Consolidated Financial Statements
(In Canadian dollars)

MORNEAU SHEPELL INC.

Years ended December 31, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Morneau Shepell Inc.

We have audited the accompanying consolidated financial statements of Morneau Shepell Inc., which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Morneau Shepell Inc. as at December 31, 2012 and 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

March 6, 2013
Toronto, Canada

MORNEAU SHEPELL INC.

Consolidated Statements of Financial Position
(In thousands of Canadian dollars)
December 31, 2012 and 2011

	December 31, 2012	December 31, 2011
Assets		
Current assets:		
Trade and other receivables (note 5)	$ 55,576	$ 50,779
Unbilled fees (note 6)	44,812	34,862
Prepaid expenses and other (note 7)	2,532	3,105
Cash and investments held in trust	14,174	12,248
Deferred implementation costs (note 8)	2,668	2,121
Total current assets	119,762	103,115
Non-current assets:		
Unbilled fees (note 6)	1,649	1,505
Deferred implementation costs (note 8)	10,360	7,000
Capital assets (note 9)	21,273	23,961
Intangible assets (note 10)	228,325	230,716
Goodwill (note 11)	304,988	301,792
Total non-current assets	566,595	564,974
Total assets	$ 686,357	$ 668,089

MORNEAU SHEPELL INC.

Consolidated Statements of Financial Position
(In thousands of Canadian dollars)
December 31, 2012 and 2011

	December 31, 2012	December 31, 2011
Liabilities and Equity		
Current liabilities:		
Bank indebtedness	$ 134	$ 807
Trade and other payables (note 12)	47,090	47,092
Income taxes payable	3,949	213
Deferred revenue	2,786	2,250
Insurance premium liabilities	14,174	12,248
Future consideration related to acquisitions (note 28)	2,858	500
Dividends payable	3,116	3,116
Total current liabilities	74,107	66,226
Non-current liabilities:		
Long-term debt (note 15)	153,073	207,121
Convertible debenture payable (note 16)	71,104	–
Interest rate swap (note 15)	3,101	5,389
Future consideration related to acquisitions (note 28)	451	1,653
Other liabilities (note 13)	7,656	7,670
Provisions (note 14)	1,419	1,887
Deferred tax liability (note 18)	28,122	20,560
Total non-current liabilities	264,926	244,280
Equity:		
Share capital (note 21)	473,838	473,838
Contributed surplus (note 21)	12,674	8,721
Equity component of convertible debenture (note 16)	757	–
Accumulated other comprehensive loss	(2,623)	(4,648)
Deficit	(137,322)	(120,328)
Total equity	347,324	357,583
Total liabilities and equity	$ 686,357	$ 668,089

Commitments and contingencies (notes 4, 27 and 28)

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Robert Chisholm"
Audit Committee Chair

"Alan Torrie"
President & CEO

MORNEAU SHEPELL INC.

Consolidated Statements of Income and Comprehensive Income
(In thousands of Canadian dollars, except per share amounts)
Years ended December 31, 2012 and 2011

		2012		2011
Operating revenue	$	419,346	$	364,988
Operating expenses:				
Salary, benefits and contractor (note 26)		287,485		237,144
Depreciation and amortization (notes 9 and 10)		24,689		21,087
Rent and occupancy		18,747		16,978
Office and administration		46,010		41,333
Total operating expenses		376,931		316,542
Finance costs (note 15)		14,036		14,214
Contingent consideration related to business acquisitions (note 4)		–		192
Bargain purchase gain on business acquisition (note 4)		(3,500)		–
Profit from operations before income taxes		31,879		34,040
Income taxes (note 18):				
Current		4,516		770
Deferred		6,329		8,367
Total income taxes		10,845		9,137
Profit for the year		21,034		24,903
Other comprehensive income (loss):				
Effective portion of change in interest rate cash flow hedge		2,288		(5,114)
Ineffective portion of changes in fair value of interest rate cash flow hedges transferred to profit		–		69
Transfer to profit due to termination of interest rate cash flow hedges		667		3,110
Foreign currency translation differences for foreign operations		(169)		14
Income tax on other comprehensive income (loss)		(761)		(372)
Other comprehensive income (loss), net of tax effect		2,025		(2,293)
Comprehensive income for the year	$	23,059	$	22,610
Earnings per share (note 22):				
Basic	$	0.43	$	0.52
Diluted	$	0.43	$	0.51

See accompanying notes to consolidated financial statements.

MORNEAU SHEPELL INC.

Consolidated Statements of Changes in Equity
(In thousands of Canadian dollars)
Years ended December 31, 2012 and 2011

2012	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Equity component of convertible debentures	Total equity
Balance, January 1, 2012	$ 473,838	$ 8,721	$ (120,328)	$ (4,648)	$ –	$ 357,583
Long-term incentive plan - non-cash expense	–	3,319	–	–	–	3,319
Long-term incentive plan - DRIP	–	634	(634)	–	–	–
Profit for the year	–	–	21,034	–	–	21,034
Dividends	–	–	(37,394)	–	–	(37,394)
Other comprehensive income	–	–	–	2,025	–	2,025
Equity component of convertible debenture (note 16)	–	–	–	–	757	757
Balance, December 31, 2012	$ 473,838	$ 12,674	$ (137,322)	$ (2,623)	$ 757	$ 347,324

2011	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total equity
Balance, January 1, 2011	$ 420,109	$ –	$ (107,429)	$ (2,355)	$ 310,325
Exchange of LP Units on reorganization (note 21)	53,729	–	–	–	53,729
Long-term incentive plan - reclassification as equity-based awards (note 21)	–	5,449	–	–	5,449
Long-term incentive plan - non-cash expense	–	2,862	–	–	2,862
Long-term incentive plan - DRIP	–	410	(410)	–	–
Profit for the year			24,903	–	24,903
Dividends	–	–	(37,392)	–	(37,392)
Other comprehensive loss	–	–	–	(2,293)	(2,293)
Balance, December 31, 2011	$ 473,838	$ 8,721	$ (120,328)	$ (4,648)	$ 357,583

See accompanying notes to consolidated financial statements.

MORNEAU SHEPELL INC.

Consolidated Statements of Cash Flows
(In thousands of Canadian dollars)
Years ended December 31, 2012 and 2011

	2012	2011
Operating activities:		
Profit for the year	$ 21,034	$ 24,903
Items not involving cash:		
Depreciation and amortization (notes 9 and 10)	24,689	21,087
Finance costs (note 15)	14,036	14,214
Long-term incentive plan (note 20)	3,319	2,862
Current income taxes (note 18)	4,516	770
Deferred income taxes (note 18)	6,329	8,367
Change in provisions	(468)	(447)
Bargain purchase gain on business acquisition (note 4)	(3,500)	–
Other	(11)	497
	69,944	72,253
Change in non-cash operating working capital (note 24)	(21,554)	(6,192)
Cash generated from operating activities	48,390	66,061
Finance costs paid	(10,822)	(10,573)
Income taxes paid	(779)	(625)
Cash provided by operating activities	36,789	54,863
Financing activities:		
Payment of credit agreement renewal fees	–	(1,200)
Change in revolving loan	(54,515)	13,000
Proceeds from convertible debentures offering (note 16)	75,000	–
Expenses related to issuance of convertible debentures (note 16)	(3,568)	–
Settlement of interest rate swap (note 15)	–	(4,150)
Dividends paid	(37,394)	(34,276)
Cash used in financing activities	(20,477)	(26,626)
Investing activities:		
Business acquisition, net of cash acquired – Mercer Canada Outsourcing (note 4 (a))	3,513	–
Business acquisition, net of cash acquired – SBC Systems Company Inc. (note 4 (b))	(4,680)	–
Business acquisition – Jacques Lamarre & Associates (note 4 (c))	–	(4,250)
Business acquisition – Leong & Associates	–	(4,864)
Additions to intangible assets	(10,125)	(7,333)
Additions to capital assets	(4,347)	(12,957)
Cash used in investing activities	(15,639)	(29,404)
Net increase/ (decrease) in cash for the year	673	(1,167)
(Bank indebtedness)/cash, beginning of year	(807)	360
Bank indebtedness, end of year	$ (134)	$ (807)

See accompanying notes to consolidated financial statements.

1. Organization and nature of the business:

Morneau Shepell Inc. (the "Company") provides health and productivity, administrative and retirement solutions to assist employers in managing the financial security, health and productivity of their employees, whose principal and head office is located at One Morneau Shepell Centre, 895 Don Mills Road, Suite 700, Toronto, Ontario, M3C 1W3. The Company offers its services to organizations that are situated in Canada, in the United States and internationally.

The Company was incorporated pursuant to the laws of the Province of Ontario on October 21, 2010 and is a continuation of Morneau Sobeco Income Fund (the "Fund"), which was converted from an income trust structure into the Company, effective January 1, 2011.

Pursuant to this Reorganization, units of the Fund ("Units") and all Class B limited partnership units of Morneau Sobeco Group Limited Partnership ("LP Units"), a subsidiary of the Fund, were exchanged, on a one-for-one basis for common shares of the Company. Holders of Units and LP Units, therefore, became sole shareholders of the Company effective January 1, 2011.

This Reorganization was treated as a change in business form rather than a change in control and therefore, has been accounted for as a continuity of interest. The carrying amounts of assets, liabilities, and unitholders' equity in the consolidated financial statements of the Fund immediately prior to the Reorganization were the same as the carrying values of the Company immediately prior to the Reorganization. The Company refers to common shares, shareholders, and dividends which were formerly referred to as units, unitholders, and distributions under the Fund.

References herein to Morneau Shepell Inc. represent the financial position, results of operations, cash flows and disclosures of the Company and its subsidiaries on a consolidated basis.

These consolidated financial statements were approved by the Company's Board of Directors on March 6, 2013.

2. Basis of preparation:

(a) Statement of compliance:

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

2. Basis of preparation (continued):

(b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis except for the following material items in the consolidated statements of financial positions:

(i) interest rate swap is measured at fair value; and

(ii) future consideration related to acquisitions is measured at fair value

(c) Functional currency:

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency. Unless otherwise noted, all financial information presented has been rounded to the nearest thousand.

(d) Use of estimates and judgments:

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting year.

Estimated values of these assets and liabilities usually depend upon estimates of the profitability of the related business which, in turn, depend upon assumptions regarding future conditions in the general or specific industry, including the effects of economic cycles, and other factors that affect the operating revenue. These assumptions are limited by the availability of reliable comparable data, economic uncertainty and the uncertainty of predictions concerning future events. Accordingly, by their nature, estimates of fair value are subjective and do not necessarily result in precise determinations. Should the underlying assumptions change, the estimated value could change by a material amount, and actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed by management on an ongoing basis, and revisions to accounting estimates are recognized in the period giving rise to the change.

