instruments are determined through valuation models on the derivative notional amounts, maturity dates and rates.
- The estimated fair values of investments in publicly listed equity securities are determined using quoted market prices.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 14. Fair Values of Financial Instruments (continued):

Fair value measurements can be classified in a hierarchy in order to discern the significance of management assumptions and other inputs incorporated into the measurements. The three levels of fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.

Level 3 – Inputs for the asset or liability that are not based on observable market data.

The following table summarizes the classification of FirstOntario's financial instruments held and reported on the balance sheet at fair value as at August 31, 2010:

(in thousands of dollars)	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Cash	\$ 18,259	\$ -	\$ -	\$ 18,259
Investments – AFS securities	2,841	-	-	2,841
Investments – Retained rights – loan securitizations	-	-	6,290	6,290
Derivative financial instruments	-	778	-	778
<b>Total assets held at fair value</b>	<b>\$ 21,100</b>	<b>\$ 778</b>	<b>\$ 6,290</b>	<b>\$ 28,168</b>
<b>Liabilities</b>				
Derivative financial instruments	\$ -	\$ 7,314	\$ -	\$ 7,314
<b>Total liabilities held at fair value</b>	<b>\$ -</b>	<b>\$ 7,314</b>	<b>\$ -</b>	<b>\$ 7,314</b>

The following table summarizes changes in fair values of financial instruments classified as Level 3 under the hierarchy during fiscal 2010:

(In thousands of dollars)	Retained Rights – Loan Securitizations
Balance, August 31, 2009	\$ 9,409
Reduction in carrying amount included in net income	(4,757)
Issues	1,638
Balance, August 31, 2010	\$ 6,290

The Reduction in carrying amount is included in Other Income in the Consolidated Statement of Earnings.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 15. Employee Retirement Benefits:

FirstOntario provides retirement benefits to certain employees. These benefits include registered pension plans, medical benefits, dental care and life insurance.

The fair value of accrued benefit obligations were determined by independent actuaries as at August 31, 2010.

(In thousands of dollars)	Defined Benefit Pensions		Other Defined Benefit Plans	
	2010	2009	2010	2009
<b>Accrued benefit obligation</b>				
Balance at the beginning of year	\$ 9,525	\$ 8,072	\$ 5,912	\$ 5,627
Current service cost	327	266	3	7
Interest cost	508	491	303	256
Benefits paid	(375)	(323)	(179)	(173)
Actuarial loss (gain)	(342)	1,019	(1,644)	1,406
Past service costs	-	-	344	-
Curtailment	-	-	-	(1,211)
Balance at end of year	9,643	9,525	4,739	5,912
<b>Plan assets</b>				
Fair value at beginning of year	7,646	7,928	-	-
Annual return on plan assets	179	(568)	-	-
Employer contributions	529	593	179	173
Employee contributions	19	16	-	-
Benefits paid	(375)	(323)	(179)	(173)
Fair value at end of year	7,998	7,646	-	-
Funded status – deficit	(1,645)	(1,879)	(4,739)	(5,912)
Unamortized net actuarial loss (gain)	3,883	4,086	(964)	692
Unamortized past service costs	108	122	172	-
Unamortized transitional obligation (asset)	(47)	(76)	-	129
Accrued benefit asset (liability)	\$ 2,299	\$ 2,253	\$ (5,531)	\$ (5,091)

During 2010 amendments were made to FirstOntario's other defined benefits plans for certain employees. These amendments affected FirstOntario's future obligation to pay employee retirement benefits for medical, dental care and life insurance. As a result of these changes, a past service cost was incurred of \$344,000.

The following table provides the amounts recognized in the Consolidated Balance Sheet as follows:

(In thousands of dollars)	Defined Benefit Pensions		Other Defined Benefit Plans	
	2010	2009	2010	2009
Prepaid benefit costs recorded in other assets	\$ 2,663	\$ 2,634	\$ -	\$ -
Accrued benefit liability recorded in other liabilities	364	381	5,531	5,091
Net amount recognized	\$ 2,299	\$ 2,253	\$ (5,531)	\$ (5,091)

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 15. Employee Retirement Benefits (continued):

The significant actuarial assumptions adopted in measuring FirstOntario's accrued benefit obligation are as follows (weighted-average assumptions):

	Defined Benefit Pensions		Other Defined Benefit Plans	
	2010	2009	2010	2009
Discount rate	<b>5.25%</b>	5.25%	<b>5.25%</b>	5.25%
Expected long-term rate of return on plan assets	<b>6.50%</b>	6.50%	-	-
Rate of compensation increase	<b>3.00%</b>	3.00%	-	-

For measurement purposes, 8.0% and 3.0% rates of increase in the per capita cost of covered health care and dental care benefits respectively were assumed for 2010. The rate for health care benefits was assumed to decrease to 5.0% by 2014 and remain at that level thereafter. The rate for dental care benefits was assumed to remain unchanged at 3.0%.

