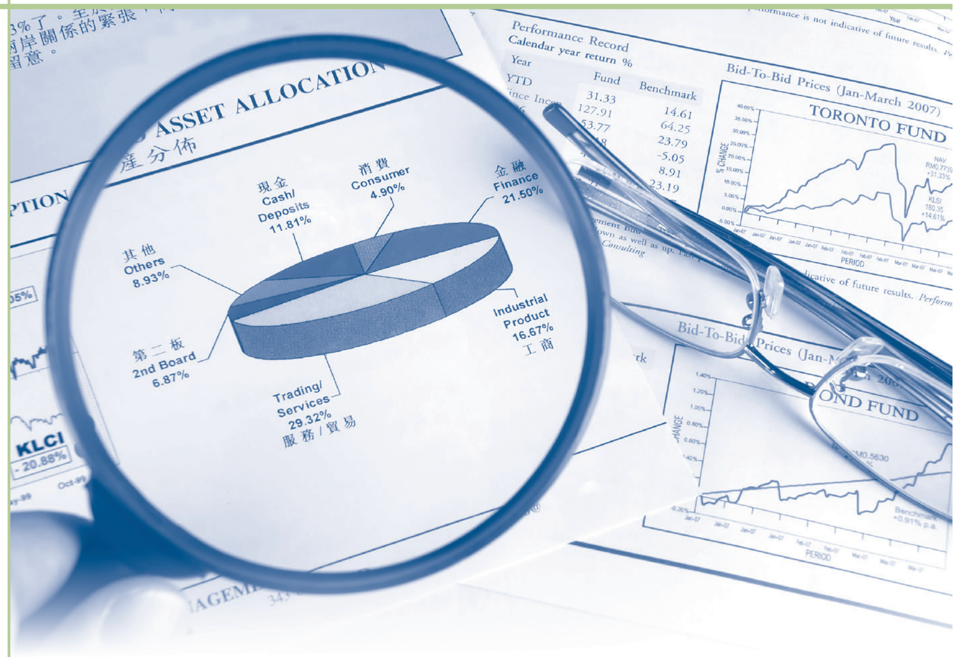
COVINGTON
CAPITAL CORPORATION

2015 | Annual Report



COVINGTON FUND II INC.

For The Year Ended August 31, 2015

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Management's Responsibility for Financial Reporting

The accompanying financial statements of Covington Fund II Inc. (the "Fund" / "Fund II") are the responsibility of management. They have been prepared in accordance with International Financial Reporting Standards and include certain amounts that are based on estimates and judgments. The significant accounting policies which management believes are appropriate for the Fund are described in Note 3 to the financial statements.

Management has developed and maintains a system of internal controls to provide reasonable assurance that all assets are safeguarded and to produce relevant, reliable and timely financial information, including the accompanying financial statements.

The Board of Directors discharges its duties to the financial statements primarily through the activities of its Valuation and Audit Committees (the "Committees"), which are composed of members of the Board of Directors. The Valuation Committee has responsibility for approving the Fund's Net Asset Values as calculated by management in accordance with the Fund's valuation policies. The Audit Committee also meets with management and the external auditors to review both the financial statements and the results of the audit examination. The external auditors have unrestricted access to the Committees. The Committees also consider, for review by the Board of Directors and approval by the shareholders, the engagement or re-appointment of the external auditors.

These financial statements have been approved by the Board of Directors and have been audited by Ernst & Young LLP, Chartered Professional Accountants and Licensed Public Accountants on behalf of the shareholders. The independent auditors' report outlines the scope of their audit and their opinion on the financial statements.