2. Basis of preparation (continued):

Information about the most significant estimates and judgments the Company is required to make is included in the following notes:

(i) Revenue recognition (outsourcing contracts) (note 3(c)):

Where a singular outsourcing contract requires the delivery of multiple components, the Company is required to assess the criteria for the recognition of revenue related to each component. These assessments require judgment by management to determine whether separately identifiable components exist, and where applicable, the appropriate fair value allocations to each. Amongst other factors, management considers whether implementation services are sold separately in the normal course of business, have stand-alone value to the customer, and look to budgeted salary costs associated with each phase of the service contract to derive fair value estimates.

Additional discussion on the Company's revenue recognition policies can be found in note 3(c). Changes in management's estimates could affect the timing of recognizing the revenues and expenses associated with these contracts.

(ii) Unbilled fees (note 6):

The Company is required to assess the recoverability of fees on services provided but not yet billed. This assessment requires judgment by management to determine whether fees will be less than fully recoverable through invoicing. Amongst other factors, management considers the solvency of the client, the age of the outstanding unbilled fees balance and historic client experience. If future billings differ from estimates, future profits could be materially affected.

(iii) Intangible assets (note 10):

(a) Internally-developed software:

The Company is required to estimate the expected period of benefit over which costs should be amortized. Management considers the anticipated rate and timing of technological obsolescence and competitive pressures, historical usage patterns, and internal business plans for the projected use of the software in deriving its useful life. Due to the rapidly changing technological environment and the uncertainty of the development processes themselves, future results could be affected if management's current assessment of future benefits materially differs from actual performance.

2. Basis of preparation (continued):

(b) Other intangible assets:

Other intangible assets consist of those acquired through business acquisitions. Purchase price allocations involve significant estimates and assumptions regarding cash flow projections, growth projections, economic risk, and weighted cost of capital. If future events or results differ adversely from these estimates and assumptions, the Company could incur increased amortization or impairment charges in future periods.

(iv) Goodwill (note 11):

Goodwill impairment review involves significant estimates and assumptions regarding cash flow projections, growth projections, economic risk, and weighted cost of capital. If future events or results differ adversely from these estimates and assumptions, the Company could incur impairment charges in future periods. Additional discussion on impairment of long-lived assets can be found in note 10.

(v) Trade receivables (allowance for doubtful accounts) (note 5):

The Company is required to assess whether accounts receivables are collectible from customers. Accordingly, management establishes an allowance for estimated losses arising from non-payment and delinquent accounts, current economic trends, and past experience. If future collections differ from estimates, future profits could be adversely affected.

(vi) Deferred income tax assets and liabilities (utilization of tax losses) (note 18):

Deferred tax assets are recognized for all unused tax losses and deductible temporary differences to the extent that it is probable that taxable profit will be available against which the losses and deductible temporary differences can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

(vii) Provisions (note 14):

In identifying required provisions, the Company has to assess the probability of the future outflows of resources. Estimates must subsequently be made by management to approximate the timing and amount of these liabilities. If future events or results differ adversely from these estimates, future profits could be adversely affected.

3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements. Certain comparative amounts in the consolidated statement of financial position relating to trade and other receivables and unbilled fees have been reclassified to conform to the current year's presentation.

(a) Basis of consolidation:

(i) Business combinations:

Acquisitions of businesses are accounted for using the acquisition method. The acquisition cost is measured at the acquisition date at the fair value of the consideration transferred, including all contingent consideration. Subsequent changes in contingent consideration are accounted for through the statement of income and comprehensive income in accordance with the applicable standards.

Goodwill arising on acquisition is initially measured at cost, being the difference between the fair value of the consideration transferred including the recognized amount of any non-controlling interest in the acquiree and the net recognized amount (generally fair value) of the identifiable assets and liabilities assumed at the acquisition date. If the net of the amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain.

For each business combination with ownership interest below 100%, non-controlling interests are measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. This determination is made on an acquisition by acquisition basis.

Acquisition-related costs, other than those that are associated with the issue of debt or equity securities that the Company incurs in connection with a business combination are expensed as incurred.

(ii) Subsidiaries:

These consolidated financial statements include the assets, liabilities, revenue and expenses of all the Company's subsidiaries. Subsidiaries are entities over which the Company has the power to govern financial and operating policies ("control"), generally represented by an ownership interest of more than 50% of voting rights. Subsidiaries are consolidated from the date control is transferred to the Company, and would be de-consolidated from the date control ceases.

3. Significant accounting policies (continued):

These consolidated financial statements include the assets, liabilities, revenue and expenses of all the Company's subsidiaries including the following operating entities:

	% Ownership
Morneau Shepell Ltd.	100.0
Morneau Shepell Limited	100.0
Morneau Shepell SBC Limited	100.0
Morneau Sobeco IT Solutions Inc.	100.0
FGI World New Caledonia	100.0
1137273 Ontario Limited	100.0
Morneau Shepell Asset & Risk Management Ltd.	100.0
Innu-Med Inc.	41.3

All intercompany transactions and balances between subsidiaries have been eliminated upon consolidation.

(b) Foreign currency translation:

Transactions denominated in currencies other than the functional currency are recorded at the exchange rates prevailing at the date of the transaction. At each reporting date, monetary assets and liabilities denominated in foreign currencies are translated at the rates prevailing as at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not re-translated.

Assets and liabilities of subsidiaries with functional currencies other than the Canadian dollar are translated at period-end rates of exchange, and operating results are translated at average rates of exchange for the period. The resulting translation adjustments are included in accumulated other comprehensive income in shareholders' equity.

(c) Revenue recognition and unbilled fees:

Revenues include fees generated from outsourcing, consulting services, Employee Support Solutions ("ESS"), and organizational health solutions contracts.

3. Significant accounting policies (continued):

Generally, revenue from the rendering of services is recognized when the following criteria are met:

(i) the amount of revenue can be reliably measured;

(ii) the stage of completion can be reliably measured;

(iii) the receipt of economic benefits is probable; and

(iv) costs incurred and to be incurred can be reliably measured.

Concurrently with the above general principles, the Company applies the following specific revenue recognition policies:

Fees for outsourcing, actuarial and consulting services are billed either on a time-and-material basis or on a fixed-fee basis. Revenue is recognized as services are rendered and expenditures are incurred.

ESS revenue is recognized through a combination of the minimum contracted amount and incremental usage above the minimum thresholds. The minimum contracted amount is recognized on a basis consistent with provision of ESS services. Incremental usage is recognized when the minimum usage threshold is exceeded.

Organizational health solutions revenue is recognized on a fixed-fee or time-and-material basis. On fixed-fee basis arrangements, where the provision of service is characterized by an indeterminate number of acts, revenue is recognized on a straight-line basis over the term of the contract. On time-and material basis arrangements, revenue is recognized as services are rendered and expenditures are incurred.

Outsourcing engagements typically involve both an implementation and administration component. Where a single contract requires the delivery of multiple components, revenue recognition criteria are applied to determine whether each component of the outsourcing contract qualifies for treatment as a separate unit of account. Multiple deliverable arrangements are determined to exist if all of the following criteria are met:

(i) the delivered item has value to the customer on a stand-alone basis; and

(ii) the fair value of the undelivered item can be reliably measured.

3. Significant accounting policies (continued):

If these criteria are not met, deliverables (components) included in an arrangement are accounted for as a single unit of accounting and revenue is deferred and recognized on a basis consistent with elements of the service contract.

Unbilled fees represent fees earned for services rendered but not yet invoiced as at the reporting date; upon billing, this balance will be transferred to trade receivables. Unbilled fees on time and material basis arrangements are recorded at the lower of unbilled hours worked at normal billing rates and at the amount which is estimated to be recoverable upon invoicing. The Company maintains a provision for amounts expected to be unrecoverable.

Other sources of operating revenue include the following:

(i) Investment income earned in the course of normal business operations, and is recorded on the accrual basis.

(ii) Commissions income are recognized when earned, which is at the later of the billing or the effective date of the policy, net of a provision for return commissions due to policy cancellations or change of brokers.

(d) Deferred implementation costs and deferred outsourcing revenues:

Implementation costs incurred in connection with outsourcing service contracts, relate to those costs necessary to set up clients and their human resource or benefit programs onto the Company's systems and operating processes. Such costs may include internal and external costs for coding and customizing systems, client data conversion costs, and contract negotiation costs. Outsourcing contracts that are accounted for as a combined unit of accounting, specific, incremental, and direct costs, net of any revenue received from the implementation component, are deferred and amortized over the term of the service contract. For outsourcing contracts where each component is considered a separate unit of accounting, those costs are deferred and amortized over the remaining term of each component.

If a client terminates an outsourcing contract prior to its end, a loss on the contract may be recorded (if necessary), and any remaining deferred implementation revenues and costs would be recognized into income over the remaining implementation period through to the date of termination.

3. Significant accounting policies (continued):

(e) Cash and bank indebtedness:

Cash is comprised of bank balances and banker's deposit notes with an original maturity of three months or less, and are primarily held in Canadian and U.S. dollars. Where the cash is in a net overdraft position, it has been presented as bank indebtedness.

(f) Trade and other receivables:

Trade receivables are fees due from customers from the rendering of services in the ordinary course of business. Trade receivables are classified as current if payment is due within one year of the reporting period date, and are initially recognized at fair value and subsequently measured at amortized cost.

The Company maintains an allowance for doubtful accounts to provide for impairment of trade receivables. An impairment loss is recognized when there is evidence that the Company will not be able to collect the amount due under the original terms of the invoice. Expenses related to doubtful accounts are reported as office and administration expenses.

Other receivables are those amounts incidental to the Company's normal business operations and are classified as current when they are expected to be settled within one year of the reporting period date. Other receivables are initially recognized at fair value, and are subsequently measured at amortized cost, less impairment.

(g) Capital assets:

Capital assets are recognized at initial cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset, including those attributable to bringing the asset to its intended working condition. Where significant parts of a capital asset have different useful lives, they are accounted for and depreciated as separate components. Software, to the extent that it is integral to the operation of the related computer equipment, has been included as part of the cost of computer equipment.

Gains and losses on disposals of a capital asset item are determined by comparing the proceeds from disposal with its carrying amount, and recognized as gain (loss) on disposal in the consolidated statement of income and comprehensive income.

3. Significant accounting policies (continued):

Depreciation is calculated over the depreciable amount, which is the cost of the asset less its residual value. Depreciation is recognized on a straight-line basis, over the assets' estimated useful lives, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful lives of the Company's capital assets are as follows:

Computer equipment	3 - 5 years
Furniture and fixtures	5 years
Leasehold improvements	Over the term of the lease

Residual values, useful lives, and depreciation methods are reviewed at the end of each reporting period and adjusted prospectively as required.