A one percentage-point change in assumed health-care cost trend rates would have the following impact on other defined benefit plans:

(In thousands of dollars)	2010	
	Obligation	Expense
1% increase	\$ 449	\$ 34
1% decrease	(500)	(29)

FirstOntario's net benefit plan expense is as follows:

(In thousands of dollars)	Defined Benefit Pensions		Other Defined Benefit Plans	
	2010	2009	2010	2009
Current service cost, net of employee's contributions	\$ 308	\$ 250	\$ 3	\$ 7
Interest cost	508	491	303	256
Expected return on assets	(503)	(527)	-	-
Amortization of past service costs	14	15	172	-
Amortization of net actuarial loss	185	73	12	(36)
Amortization of transitional obligation	(29)	(27)	129	129
Net curtailment gain	-	-	-	(1,140)
Net benefit plan expense	\$ 483	\$ 275	\$ 619	\$ (784)

(In thousands of dollars)	Defined Contribution Pension	
	2010	2009
Net benefit plan expense	\$ 712	\$ 660

These net benefits expenses are included in Salaries and employee benefits on the Consolidated Statement of Earnings.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

### 16. Income Taxes:

FirstOntario's effective income tax rate is derived as follows:

	August 31 2010	August 31 2009
Combined basic Canadian Federal and Ontario income tax rate	42.0%	42.0%
Small business and credit union deductions	(25.7)	(25.5)
Income and expense permanent differences	(1.8)	-
Corporate minimum tax	(6.3)	-
Prior year adjustment	7.9	(4.6)
Other	(1.5)	1.4
Effective income tax rate	14.6%	13.3%

### 17. Commitments:

#### (a) Leases:

FirstOntario leases space for most of its branches and some computer equipment. Total future lease payments are as follows:

(In thousands of dollars)	
2011	\$ 1,213
2012	1,034
2013	1,034
2014	995
2015	828
Aggregate for years thereafter	2,871

#### (b) Mortgage commitments and lines of credit:

At August 31, 2010, FirstOntario has issued commitments to provide residential mortgage and commercial loans totaling \$18.5 million. FirstOntario has also provided lines of credit to Members totaling \$371.8 million at August 31, 2010, against which Members have drawn \$228.7 million.

#### (c) Credit facilities:

Central 1 has provided an operating loan facility to FirstOntario of \$100.0 million. Loans to Members have been pledged as security for this facility and the term loan by an assignment of book debts and a general security agreement. See the Consolidated Balance Sheet and note 11 for the outstanding amount on this facility.

#### (d) Contracts:

Interac ATM and point of sale switching servicing totaling \$2.7 million over the next 3 years at present service levels.

Banking system support services and software maintenance totaling \$0.3 million over the next 5 years.

# FIRSTONTARIO CREDIT UNION LIMITED

## Notes to Consolidated Financial Statements

For the year ended August 31, 2010

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### 18. Restricted Party Transactions:

The aggregate remuneration paid to directors was \$164,000 in 2010 (2009 - \$162,000).

Outstanding loans to current directors and officers of FirstOntario amounted to \$3,165,657 at August 31, 2010 (2009 - \$2,712,000).

### 19. Acquisition of Canal City Savings and Credit Union Limited:

On July 24, 2010, for the beneficial interest of its members and surrounding community, FirstOntario acquired substantially all of the financial assets and liabilities of Canal City Savings and Credit Union Limited ("Canal City"). No equity interests were acquired; all members of Canal City were issued new FirstOntario shares. Cash consideration was received from DICO in the amount of \$1,508,000 to ensure that the fair market values of net assets and liabilities acquired were equivalent to zero. As at August 31, 2010, the transaction was subject to certain price adjustments and final settlements. These settlements are not expected to be significant to the financial statements.

Below represents the fair market values of assets and liabilities acquired as a result of the transaction:

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	As at July 24, 2010
Residential mortgage and personal loans	\$ 8,564,000
Liquidity reserve deposits – Central 1	1,329,000
Cash (including cash received from DICO)	2,519,000
Other assets	322,000
Deposits	(12,734,000)
Fair market value of net assets acquired	\$ -

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### 20. Comparative Figures:

Certain 2009 comparative figures have been reclassified to conform to the financial statement presentation adopted during the current year.