Scott Clark

Scott D. Clark
President & CEO,
Covington Capital Corporation

L Low

Lisa Low
Chief Financial Officer,
Covington Capital Corporation

Toronto, Canada
November 19, 2015

INDEPENDENT AUDITORS' REPORT

To the Class A Shareholders of Covington Fund II Inc. (the "Fund")

We have audited the accompanying financial statements of the Fund, which comprise the statements of financial position as at August 31, 2015 and August 31, 2014, and September 1, 2013, and the statements of comprehensive income, changes in net assets attributable to holders of redeemable shares, and cash flows for the years ended August 31, 2015 and 2014, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of 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 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the 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 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 financial statements present fairly, in all material respects, the financial position of the Fund as at August 31, 2015 and August 31, 2014, and September 1, 2013, and its financial performance and cash flows for the years ended August 31, 2015 and 2014 in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Chartered Professional Accountants
Licensed Public Accountants

Toronto, Canada
November 19, 2015

STATEMENTS OF FINANCIAL POSITION

[in $ thousands of Canadian dollars except per share amounts and number of shares]

As at	August 31, 2015 $	August 31, 2014 $	September 1, 2013 $
ASSETS AND LIABILITIES			
Current assets			
Cash	**17,951**	9,483	3,804
Marketable securities	**3,528**	13,259	703
Venture investments	**193,450**	242,515	278,540
Receivable for investments sold	**6,761**	5,380	10,772
Interest and dividend receivable	**28**	52	1
	221,718	270,689	293,820
Current liabilities			
Accrued expenses	**3,073**	3,269	4,668
Conditional incentive participation amount payable [Note 8]	**3,940**	6,831	13,545
Redemptions payable	**117**	-	2
	7,130	10,100	18,215
Net assets attributable to holders of redeemable shares [Note 12]	**214,588**	260,589	275,605
Net assets attributable to holders of redeemable shares per Series			
Class A, Series I	**$ 127,748**	$ 151,027	$ 151,633
Class A, Series II	**$ 86,840**	$ 109,562	$ 123,972
Redeemable Class A Shares outstanding [Note 6]			
Class A, Series I	**15,655,888**	16,824,904	17,673,307
Class A, Series II	**11,166,508**	12,747,483	14,966,676
Net assets attributable to holders of redeemable shares per share [Note 6 and 12]			
Class A, Series I	**$ 8.16**	$ 8.98	$ 8.58
Class A, Series II	**$ 7.78**	$ 8.59	$ 8.28

On behalf of the Board of Directors:

Henry J. Pankratz
Director

Terrence B. Kulka
Director

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF COMPREHENSIVE INCOME

[in $ thousands of Canadian dollars except per share amounts]

For the years ended August 31,	2015 $	2014 $
INCOME		
Net gain/(loss) on financial instruments:		
Interest for distribution purposes	**1,444**	474
Dividends	**665**	172
Realized gain on sale of investments[1]	**24,282**	35,750
Realized gain on foreign exchange	**2,537**	1,026
Change in unrealized appreciation/(depreciation) of marketable securities	**(183)**	196
Change in unrealized appreciation/(depreciation) of venture investments	**(38,175)**	(6,097)
Other income/(loss)	**(4)**	15
	(9,434)	31,536
EXPENSES		
VenGrowth contract amount [Note 8]	**3,293**	3,782
Management fees [Note 8]	**3,222**	3,647
Conditional incentive participation amount [Note 8]	**1,421**	2,015
Service fees [Note 8]	**1,156**	1,321
Fund administrator fees [Note 8]	**1,074**	1,216
Harmonized Sales Taxes	**802**	69
Capital maintenance payment [Note 8]	**477**	1,001
Sponsor fees [Note 8]	**382**	432
Directors' fees	**350**	387
Audit fees	**337**	378
Shareholder communications	**278**	329
Transaction costs	**192**	456
Custody fees	**60**	67
Other	**29**	33
Independent Review Committee	**27**	30
Legal fees	**18**	165
Write-down of escrow receivable	**-**	4,764
	13,118	20,092
Increase (decrease) in net assets attributable to holders of redeemable shares	**(22,552)**	11,444
Increase (decrease) in net assets attributable to holders of redeemable shares per Series		
Class A, Series I	**(13,427)**	6,640
Class A, Series II	**(9,125)**	4,804
Increase (decrease) in net assets attributable to holders of redeemable shares per share (based on weighted average number of shares outstanding)		
Class A, Series I	**$ (0.84)**	$ 0.38
Class A, Series II	**$ (0.77)**	$ 0.35
Weighted average number of shares outstanding		
Class A, Series I	**16,078,242**	17,268,618
Class A, Series II	**11,808,348**	13,774,448