(h) Intangible assets:

Intangible assets consist of customer relationships, customer contracts, proprietary software, and trade names acquired through acquisitions or business combinations, internally-developed software and purchased software.

Internally-developed software is recognized at the aggregate cost of all eligible development costs, when all the following criteria are met:

(i) it is technically feasible to complete the software so that it will be available for use;

(ii) management intends to complete the software and use or sell it;

(iii) the Company is able to use or sell the software;

(iv) future benefits associated with the software can be demonstrated;

(v) adequate technical, financial, and other resources to complete the development and to use or sell the software are available; and

(vi) the expenditures attributable to the software during its development can be reliably measured.

3. Significant accounting policies (continued):

Eligible expenditures capitalized as part of internally-developed software include external direct costs of materials and services consumed in development, and payroll and payroll-related costs for employees who are directly associated with and who devote time to the development of the software. All costs incurred in the preliminary research stage of the projects are expensed as incurred.

Purchased software is recognized at initial cost.

Intangible assets with a finite life are amortized on a straight-line basis over their estimated useful lives. Amortization is recognized over the assets' estimated useful lives as follows:

Customer relationships	15 - 20 years
Customer contracts	1 - 2 years
Proprietary software	5 - 10 years
Trade names	Indefinite
Internally-developed software	3 -10 years
Purchased software	3 years

Intangible assets with an indefinite life are not amortized, but are subject to impairment tests annually or whenever impairment indicators are identified. Trade names have been determined to have an indefinite life based on their strength, history, and expected future use.

Amortization expense has been presented in profit or loss as depreciation, amortization, and impairment losses. Assets are removed from asset and accumulated amortization balances once they become fully depreciated. Proceeds from disposals are netted against the related assets and accumulated amortization, and resulting gains and losses are included in profit.

Amortization on internally-developed software does not commence until the asset is ready for use as management intended.

(i) Goodwill:

Goodwill represents the excess of the cost of the Company's business acquisitions over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is carried at cost less accumulated impairment charges, and is not amortized but is subject to an impairment test annually or whenever impairment indicators are identified.

3. Significant accounting policies (continued):

(j) Impairment of non-financial assets:

The Company's identifiable tangible and intangible assets with finite useful lives are reviewed for indications of impairment at each statement of financial position date and when events or changes in circumstances indicate that they may be impaired. Impairments are recorded when the recoverable amount of assets are less than their carrying amounts. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use. Impairment losses, other than those relating to goodwill, are evaluated for potential reversals when events or changes in circumstances warrant such consideration.

Similarly, intangible assets with indefinite useful lives and goodwill are tested annually or whenever impairment indicators are identified, by estimating their recoverable amounts and comparing it to their carrying amounts. Where individual assets cannot be tested individually, they are grouped together into cash-generating units ("CGU"), which represent the smallest group of assets that are capable of generating cash inflow from continuing use largely independent of other groups of assets, and tested on this basis. Goodwill acquired through business combination is allocated to each CGU, or groups of CGU's but not larger than an operating segment, that are expected to benefit from the synergies of the combination.

An impairment loss is recognized if the carrying amount of the CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss, and those impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU, and then to reduce the carrying amount of the other assets in the CGU on a pro rata basis.

Impairment losses in respect of goodwill are not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, had no impairment charge been recorded.

(k) Provisions:

Provisions are recognized when the Company has a present obligation to a third-party and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. The obligation may be legal, regulatory or contractual or it may represent a constructive obligation deriving from the Company's actions where, by an established pattern of past practice or published policies, the Company creates a valid expectation on the part of other parties that the Company will discharge certain responsibilities.

3. Significant accounting policies (continued):

(l) Deferred revenue:

Deferred revenue represents the excess of retainer amounts billed over costs incurred and revenue earned on service contracts. The amount is amortized into profit as services are rendered, in accordance with the revenue recognition policies described above.

(m) Convertible debentures:

Compound financial instruments issued by the Company comprise convertible debentures that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially as the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest rate method. The equity component of a compound financial instrument is not remeasured subsequent to initial recognition.

Interest, losses and gains relating to the financial liability are recognized in profit or loss.

(n) Share capital:

Common shares are classified as an equity instrument. Incremental costs directly attributable to the issuance of common shares are recognized as a reduction of equity, net of the related tax effect.

(o) Insurance premium liabilities and related cash and investments:

In its capacity as consultants, the Company collects premiums from insurers and remits premiums, net of agreed deductions, such as taxes, administrative fees and commissions, to insurance underwriters. The cash and investment balances and the related liabilities have been presented separately in the Company's consolidated statements of financial position.

3. Significant accounting policies (continued):

(p) Employee benefits:

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

The Company also offers a pension benefit plan for its eligible employees, which includes a defined benefit option and a defined contribution option.

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. The Company matches member contributions and is required to make additional contributions at the option of the member, up to the limits defined in the plan text. A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Company accrues its obligations under the defined benefit option of the plan as the employees render the services necessary to earn the pension.

(i) Defined benefit plan:

The liability recognized in the consolidated statements of financial position in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognized past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected benefit method pro-rated on service. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the fair value of plan assets or 10% of the present value of the defined benefit obligation are charged or credited to income over the employees' expected average remaining working lives.

Past-service costs are recognized immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period.

The defined benefit option was closed effective January 1, 1998 and included 59 employees as at December 31, 2012, comprising of active employees, retirees, and deferred vested members. All other employees are covered by the defined contribution option of the plan.

3. Significant accounting policies (continued):

(ii) Defined contribution plan:

Under the defined contribution option, each member is required to contribute a percentage of earnings. The Company matches this required contribution. Each member may elect to make an optional contribution in addition to the required contribution. The Company contributes 50% of the optional contributions.

For members who had completed at least 10 years of service on December 31, 2010, their contributions follow the grandfathered provisions. Each member is required to contribute a specific dollar amount based on the member's job level classification. Each member may elect to make an optional contribution up to 300% of the member's required contribution. The Company matches required contributions and contributes 75% of optional contributions.

The Company has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in future payments is available.

(q) Share-based compensation plan:

The Company offers an equity-settled compensation plan under which it receives services from employees as consideration for equity instruments of the Company. Under the long-term incentive plan ("LTIP"), the Company may grant participants restricted share units ("RSUs"), retirement deferred share units ("Retirement DSUs"), or post-retirement deferred share units ("Post-Retirement DSUs"), collectively referred to as "LTIP Units".

Expense related to LTIP Units is measured based on the fair value of the awards at grant date. The expense is recognized as salary, benefit and contractor expenses over the vesting period, which is the period over which all of the specified vesting conditions are satisfied. As LTIP Units vest, they are transferred or issued to the participant and are recorded as share capital. Holders of LTIP Units are entitled to additional LTIP Units as determined based on the fair market value of those LTIP Units on the date credited or cash bonuses equivalent to the dividends payable had those Units been common shares. LTIP Units credited under the dividend reinvestment policy ("DRIP") vest at the same rate as the LTIP Units to which they are determined. Cash bonuses are recorded as salary, benefit, and contractor expense as dividends are declared. Units issued under DRIP are accounted for as a credit to contributed surplus, with a corresponding charge to deficit.

At the end of each reporting period, the Company reassesses its estimates of the number of awards that are expected to vest and be forfeited, and recognizes the impact of any revisions into profit or loss.

3. Significant accounting policies (continued):

(r) Income taxes:

Income tax expenses comprises current and deferred taxes. Current taxes and deferred taxes are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current taxes are the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred taxes are recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred taxes are not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill.

In determining the amount of current and deferred taxes, the Company takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The Company believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax laws and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Company to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

Deferred taxes are measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

3. Significant accounting policies (continued):

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(s) Financial instruments:

Financial assets and liabilities are recognized initially at fair value, defined as the amount of consideration that could be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. In certain circumstances, however, the initial fair value may be based on other observable current market transactions in the same instrument, without modification or on a valuation technique using market based inputs. Subsequent measurement of the Company's financial assets and liabilities is dependent on their classification as held for trading, loans and receivables, other financial liabilities or derivative instruments.

The Company initially recognizes loans and receivables on the date that they originated. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the consolidated statements of financial position, when and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The Company assesses as at each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. When an impairment has occurred, the cumulative loss is recognized into profit or loss. The cumulative loss is measured as the difference between the trade date cost and the current fair value, less any impairment loss previously recognized in profit or loss.

3. Significant accounting policies (continued):

(i) Non-derivative financial assets:

(a) Financial assets at fair value through profit and loss:

Financial assets at fair value through profit and loss are comprised of foreign exchange contracts. A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if it is a part of an identified portfolio of financial instruments that the Company manages and has an actual pattern of short-term profit-taking, or it is a derivative that is not accounted for as a hedging instrument. Upon initial recognition attributable transaction costs are recognized in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value at each reporting date, and any unrealized gains or losses from market fluctuations are recognized in profit or loss.

(b) Loans and receivables:

Loans and receivables comprise trade and other receivables. Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Non-derivative financial liabilities:

The Company initially recognizes debt securities issued and subordinated liabilities on the date that they originated. All other financial liabilities are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

Financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method. Financial liabilities are derecognized when the contractual obligations are discharged, cancelled or expire.

Non-derivative financial liabilities of the Company include long-term debt, bank indebtedness, and trade and other payables.

3. Significant accounting policies (continued):

(iii) Derivative financial instruments:

Derivative financial instruments are used by the Company in the management of its interest rate risk exposure on debt financing. Derivatives that have been designated and function effectively as hedges are accounted for using hedge accounting principles (see note 3(t) below).

(iv) Fair value of financial instruments:

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement.

(t) Cash flow hedge - derivative instruments:

Derivative instruments are initially recognized at fair value on the date the contract is entered into and are subsequently re-measured to fair value at each reporting date. The Company holds derivative instruments for hedging purposes only, and does not enter into derivative contracts for speculative purposes.

The Company prepares formal documentation at the inception of the transaction to detail the relationship between derivative hedging instruments and hedged items, as well as its risk management objectives and strategy in partaking in the hedging transaction. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivative used in hedging transactions is highly effective in offsetting the changes in cash flows of the hedged items.

Non-performance risk, inclusive of the Company's credit risk, is considered in determining the fair value of the financial instruments.

3. Significant accounting policies (continued):

The Company has designated its derivative instruments as cash flow hedges. Cash flow hedges are hedges against highly probable forecasted transactions. The effective portion of changes in the fair value of derivatives that are designated as a cash flow hedge is recognized as a component of other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately into the profit or loss. Amounts accumulated in other comprehensive income are recycled into profit or loss in the period in which the hedged item will affect profit or loss. When a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss in other comprehensive income remains in other comprehensive income and is recognized when the original forecasted transaction is ultimately recognized into profit or loss. If a forecasted transaction is no longer expected to occur, the cumulative gain or loss in other comprehensive income is immediately recognized into profit or loss.

(u) Future accounting changes:

(i) IFRS 9, Financial Instruments ("IFRS 9"):

IFRS 9 introduces new requirements for classifying and measuring financial assets and may affect the Company's accounting for its financial assets. Specifically, IFRS 9 requires financial assets to be classified into two measurement categories, those measured at fair value and those measured at amortized cost. The standard is not applicable until January 1, 2015 but is available for early adoption. The Company has not early adopted IFRS 9 for the year ended December 31, 2012, and the extent of its impact has not been determined.

(ii) IFRS 10, Consolidated Financial Statements ("IFRS 10"):

IFRS 10 replaces International Accounting Standard ("IAS") 27, Consolidated and Separate Financial Statements, and SIC-12, Consolidation - Special Purpose Entities. This new standard contains a single consolidation model that identifies control as the basis for consolidation for all types of entities, sets forth factors to consider in assessing control, and requires control to be assessed on a continuous basis. The standard is not applicable until January 1, 2013, but is available for early adoption. The Company does not expect IFRS 10 to have a material impact on the Consolidated Financial Statements.

3. Significant accounting policies (continued):

(iii) IFRS 13, Fair Value Measurement ("IFRS 13"):

IFRS 13 defines and provides a framework for measuring fair value and sets forth related disclosure requirements. Specifically, IFRS 13 defines fair value to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. an exit price). The standard is applicable prospectively for annual periods beginning on or after January 1, 2013, but is available for early adoption. The Company has not early adopted IFRS 13 for the year ended December 31, 2012, and the extent of the impact has not been determined.

(iv) IAS 1, Presentation of Financial Statements (“IAS 1”):

IAS 1 was amended to require an entity to present separately the items of other comprehensive income that may be reclassified to profit or loss in the future from those that would never be reclassified to profit or loss. The standard is applicable retrospectively for annual periods beginning on or after July 1, 2012, but is available for early adoption. The Company has not early adopted the amendments to IAS 1, and the extent of the impact has not been determined.

(v) IAS 19, Employee Benefits ("IAS 19"):

IAS 19 was amended to improve and provide clarity on the recognition, presentation, and disclosure requirements of defined benefit plans. Specifically, the amendments will require the recognition of changes in the net defined benefit liability (asset), modify the accounting for termination benefits, and enhance disclosures. The standard is applicable retrospectively for annual periods beginning on or after January 1, 2013, but is available for early adoption. The Company has not early adopted the amendments to IAS 19. The company has determined that the impact of the initial application of the revised standard in 2013 will not be material. The impact of the revised IAS 19 standard comes from the requirement to immediately recognize all actuarial gains and losses in other comprehensive income and the introduction of net interest income as the equivalent of the expected return on plan assets under the current IAS 19 standard.

(In thousands of Canadian dollars, except per share amounts)

4. Business acquisitions:

(a) Mercer Canada's pension and benefits outsourcing business ("Mercer Canada Outsourcing"):

On November 1, 2012, the Company completed the acquisition of Mercer Canada's pension and benefits outsourcing business ("Mercer Canada Outsourcing"). This acquisition complements the Company's existing Administrative Solutions service offering and expands the Company's market presence in Canada. Through this acquisition, the Company gains approximately 60 clients which represents an estimated $25 million in additional annual revenue to the Company.

The net assets of Mercer Canada Outsourcing were acquired for nil cash consideration. This acquisition has been accounted for using the acquisition method of accounting and is final. In the purchase price allocation presented below, the Company has calculated that the identifiable assets acquired and liabilities assumed exceed the consideration transferred by $3,500, resulting in the recognition of a bargain purchase gain in the consolidated statements of income and comprehensive income for the year ended December 31, 2012. The transaction was a bargain purchase due to the net working capital payment received as part of the acquisition and to fund the investments required to continue to service the clients gained.

Cash	$ 3,513
Prepaid expenses and other	121
Capital assets	952
Intangible assets	286
Trade and other payables	(1,372)
Bargain purchase gain	(3,500)
	$ –

These consolidated financial statements include the results of Mercer Canada Outsourcing from the date of acquisition, November 1, 2012. For the year ended December 31, 2012, Mercer Canada Outsourcing contributed revenue and profit of $5,220 and $263, respectively. Had this acquisition occurred on January 1, 2012, the revenue would have increased by approximately $19,000 and profit $nil, excluding system conversion costs, for the year ended December 31, 2012. In determining these amounts, management has assumed that the fair values determined provisionally that arose on the date of acquisition would have been the same if the acquisition had occurred on January 1, 2012.

(In thousands of Canadian dollars, except per share amounts)

4. Business acquisitions (continued):

(b) SBC Systems Company Inc. ("SBC Systems Company"):

On January 31, 2012, the Company completed the acquisition of SBC Systems Company, a company specializing in providing employee benefits administration systems in the United States. This acquisition provides the Company with a suite of flexible administration products and a technology platform that will allow it to further build its Administrative Solutions business, broadening its distribution channel to reach more U.S. clients. The purchase price is contingent on future business results and is expected to approximate U.S. $6,000 payable in three instalments.

The first instalment of approximately $5,014 (U.S. $5,000) was satisfied on closing through cash consideration. The second and final instalments estimated at U.S. $500 each, are subject to adjustments, dependent on achieving certain revenue targets, and will be settled in March 2013 and 2014, respectively. The Company expects that the revenue targets will be achieved, therefore, the full amount of the future consideration has been recognized. At December 31, 2012, $940 has been recognized as an acquisition liability on the statement of financial position, representing the U.S. $1,000 final instalments discounted and translated to Canadian dollars.

This acquisition has been accounted for using the acquisition method of accounting. The purchase price allocation presented below is final. During the second and third quarters of 2012 the Company amended the initial purchase price allocation as a result of adjustments for working capital, intangible assets and goodwill.

	Initial	YTD Adjustments	Revised
Cash	$ 274	$ 60	$ 334
Trade and other receivables	180	–	180
Prepaid expenses and other	129	36	165
Capital assets	250	(62)	188
Intangible assets	5,601	(2,285)	3,316
Goodwill	–	2,442	2,442
Trade and other payables	–	(104)	(104)
Deferred revenue	(552)	(87)	(639)
	$ 5,882	$ –	$ 5,882

The goodwill is attributable mainly to the workforce and the synergies expected to be achieved from the integration of SBC Systems Company as well as the ability to expand the Company's existing Administrative Solutions business in the US.

(In thousands of Canadian dollars, except per share amounts)

4. Business acquisitions (continued):

These consolidated financial statements include the results of SBC Systems Company from the date of acquisition, January 31, 2012. For the year ended December 31, 2012, SBC Systems Company contributed revenue and a loss of $7,142 and ($79), respectively. Had this acquisition occurred on January 1, 2012, the revenue would have increased by approximately $565 and profit decreased by ($78) for the year ended December 31, 2012. In determining these amounts, management has assumed that the fair values determined provisionally that arose on the date of acquisition would have been the same if the acquisition had occurred on January 1, 2012.

(c) Jacques Lamarre & Associates and Parcours d'enfant ("Jacques Lamarre & Associates"):

On September 30, 2011, the Company completed the acquisition of Jacques Lamarre & Associates, a company specializing in providing ESS services, crisis management, and organizational health and productivity solutions. This acquisition allows the Company to broaden its portfolio of ESS solutions, and to expand its presence in the province of Québec. The purchase price is contingent on future business results and is expected to approximate $6,750 payable in two instalments. The first instalment of approximately $4,750 of which $500 will be released in the first half of 2013, was satisfied on closing through cash consideration. The second and final instalment of $2,000, is subject to certain revenue adjustments, and will be settled in October 2013. The Company expects that the revenue targets will be achieved, therefore the full amount of the future consideration has been recognized. At December 31, 2012, $2,369 has been recognised as an acquisition liability on the statement of financial position, representing the $2,500 final instalment discounted.

This acquisition has been accounted for using the acquisition method of accounting. During 2012 the Company finalized the purchase price allocation, making changes to working capital, intangible assets and goodwill. Below is the final purchase price allocation.

	Initial	Adjustment	Final
Trade and other receivables	$ 1,250	$ (230)	$ 1,020
Unbilled fees	2,210	(910)	1,300
Prepaid expenses and other	20	(20)	–
Capital assets	160	–	160
Intangible assets – customer relationships	2,950	410	3,360
Goodwill	1,000	774	1,774
Trade and other payables	(1,190)	176	(1,014)
Deferred tax liability	–	(200)	(200)
	$ 6,400	$ –	$ 6,400

(In thousands of Canadian dollars, except per share amounts)

4. Business acquisitions (continued):

The goodwill acquired is attributable mainly to the Jacques Lamarre & Associates workforce, and the synergies expected to be achieved from integrating the company into the Company's existing ESS business. 75% of the estimated goodwill amount is eligible for tax deduction. For the purpose of impairment testing the additional goodwill amount has been included under the ESS CGU.

5. Trade and other receivables:

The Company's trade and other receivables are as follows:

	December 31, 2012	December 31 2011
Trade receivables	$ 54,328	$ 47,170
Less allowance for doubtful accounts	418	246
Net trade receivables	53,910	46,924
Other receivables	1,666	3,855
	$ 55,576	$ 50,779

The aging of trade receivables at each reporting date was as follows:

	December 31, 2012	December 31, 2011
Current	$ 26,335	$ 23,410
Past due 1 - 30 days	13,471	9,599
Past due 31 - 90 days	6,055	9,469
Past due > 90 days	8,467	4,692
	$ 54,328	$ 47,170

(In thousands of Canadian dollars, except per share amounts)

5. Trade and other receivables (continued):

The change in allowance for doubtful accounts was as follows:

Balance, January 1, 2011	$ 426
Additions	708
Amounts written off as uncollectible	(888)
Balance, December 31, 2011	246
Additions	229
Amounts written off as uncollectible	(57)
Balance, December 31, 2012	$ 418

6. Unbilled fees:

The Company's unbilled fees are as follows:

	December 31, 2012	December 31, 2011
Total unbilled fees	$ 46,461	$ 36,367
Less non-current portion	1,649	1,505
Current portion	$ 44,812	$ 34,862

7. Prepaid expenses and other:

The Company's prepaid expenses and other comprise the following:

	December 31, 2012	December 31, 2011
Vendor prepayments	$ 1,617	$ 1,550
Prepaid insurance	14	802
Prepaid deposits	657	565
Prepaid supplies	244	188
	$ 2,532	$ 3,105

(In thousands of Canadian dollars, except per share amounts)

8. Deferred implementation costs:

The Company's deferred implementation costs comprise the following:

	Cost	Accumulated amortization	Net book value
Balance, January 1, 2011	$ 3,956	$ (416)	$ 3,540
Deferred implementation costs for the year, net of revenue	6,649	–	6,649
Amortization for the year	–	(1,068)	(1,068)
Balance, December 31, 2011	10,605	(1,484)	9,121
Deferred implementation costs for the year, net of revenue	6,132	–	6,132
Amortization for the year	–	(2,225)	(2,225)
Balance, December 31, 2012	$ 16,737	$ (3,709)	$ 13,028
Less current portion			2,668
Non-current portion			$ 10,360

(In thousands of Canadian dollars, except per share amounts)

9. Capital assets:

The Company's capital assets comprise the following:

	Computer hardware	Furniture and fixtures	Leasehold improvements	Total
Cost				
Balance, January 1, 2011	$ 11,513	$ 7,252	$ 13,507	$ 32,272
Additions	5,018	1,509	7,110	13,637
Acquired through business acquisitions	–	160	–	160
Balance, December 31, 2011	16,531	8,921	20,617	46,069
Additions	3,045	919	383	4,347
Acquired through business acquisitions (note 4)	256	251	633	1,140
Balance, December 31, 2012	$ 19,832	$ 10,091	$ 21,633	$ 51,556
Accumulated depreciation				
Balance, January 1, 2011	$ 4,578	$ 3,788	$ 6,872	$ 15,238
Depreciation	3,404	1,286	2,180	6,870
Balance, December 31, 2011	7,982	5,074	9,052	22,108
Depreciation	4,291	1,328	2,556	8,175
Balance, December 31, 2012	$ 12,273	$ 6,402	$ 11,608	$ 30,283
Carrying amount				
December 31, 2011	$ 8,549	$ 3,847	$ 11,565	$ 23,961
December 31, 2012	7,559	3,689	10,025	21,273

(In thousands of Canadian dollars, except per share amounts)

10. Intangible assets:

The Company's intangible assets comprise the following:

	Indefinite useful life	Finite useful life					
	Trade names	Customer relationships	Customer contracts	Proprietary software	Internally-developed software	Purchased software	Total
Cost							
Balance, January 1, 2011	$ 70,000	$ 199,557	$ 27,900	$ 41,000	$ 6,081	$ 5,113	$ 349,651
Internally developed	–	–	–	–	5,678	–	5,678
Purchased	–	–	–	–	–	1,655	1,655
Acquired through business acquisitions	–	2,950	–	–	–	–	2,950
Balance, December 31, 2011	70,000	202,507	27,900	41,000	11,759	6,768	359,934
Internally developed	–	–	–	–	7,176	–	7,176
Purchased	–	–	–	–	–	2,949	2,949
Acquired through business acquisitions	–	1,032	–	2,497	–	469	3,998
Balance, December 31, 2012	$ 70,000	$ 203,539	$ 27,900	$ 43,497	$ 18,935	$ 10,186	$ 374,057
Accumulated amortization							
Balance, January 1, 2011	$ –	$ 43,863	$ 27,722	$ 40,518	$ 200	$ 2,698	$ 115,001
Amortization	–	11,813	178	200	730	1,296	14,217
Balance, December 31, 2011	–	55,676	27,900	40,718	930	3,994	129,218
Amortization	–	12,110	–	429	1,890	2,085	16,514
Balance, December 31, 2012	$ –	$ 67,786	$ 27,900	$ 41,147	$ 2,820	$ 6,079	$ 145,732
Carrying amount							
December 31, 2011	$ 70,000	$ 146,831	$ –	$ 282	$ 10,829	$ 2,774	$ 230,716
December 31, 2012	70,000	135,753	–	2,350	16,115	4,107	228,325

(In thousands of Canadian dollars)

10. Intangible assets (continued):

As at December 31, 2012, $4,841 (2011 - $2,701) of internally-developed software remained under development and had not been put into use.

Impairment test of indefinite-lived intangible assets:

The Company has determined, in accordance with IAS 36, Impairment of Assets ("IAS 36"), that it has the following seven CGUs: Retirement Solutions and Health and Benefits Consulting (“Consulting”) - East, Consulting - Ontario, Consulting - West, Consulting - Québec, Administrative Solutions, Employee Support Solutions (“ESS”), and Organizational Health Solutions.

For the purposes of impairment testing, the cash flows associated with the Company's trade name could not reasonably be allocated between ESS and Organizational Health Solutions, and as a result, has been allocated to both CGUs and recoverable amount determined on an aggregate basis. An impairment test for the trade name was performed for the year ended December 31, 2012 in accordance with our policy described per note 2. The estimated fair value less cost to sell exceeded its carrying value, and as a result, no impairment charge was recorded. The valuation techniques, significant assumptions and sensitivities applied in the trade mark impairment test are similar to Goodwill and are described in Note 11.

11. Goodwill:

The change in Goodwill was as follows:

Balance, January 1, 2011	$ 300,792
Acquired through business acquisition – Jacques Lamarre & Associates	1,000
Balance, December 31, 2011	301,792
Acquired through business combinations – SBC Systems Company Inc.	2,422
Acquired through business combination – Jacques Lamarre & Associates	774
Balance, December 31, 2012	$ 304,988

(In thousands of Canadian dollars)

11. Goodwill (continued):

Impairment test of goodwill:

For the purposes of impairment testing, goodwill has been allocated to the Company's lines of businesses, which represent the Company's operating segments and the lowest level within the Company at which goodwill is monitored for internal management purposes, as defined in IAS 36. The aggregate carrying amount of goodwill has been allocated to each as follows:

	December 31, 2012	December 31, 2011
Consulting	$ 113,536	$ 113,536
Administrative Solutions	64,050	61,628
ESS	116,652	115,878
Organizational Health Solutions	10,750	10,750
	$ 304,988	$ 301,792

Goodwill impairment is assessed on an annual basis or whenever there is an indication that the asset may be impaired. The valuation techniques, significant assumptions and sensitivities applied in the goodwill impairment test as at December 31, 2012 and December 31, 2011 are described below.

(a) Valuation technique:

The recoverable amount of each CGU or segment was calculated based on its fair value less costs to sell, using an income approach to estimate its fair value. The income approach is predicated upon the value of the future cash flows that the business is expected to generate going forward. The discounted cash flow ("DCF") method was used which involved projecting cash flows and converting them into a present value equivalent through discounting. The discounting process uses a rate of return that is commensurate with the risks associated with the business and the time value of money. This approach requires assumptions about revenue growth rates, operating margins, prevailing tax rates, and discount rates.

The significant assumptions and sensitivities of this methodology considered are described below.

(In thousands of Canadian dollars)

11. Goodwill (continued):

(b) Growth and EBITDA margins

The assumptions used were based on the Company's internal forecasts. The Company projected revenue, EBITDA margins, working capital, and capital expenditures for a period of five years, and applied a perpetual long-term growth rate thereafter. Customer retention rates, past experience, economic trends (i.e. GDP, CPI, interest rate, and unemployment rate projections), and human resource industry and market trends were also considered in deriving these forecasts. A perpetuity growth rate of 2.5 percent (2011: 3.0 percent) was applied in determining the recoverable amount of the units.

(c) Discount rate:

A discount rate was required in order to calculate the present value of projected cash flows. The discount rate represented a weighted average cost of capital ("WACC") applicable to each CGU or segment. The WACC is an estimate of the overall required after-tax rate of return on investment required by all investors of capital and serves as the basis for developing the appropriate discount rate. Determination of the discount rate requires separate analysis of the cost of equity and debt, and considers a market risk premium based on an assessment of specific risks related to the projected cash flows of each CGU or segment. Discount rates represent the volatility assessment of expected cash flows based on past performance, competition, market conditions, and other factors. The following discount rates were applied in determining the recoverable amount of the CGU or segment:

	December 31, 2012	December 31, 2011
Consulting	9.4%	10.0%
Administrative Solutions	9.4%	10.2%
ESS	9.6%	10.2%
Organizational Health Solutions	12.8%	13.3%
ESS and Organizational Health Solutions (business segment - for purposes of trade name impairment testing)	9.8%	10.5%

The recoverable amounts of each CGU or segment, assessed as at December 31, 2012 and 2011 were in excess of their respective carrying amounts and therefore, no impairment charges were incurred.

(In thousands of Canadian dollars)

11. Goodwill (continued):

The Company has performed a sensitivity analysis on the perpetuity growth rate and discount rate in assessing the recoverable amounts of each CGU or business segment at December 31, 2012 and 2011. Sensitivity analysis indicates reasonable changes to key assumptions will not result in an impairment loss.

12. Trade and other payables:

The Company's trade and other payables comprise the following:

	December 31, 2012	December 31, 2011
Trade payables and accrued liabilities	$ 23,235	$ 26,162
Accrued salaries and compensation	20,804	19,500
Other current liabilities	3,051	1,430
	$ 47,090	$ 47,092

13. Other liabilities:

The Company's other liabilities comprise obligations related to rental premises, including acquired above-market rent lease obligations and deferred lease obligations.

The Company's other liabilities were as follows:

	December 31, 2012	December 31, 2011
Acquired above-market leases	$ 3,471	$ 4,020
Deferred lease obligations	4,185	3,650
	$ 7,656	$ 7,670

(In thousands of Canadian dollars)

14. Provisions:

The Company has recognized sublease loss provisions associated with the lease of excess office space, and for expenditures related to contingency reserves on legal matters that the Company may become privy to in the normal course of operations. The sublease loss provision has been initially measured at the discounted present value of the minimum rental payments liable on the subleased properties and related commissions, net of sublease income related to these premises, and subsequently measured at best estimate. The estimate of the contingency reserve corresponds to the expenditure likely to be incurred by the Company to settle its obligation.

	December 31, 2012	December 31, 2011
Contingency reserve	$ 391	$ 444
Sublease loss provisions	1,028	1,443
	$ 1,419	$ 1,887

The following tables present the movement in provisions for the years ended December 31, 2012 and 2011:

	Sublease loss provisions	Contingency reserve	Total provisions
Balance, January 1, 2011	$ 1,890	$ 500	$ 2,390
Accrual	–	204	204
Utilization and amortization	(225)	(260)	(485)
Commission and other payments	(222)	–	(222)
Balance, December 31, 2011	$ 1,443	$ 444	$ 1,887
Accrual	–	31	31
Utilization and amortization	(198)	(84)	(282)
Commission and other payments	(217)	–	(217)
Balance, December 31, 2012	$ 1,028	$ 391	$ 1,419

(In thousands of Canadian dollars)

15. Long- term debt:

The Company's long-term debt obligations can be broken down as follows:

	December 31, 2012	December 31, 2011
Non-revolving loans	$ 130,000	$ 130,000
Revolving loans	23,985	78,500
	153,985	208,500
Less: debt issuance costs, net of accumulated amortization	912	1,379
	$ 153,073	$ 207,121

The Company has a credit facility agreement with a term of four years, maturing on January 5, 2015. The credit facility provides for a term loan of $130,000 and a revolving facility of $100,000 (which includes a swing line of $7,000).

The interest rates for the credit facilities are floating, based on a margin over certain reference rates of interest. The applicable margin may vary up or down depending on the ratio of the Company's consolidated Debt to Adjusted EBITDA as calculated in the credit facility agreement.

The credit facilities are secured by a general assignment of all the assets of the Company and require the Company to maintain, on a consolidated basis, Debt to Adjusted EBITDA financial covenant of not more than 3.25:1.00 up to March 30, 2013, and 3.00:1.00 on March 31, 2013, and thereafter and an EBITDA to interest expense ratio of not less than 3.00:1.00.

EBITDA in the amended and restated credit agreement is defined as profit before finance costs, income taxes, depreciation, amortization, non-controlling interest, and non-recurring expenditures. Adjusted EBITDA is defined as EBITDA plus the pro-forma EBITDA from permitted acquisitions' entities.

15. Long- term debt (continued):

At December 31, 2012, the Company had utilized the following credit facilities:

- $130,000 of term loans. The term loan is repayable in full on January 5, 2015 and bears interest at the one-month BA rate plus an applicable margin of 2.375%.

- $18,500 of BA loans under the revolving loan. The BA loan is renewed on a monthly basis, bearing interest at the one-month BA rate plus an applicable margin of 2.375%.

- $2,000 of prime loans under the revolving loan. The prime loan bears interest at the prime rate plus an applicable margin of 1.375%.

- $3,500 USD of Libor loans under the revolving loan. The Libor loan is renewed on a monthly basis, bearing interest at the one- month Libor rate plus an applicable margin of 2.375%.

- $nil of the swing line available. The swing line carries interest at prime plus an applicable margin of 1.375%.

As at December 31, 2012, the Company complied with all the required financial covenants. At December 31, 2012, the Debt to Adjusted EBITDA ratio was 2.0 and the EBITDA to interest expense ratio was 5.6.

(a) Interest rate swaps:

The Company entered into interest-rate swap agreements to hedge against the variable interest rate component of the term loans outstanding. The notional amount of the swap is $130,000, for the period from February 1, 2011 up to and ending January 5, 2015. This swap is used to fix the variable component of the interest rate at 2.48%, before the applicable margin, for the duration of the term and has been designated as a cash flow hedge. The fair value of the interest rate swap at December 31, 2012 was a liability of $3,101 (December 31, 2011 - $5,389).

On January 7, 2011, pursuant to the Reorganization (note 1) and the new and amended credit agreement, the Company terminated its interest-rate swap agreements in the notional amounts of $137,000 and $23,000, previously entered into to fix the variable component of the term loans outstanding at 3.65% and 2.22%, respectively (before the applicable margin). As a result of this transaction, the Company incurred a termination expenditure of $4,150.

(In thousands of Canadian dollars)

15. Long- term debt (continued):

On January 1, 2011, borrowings under the term loan were reduced from $160,000 to $130,000, removing the expectation that the forecasted variable interest payments associated with $30,000 of term loans that were previously hedged would occur. As a result, $778 of the $4,150, representing the cumulative loss on the interest rate swap cash flow hedges recognized through other comprehensive income up to the date of termination on $30,000, and $69 representing the ineffective portion up to that date, were recognized immediately into profit or loss as finance costs. The remaining $3,303 was amortized into profit or loss as finance costs concurrently with the variable interest payments on the term loan remaining, until June 1, 2012, the maturity date of the original credit facility.

(b) Finance costs:

The Company's finance costs comprise the following:

	2012	2011
Interest on term loan	$ 6,496	$ 6,916
Interest on revolving loan, bank indebtedness and other charges	2,047	2,966
Interest on convertible debenture	3,473	–
Amortization of debt issuance costs	1,002	466
Immediate recognition and amortization of terminated interest rate swap	972	3,178
Other	46	688
	$ 14,036	$ 14,214

16. Convertible debentures:

On March 27, 2012, the Company issued $75,000 principal amount of 5.75% Convertible Unsecured Subordinated Debentures for net proceeds of $71,432. The debentures pay interest semi-annually on March 31 and September 30, commencing with the initial interest payment on September 30, 2012 and have a maturity date of March 31, 2017. The debentures are convertible at the option of the holder to common shares at a conversion price of $15.00 per common share.

(In thousands of Canadian dollars)

16. Convertible debentures (continued):

The Company has the option to redeem the debentures on and after March 31, 2015 and at any time prior to March 31, 2016 at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest provided that the weighted average trading price for the 20 consecutive trading days ending five days preceding the date on which the notice of redemption is given is at least 125% of the conversion price of $15.00. On and after March 31, 2016, but prior to the maturity date, the debentures will be redeemable at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest. On redemption or maturity the Company may elect to repay the principal and satisfy its interest obligations by issuing common shares.

Upon issuance of the debentures, the liability component of the convertible debentures was recognized initially at the fair value of a similar liability that does not have an equity conversion option, using an effective interest rate of 6.1%. The difference between these two amounts of $1,079 has been recorded as equity with the remaining $73,921 allocated to long-term debt.

The discount on the debentures is being accreted such that the liability at maturity will equal the face value of $75,000. The transaction costs of $3,568 were proportionally allocated to the liability and equity components.

The convertible debenture has been allocated as follows:

	March 27, 2012
Long-term liability, net of transaction costs	$ 70,404
Equity component, net of transaction costs and deferred tax	757
Deferred tax on equity component of convertible debentures	271
Transaction costs	3,568
Face value	$ 75,000

The following table indicates the changes in the convertible debentures during the year ended December 31, 2012:

	Debt component	Equity component
Balance at March 27, 2012	$ 70,404	$ 757
Accretion and amortization on convertible debentures	700	–
	$ 71,104	$ 757

17. Financial instruments:

(a) Financial risk management:

The Company's financial instruments are exposed to certain financial risks, including interest rate risk, credit risk, currency risk and liquidity risk. The Company's exposure to these risks and its methods of managing the risks remain consistent.

(i) Interest rate risk:

The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's long-term debt obligations with floating interest rates. Specifically, the Company is subject to interest rate risk as its secured term loan bears interest at market rates. Interest rate swap agreements are used as part of the Company's program to manage the floating interest rate mix of the Company's total debt outstanding and related overall cost of borrowing.

The interest-rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based.

Interest rate sensitivity analysis:

A sensitivity analysis that assumes interest rates increased or decreased by 50 basis points with all other variables held constant would result in an increase or decrease of the Company's interest expense, excluding the interest subjected to interest rate swap agreements, by $224 (2011 - $381).

(ii) Credit risk:

The Company's exposure to credit risk is limited to carrying amount of cash and accounts receivable recognized at the reporting date.

No allowance for credit losses on financial assets was required as of December 31, 2012, other than the allowance for doubtful accounts (note 5). The Company determines its allowance for doubtful accounts based on its best estimate of the net recoverable amount by customer account. Accounts that are considered uncollectible are written off. The Company's bad debt expense for the year ended December 31, 2012 was $292 (2011 - $668).

17. Financial instruments (continued):

The Company believes that the credit risk of accounts receivable is limited for the following reasons:

(a) Risk associated with concentration of credit risk with respect to accounts receivable is limited due to the credit rating of the Company's top 10 clients.

(b) Management regularly reviews and assesses customer accounts and credit risk. Historically, bad debt as a percentage of revenue has been minimal.

The credit risk on cash and investments held in trust is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

(iii) Currency risk:

The Company realizes a portion of sales in U.S. dollars and has operations in the United States and thus is exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. The net revenue exposure after accounting for related expenses denominated in U.S. dollars for the year ended December 31, 2012 was $15,111 (2011 - $19,243).

Foreign exchange sensitivity analysis:

As at December 31, 2012, the Company's net exposure to currency risk through its current assets and liabilities denominated in U.S. dollars was U.S. $3,907. An appreciation (depreciation) of the Canadian dollar against the U.S. dollar would have resulted in an increase (decrease) of $195 in the Company's income and other comprehensive income. This analysis is based on a foreign currency exchange rate variance of 5% which the Company considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

(iv) Liquidity risk:

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due. The Company manages liquidity risk through regular monitoring of financial results and actual cash flows, and also the management of its capital structure and financial leverage as outlined in note 29.

The Company's principal liquidity needs arise from working capital requirements, debt servicing and repayment obligations, capital expenditures, dividends to shareholders and acquisition funding requirements. The Company has historically utilized cash from operations to satisfy the above needs, with the exception of acquisition funding requirements.

(In thousands of Canadian dollars)

17. Financial instruments (continued):

The tables below set forth non-derivative and derivative financial liabilities by maturity based on the remaining period from December 31 to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows.

2012	<1 year	1 - 2 years	3 -5 years
Non-derivative financial liabilities:			
Bank indebtedness	$ 134	$ –	$ –
Trade and other payables	47,090	–	–
Dividends payable	3,116	–	–
Insurance premium liabilities	14,174	–	–
Future consideration related to acquisitions	2,858	451	–
Long-term debt	–	–	153,073
Convertible debentures	–	–	71,104
Derivative financial liabilities:			
Cash flow hedges - interest rate swaps	–	–	3,101
	$ 67,372	$ 451	$ 227,278

2011	<1 year	1 - 2 years	3 -5 years
Non-derivative financial liabilities:			
Bank indebtedness	$ 807	$ –	$ –
Trade and other payables	47,092	–	–
Dividends payable	3,116	–	–
Insurance premium liabilities	12,248	–	–
Future consideration related to acquisitions (note 4)	500	2,000	–
Long-term debt	–	–	208,500
Derivative financial liabilities:			
Cash flow hedges - interest rate swaps	–	–	5,389
	$ 63,763	$ 2,000	$ 213,889

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

(In thousands of Canadian dollars)

17. Financial instruments (continued):

(b) Fair values:

Fair value represents management's estimates of the market value at a given point in time. The fair value of the Company's financial assets and liabilities, with the exception of convertible debentures, approximate their carrying values due to their short-term nature, or in relation to long-term debt instruments, because they bear interest at market rates.

The following table summarizes information regarding the carrying and fair value of the Company's financial assets and liabilities:

	December 31, 2012	December 31, 2011
Assets carried at fair value:		
Cash and investments held in trust	$ 14,174	$ 12,248
Assets carried at amortized cost:		
Trade and other receivables (note 5)	55,576	50,779
	$ 87,280	$ 75,157
Liabilities carried at fair value:		
Cash flow hedges - interest rate swaps	$ 3,101	$ 5,389
Bank indebtedness	134	807
Future consideration related to acquisitions (note 4)	3,309	2,153
Insurance premium liabilities	14,174	12,248
Liabilities at amortized cost:		
Trade and other payables (note 12)	47,090	47,092
Long-term debt (note 15)	153,073	207,121
Convertible debentures (note 16)	71,104	–
Dividends payable	3,116	3,116
	$ 295,101	$ 277,926

The fair value of the convertible debentures as at December 31, 2012 is $79,875.

(In thousands of Canadian dollars)

17. Financial instruments (continued):

Fair value hierarchy:

The interest rate swap is a financial instrument carried at fair value. The liability is measured at fair value through other comprehensive income. For the year ending December 31, 2012, the liability was $3,101 (2011 - $5,389) and level 2 (2011 – level 2) was used to determine the fair value measurement of the interest rate swap. The convertible debentures are a financial instrument carried at amortized cost. For the year ending December 31, 2012, the liability was $71,104 and level 1 was used to determine the fair value measurement of the convertible debentures.

During the year ended December 31, 2012, there were no transfers between Level 1 and Level 2 fair value measurements.

18. Income taxes:

The income taxes recognized in profit or loss comprise the following:

		2012		2011
Current tax expense:				
Current year	$	4,516	$	770
Deferred tax expense:				
Origination and reversal of temporary differences		5,536		9,671
Effect of changes in tax rates		742		(1,681)
Interest rate swaps		(177)		293
Other		228		84
		6,329		8,367
Total income tax expense	$	10,845	$	9,137

The difference between income taxes calculated using the Company's effective income tax rates and the amounts that would result from the application of the statutory income tax rates arises from the following:

	2012	2011
Income taxes at statutory rates:		
Federal	15.00%	16.50%
Provincial	11.53%	11.63%

The decrease in statutory rate is due to decrease in Canadian income tax rate.

(In thousands of Canadian dollars)

18. Income taxes (continued):

	2012	2011
Income tax provision applied to income before income taxes:		
Combined basic federal and provincial income taxes at statutory rates applied to income from continuing operations	$ 8,468	$ 9,599
Non-deductible expenses	1,184	1,007
Adjustment to deferred income taxes and liabilities for change in income tax rate	742	(1,681)
Other	451	212
	$ 10,845	$ 9,137

The income taxes recognized on components of other comprehensive income are as follows:

2012	Before taxes	Tax expense (benefits)	Net of taxes
Change in fair value of interest rates swaps	$ (2,288)	$ 607	$ (1,681)
Transfer to profit due to termination of interest rates swaps	(667)	177	(490)
Change in effective tax rate	-	(23)	(23)
	$ (2,955)	$ 761	$ (2,194)

2011	Before taxes	Tax expense (benefits)	Net of taxes
Change in fair value of interest rates swaps	$ (5,045)	$ 1,312	$ (3,733)
Transfer to profit due to termination of interest rates swaps	3,110	(782)	2,328
Change in effective tax rate	-	(902)	(902)
	$ (1,935)	$ (372)	$ (2,307)

(In thousands of Canadian dollars)

18. Income taxes (continued):

The approximate tax effect of each item that gives rise to the Company's deferred tax assets and liabilities are as follows:

	December 31, 2012	December 31, 2011
Deferred tax assets:		
Financing costs	$ 186	$ 945
Capital assets	88	842
Loss carryforward	115	4,606
Interest rate swaps	821	1,405
Other assets	279	155
	1,489	7,953
Deferred tax liabilities:		
Intangible assets	29,126	28,257
Other liabilities	485	256
	29,611	28,513
	$ (28,122)	$ (20,560)

Movement in temporary differences during the year 2012:

	Balance at January 1, 2012	Recognized in profit and loss	Recognized in equity	Recognized in other comprehensive income	Acquisition & other	Balance at December 31 2012
Financing costs	$ 945	$ (759)	$ -	$ -	$ -	$ 186
Capital assets	842	(754)	-	-	-	88
Intangible assets	(28,257)	(869)	-	-	-	(29,126)
Tax value – losses carried forward	4,606	(4,491)	-	-	-	115
Interest rate swap	1,405	177	-	(761)	-	821
Other	(101)	367	(271)	-	(200)	(206)
	$ (20,560)	$ (6,329)	$ (271)	$ (761)	$ (200)	$ (28,122)

(In thousands of Canadian dollars)

18. Income taxes (continued):

The Company is subject to assessments by various taxation authorities which may interpret tax legislation and tax filing positions differently from the Company. The Company provides for such differences when it is probable that a taxation authority will not sustain the Company's filing position and the amount of the tax exposure can be reasonably estimated. As at December 31, 2012, no provisions have been made in the financial statements for any estimated tax liability.

19. Employee future benefits:

The Company offers a pension benefit plan for its employees, which includes a defined benefit option and a defined contribution option. The defined benefit option was closed to new members effective January 1, 1998. Under the defined contribution option, each member is required to contribute a percentage of earnings. The Company matches this required contribution. Each member may elect to make an optional contribution in addition to the required contribution. The Company contributes 50% of the optional contributions. For members who had completed at least 10 years of service on December 31, 2010, their contributions follow the grandfathered provisions. Each member is required to contribute a specific dollar amount based on the member's job level classification. Each member may elect to make an optional contribution up to 300% of the member's required contribution. The Company matches required contributions and contributes 75% of optional contributions.

The defined benefit option was closed effective January 1, 1998 and included three employees, 15 retirees and 41 deferred vested members as at December 31, 2012. All other employees are covered by the defined contribution option of the plan.

The amounts recognized in the consolidated statements of financial position are determined as follows:

	December 31, 2012	December 31, 2011
Present value of funded obligations	$ 4,631	$ 4,273
Fair value of plan assets	(3,761)	(3,531)
Deficit of funded plans	870	742
Unrecognized actuarial losses	(961)	(637)
(Asset)/ Liability in the consolidated statements of financial position	$ (91)	$ 105

(In thousands of Canadian dollars)

19. Employee future benefits (continued):

The allocation of fair value of plan assets as a percentage of total plan assets was as follows:

	December 31, 2012	December 31, 2011
Pooled Equities Fund	50%	50%
Pooled Bond Fund	50%	50%
	100%	100%

The movement in the defined benefit obligation over the year is as follows:

	2012	2011
Defined benefit obligations at January 1	$ 4,273	$ 3,631
Current service cost	72	57
Interest cost	181	186
Actuarial losses	281	377
Benefits paid by the plan	(176)	(115)
Plan amendments	–	137
Defined benefit obligations at December 31	$ 4,631	$ 4,273

The movement in the fair value of plan assets during the year is as follows:

	2012	2011
Fair value of plan assets at January 1	$ 3,531	$ 3,332
Actual return on plan assets	172	105
Employer contributions	234	209
Benefits paid	(176)	(115)
Fair value of plans assets at December 31	$ 3,761	$ 3,531

(In thousands of Canadian dollars)

19. Employee future benefits (continued):

The amounts recognized in profit or loss:

	Year ended 2012	Year ended 2011
Current service cost	$ 72	$ 57
Interest cost	181	186
Actual return on plan assets	(172)	(105)
Actuarial losses	281	377
Past service cost arising from a plan amendment in the year	–	137
Other adjustments:		
Difference between actual and expected return on plan assets	(77)	(132)
Amortization of actuarial losses	(247)	(377)
	$ 38	$ 143

The expected return on plan assets is determined by applying the expected long-term rate of return on plan assets to the fair value of plan assets at the beginning of the reporting period and the net cash flow for the period.

(a) Actuarial assumptions:

The principal actuarial assumptions (expressed as weighted averages) were as follows:

	2012	2011
Discount rate at the end of the current fiscal period used to determine the accrued benefit obligation	3.75%	4.25%
Discount rate at the end of preceding period used to determine the benefit cost	4.25%	5.00%
Rate of compensation increase used to determine the accrued benefit obligation	3.50%	3.50%
Rate of compensation increase used to determine the benefit cost	3.50%	3.50%
Expected long-term rate of return on plan assets	7.00%	7.00%

(In thousands of Canadian dollars)

19. Employee future benefits (continued):

(b) Expected rate of return on assets:

The Company must make assumptions about the expected long-term rate of return on plan assets, but there is no assurance that a plan will be able to earn the assumed rate of return. In determining the long-term rate of return assumption, the Company considers historical returns and input from investment advisors.

(c) Mortality assumptions:

Assumptions regarding future mortality experience are based on published statistics and mortality tables. The current longevities underlying the values of the liabilities in the defined benefit plans are as follows:

	2012	2011
Longevity at age 65 for current pensioners:		
Males	19	19
Females	22	22
Longevity at age 65 for current member aged 45:		
Males	19	19
Females	22	22

The calculation of the defined benefit obligation is sensitive to the mortality assumptions set out above. For the Company, an increase in life expectancy of one year across all age groups would result in a $139 increase in the defined benefit obligation as of December 31, 2012.

(d) Historical information:

	December 31, 2012	December 31, 2011
Present value of the defined benefit obligation	$ 4,631	$ 4,273
Fair value of plan assets	3,761	3,531
Deficit in the plan	$ 870	$ 742
Experience adjustments arising on plan liabilities	$ 281	$ 377
Experience adjustments arising on plan assets	77	132

20. Long-term incentive plan:

Under the LTIP, the Company may grant participants restricted share units, retirement deferred share units, or post-retirement deferred share units, collectively referred to as LTIP Units. The characteristics of each are as follows:

(a) Retirement DSU:

Retirement DSUs generally vest three years after the date of grant and become redeemable only on the participant's termination of employment. Retirement DSUs are redeemable either for one common share or for an amount in cash equal to the fair market value of one common share (at the option of the Company). The value of the award is determined at grant date, and the related salary expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied. Participants are entitled to receive cash bonuses or additional Units equivalent to the dividends payable had those Units been common shares. The number of DSUs awarded as bonus is determined based on the fair market value of those DSUs on the date credited.

(b) Post-Retirement DSU:

Post-Retirement DSUs vest at such times as determined by the Company, with each being redeemable for one Common Share issued from treasury of the Company. Except in certain circumstances or in the retirement of a participant, any unvested LTIP Units will terminate on their termination date. The value of the award is determined as at grant date, and related salary expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied, not exceeding five years following the date the participant ceases to be an employee or a director.

(c) RSU:

RSUs generally vest over three years (one-third each year) after the date of grant and is redeemable for either one Common Share or for an amount in cash equal to the fair market value of one Common Share (at the option of the Company). The fair value of each tranche of the three year vesting period is determined as at grant date, and is recognized as salary expense over its respective vesting period. RSU participants are entitled to receive dividends on all RSUs held for their account prior to the applicable vesting date. Unvested RSUs will typically be forfeited if the participant resigns or is terminated prior to the applicable vesting date. Forfeited RSUs will be sold and the proceeds returned to the Company, or as otherwise directed.

(In thousands of Canadian dollars)

20. Long-term incentive plan (continued):

No RSUs were awarded and outstanding during the years ended December 31, 2012 and 2011.

The fair value at grant date is calculated with reference to the closing price of the Company's common shares on the Toronto Stock Exchange ("TSX") for the five business days preceding grant date.

The change in the number of awards outstanding, and their related weighted average grant prices for the years ended December 31, 2012 and 2011 were as follows:

	RSU	Retirement DSU	Post-retirement DSU	Total
Awards outstanding, January 1, 2011	7,854	829,515	–	837,369
Granted (at $10.24 per unit)	–	321,918	24,819	346,737
Exercised	(7,854)	–	–	(7,854)
Forfeited	–	(25,181)	–	(25,181)
Awards outstanding, December 31, 2011	–	1,126,252	24,819	1,151,071
Granted (at $11.62 per unit)	–	306,631	24,071	330,702
Exercised	–	–	–	–
Forfeited	–	(10,796)	–	(10,796)
Awards outstanding, December 31, 2012	–	1,422,087	48,890	1,470,977
Total vested awards, December 31, 2011	–	268,478	24,819	293,297
Total vested awards, December 31, 2012	–	522,132	48,890	571,022

Share-based compensation expense, year ended December 31, 2011	$ 3,260
Share-based compensation expense, year ended December 31, 2012	$ 3,403

20. Long-term incentive plan (continued):

While the Fund offered an LTIP arrangement similar to that described above prior to the Reorganization (note 1), the classification of Fund Units as financial liabilities for purposes other than financial statement presentation), resulted in the classification of LTIP awards as debt instruments, and re-valued at each reporting period based on the market value of the underlying Fund Units. On January 1, 2011 pursuant to the Reorganization (note 1), the LTIP units were considered share-based payments in accordance with IFRS 2, Share-based Payment ("IFRS 2"), and therefore, the balance payable to LTIP unit holders was reclassified to Contributed Surplus.

21. Share capital:

(a) Common shares:

The Company is authorized to issue an unlimited number of common shares, with no par value. As of December 31, 2012, 47,940,409 common shares were issued and outstanding.

(b) Preferred shares:

The Company is authorized to issue 10 million preferred shares, with no limit on their value. As of December 31, 2012, no preferred shares were issued or outstanding.

(c) Dividends:

Dividends are declared in Canadian dollars. The monthly dividend rate was $0.065 for the year ended December 31, 2012 (2011 - $0.065). The Company continued to declare the same monthly dividend amount in January and February of 2013.

(In thousands of Canadian dollars)

21. Share capital (continued):

The change in share capital, including contributed surplus was as follows:

	Number of Fund Units	Number of common shares	Stated capital	Contributed surplus
Balance, January 1, 2011	42,749,215	–	420,109	–
Exchange of Fund Units on reorganization	(42,749,215)	42,749,215	–	–
Exchange of LP Units on reorganization	–	5,191,194	53,729	–
LTIP - reclassification as equity-based awards	–	–	–	5,449
LTIP non-cash expense and DRIP - current year	–	–	–	3,272
Balance, December 31, 2011	–	47,940,409	473,838	8,721
LTIP non-cash expense and DRIP - current year	–	–	–	3,953
Balance, December 31, 2012	–	47,940,409	$ 473,838	$ 12,674

Prior to the conversion, the Company operated under an income trust structure, where the equity of the Fund was held in the form of Units and LP Units. A description of the Fund's Units and LP Units was as follows:

The Fund was authorized to issue an unlimited number of Units and an unlimited number of special voting units ("Special Voting Units"). Special Voting Units were not entitled to any beneficial interest in any distribution from the Fund. The Special Voting Units were issued in series and only in connection with, or in relation to, LP Units or other securities that were, directly or indirectly, exchangeable for Units, in each case for the sole purpose of providing voting rights at the Fund level to the holders of such securities.

Units were redeemable at any time on demand by the unitholders up to an aggregate maximum monthly amount of $50. Trustees could, in their sole discretion, waive this limitation. The redemption price was calculated based on the lesser of:

- 90% of the "market price", as defined in the prospectus, as of the date on which the Units were surrendered for redemption; and

- 100% of the "closing market price", as defined in the prospectus, on the redemption date.

21. Share capital (continued):

An assessment by the Company of the characteristics of the Fund's Units and LP Units against the criteria set forth per IAS 32, Financial Instruments - Presentation ("IAS 32"), determined that while Units and LP Units had the characteristics of financial liabilities (puttable financial instruments), presentation as equity was allowed if certain criteria were met. Against these criteria, Fund Units qualified for classification as equity given the Fund's ability to affect distributable cash, but LP Units did not given the need for these units to be converted to Fund Units in order to be the most subordinate class.

On January 1, 2011, all outstanding Units and LP Units were exchanged on a one-for-one basis for common shares of the Company.

22. Earnings per share:

Basic earnings per share was calculated by dividing profit attributable to common shares by the sum of the weighted average number of common shares outstanding during the period, plus vested LTIP awards.

Diluted earnings per share was calculated using the basic calculation described above, and adjusting for the potentially dilutive effect of total number of additional common shares that would have been issued by the Company on unvested LTIP awards and the redemption of the convertible debenture.

(In thousands of Canadian dollars)

22. Earnings per share (continued):

The following details the earnings per share, basic and diluted, calculations for the years ended December 31, 2012 and 2011:

	2012	2011
Profit attributable to common shares (basic and diluted)	$ 21,034	$ 24,903
Weighted average number of common shares (in actual number of shares):		
January 1	47,940,409	47,940,409
Vested LTIP awards	526,678	293,297
Basic	48,467,087	48,233,706
Dilutive effect of unvested LTIP awards	447,711	424,729
Diluted	48,914,798	48,658,435
Earnings per share:		
Basic	$ 0.43	$ 0.52
Diluted	$ 0.43	$ 0.51

Due to its anti-dilutive effect, the potential issuance related to the convertible debenture has been excluded from the earnings per share calculation.

23. Segmented information:

The Company provides health and productivity, administrative and retirement solutions to assist employers in managing the financial security, health and productivity of their employees. As at December 31, 2012, on the basis of the type of services provided and in accordance with IFRS 8, Operating Segments, the Company was represented by and had one reportable segment.

(In thousands of Canadian dollars)

23. Segmented information (continued):

The Company operates primarily within two geographical areas: Canada and the United States. The following details the revenues and total assets by geographical area, reconciled to the Company's consolidated financial statements:

	2012	2011
Revenue:		
Canada	$ 396,250	$ 349,995
United States	23,096	14,993
Consolidated total	$ 419,346	$ 364,988

	2012	2011
Total assets:		
Canada	$ 674,038	$ 660,581
United States	12,319	7,508
Consolidated total	$ 686,357	$ 668,089

24. Supplementary cash flow information:

Change in non-cash operating working capital for the years ended December 31, 2012 and 2011 was as follows:

	2012	2011
Trade and other receivables	$ (4,847)	$ (214)
Unbilled fees, current and non-current	(11,003)	(6,109)
Prepaid expenses and other	835	(1,282)
Deferred implementation costs, current and non-current	(3,907)	(5,582)
Trade and other payables	(2,530)	6,329
Deferred revenue	(102)	666
	$ (21,554)	$ (6,192)

(In thousands of Canadian dollars)

25. Related parties:

These consolidated financial statements include the assets, liabilities, revenue and expenses of the Company's subsidiaries; all intercompany balances and transactions have been eliminated upon consolidation and therefore are not disclosed in this note.

Compensation of key management personnel:

Key management personnel include the Company's executive officers and directors; remuneration related to this group was as follows:

		2012		2011
Salaries and other benefits	$	5,075	$	4,246
Share-based payments		2,105		2,073
	$	7,180	$	6,319

26. Salary, benefit and contractor:

The Company's salary, benefit and contractor expenses comprised of the following:

		2012		2011
Salaries and other benefits	$	239,037	$	196,134
Contractors		48,448		41,010
	$	287,485	$	237,144

(In thousands of Canadian dollars)

27. Commitments:

The Company has lease commitments for office premises and equipment with options for renewal. As at December 31, 2012 the minimum payments not including operating expenses, due in each of the next five years and thereafter, are expected to be as follows for each year ending December 31:

	Gross commitment	Sublease income	Net commitment
2013	$ 12,601	$ (717)	$ 11,884
2014	11,970	(717)	11,253
2015	9,849	(717)	9,132
2016	8,843	(729)	8,114
2017	8,079	(648)	7,431
Thereafter	40,008	(2,124)	37,884
Total	$ 91,350	$ (5,652)	$ 85,698

The Company is party to various subleases to which the Company would be liable for the rental payment in the case of a default by the subtenants. The minimal payments and the aggregate sublease income related to these premises have been included above. The Company considers the risk of default by the subtenants to be low therefore no accrual has been set up.

28. Contingencies:

(a) Lawsuits and legal claims:

From time to time, the Company is involved in routine litigation incidental to the Company's business. Management believes that adequate provisions have been made where required and the ultimate resolution with respect to any claim will not have a material adverse effect on the financial position or results of operations of the Company.

28. Contingencies (continued):

(b) Business combinations:

The Company has obligations to pay additional consideration for prior acquisitions, typically based upon performance measures contractually agreed at the time of purchase. In the acquisition of Jacques Lamarre & Associates, contingent consideration based upon financial performance was agreed at the time of purchase with payment expected to be finalized in October 2013.

In the acquisition of SBC Systems Company (note 4), contingent consideration based on financial performance was agreed at the time of purchase with payment expected to be finalized in March 2013 and 2014.

As at December 31, 2012, the total contingent consideration of $3,309 has been recognized as future consideration related to acquisitions on the consolidated statements of financial position at the estimated discounted value plus accretion.

29. Management of capital:

The Company views its capital as the combination of its cash (bank indebtedness), long-term debt, convertible debentures and shareholders' equity. As at December 31, 2012 the Company's capital is $571,635 (2011 - $565,511) The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern while maintaining dividends to its shareholders and the growth of the Company's business through organic growth and new acquisitions.

The Company manages the capital structure and makes adjustments to it in accordance with the aforementioned objectives, as well as taking into consideration changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, issue new or repurchase existing shares and assume new or repay existing debt.

No changes were made in the objectives, policies or processes for managing capital during the year.

The credit facilities require the Company to maintain certain financial covenants. Management also uses these ratios as key indicators in managing the Company's capital. Dividends are made to shareholders monthly. Ratios of dividends to free cash flow, cash from operating activities, and EBITDA are used by management to assist with the determination of dividends.

The Company is subject to externally imposed capital requirements to maintain certain financial covenants as mentioned above. The Company complied with all the required financial covenants at December 31, 2012.