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF COMPREHENSIVE INCOME [Cont'd]

[in $ thousands of Canadian dollars]

For the years ended August 31,	2015 $	2014 $
[1] **Breakdown of realized gain/(loss) on sale of investments:**		
Marketable securities		
Bonds, at cost, beginning of year	**498**	-
Accretion of discount	**5**	5
Bonds purchased during the year	**-**	493
	503	498
Bonds, at cost, end of year	**-**	498
Cost of bonds sold	**503**	-
Proceeds from sale of bonds	**507**	-
Realized gain on sale of bonds	**4**	-
Equities, at cost, beginning of year	**11,552**	689
Equities purchased during the year	**-**	21,964
	11,552	22,653
Equities, at cost, end of year	**3,501**	11,552
Cost of equities sold	**8,051**	11,101
Proceeds from sale of equities	**8,407**	12,173
Realized gain on sale of equities	**356**	1,072
Venture investments		
Venture investments, at cost, beginning of year	**233,855**	263,783
Venture investments purchased during the year	**42,811**	41,284
Venture investments repaid during the year	**(1,858)**	(3,601)
	274,808	301,466
Venture investments, at cost, end of year	**222,966**	233,855
Cost of venture investments sold	**51,842**	67,611
Proceeds from sale of venture investments	**75,764**	102,289
Realized gain on sale of venture investments	**23,922**	34,678
Realized gain on sale of investments	**24,282**	35,750

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CHANGES IN NET ASSETS ATTRIBUTABLE TO HOLDERS OF REDEEMABLE SHARES

[in $ thousands of Canadian dollars]

For the years ended August 31,	**2015** **$**	2014 $
Net assets attributable to holders of redeemable shares, beginning of year	**260,589**	275,605
Increase (decrease) in net assets attributable to holders of redeemable shares	**(22,552)**	11,444
REDEEMABLE SHARE TRANSACTIONS		
Class A Shares, Series I		
Proceeds from issuance of Class A Shares	-	33
Proceeds from issuance of Class A Shares due to merger	-	6,559
Amounts paid for Class A Shares, Series I redeemed	**(10,241)**	(14,101)
Class A Shares, Series II		
Amounts paid for Class A Shares, Series II redeemed	**(13,208)**	(18,951)
Net assets attributable to holders of redeemable shares, end of year	**214,588**	260,589

The accompanying notes are an integral part of these financial statements.

STATEMENTS OF CASH FLOWS

[in $ thousands of Canadian dollars]

For the years ended August 31,	2015 $	2014 $
Operating activities		
Increase (decrease) in net assets attributable to holders of redeemable shares	**(22,552)**	11,444
Items not affecting cash:		
Realized gain on sale of investments	**(24,282)**	(35,750)
Accretion of bond discount	**(5)**	(5)
Change in unrealized depreciation of investments	**38,358**	5,901
Fee income from venture investments [Note 7]	**(1,088)**	(38)
Purchase of bonds	-	(493)
Purchase of equities	-	(21,964)
Purchase of venture investments	**(14,081)**	(32,247)
Net proceeds/(purchase) of short term investments	**999**	(999)
Repayment of venture debt	**1,858**	3,601
Proceeds from sale of bonds	**507**	-
Proceeds from sale of equities	**8,407**	12,173
Proceeds from sale of venture investments	**48,122**	100,105
Change in non-cash working capital:		
Change in other assets and liabilities	**(4,441)**	(3,204)
	31,802	38,524
Financing activities		
Net proceeds from issuance of Class A Shares, Series I and II	-	33
Net proceeds from issuance of Class A Shares due to merger, Series I and II	-	176
Amounts paid for Class A Shares redeemed, Series I and II	**(23,334)**	(33,054)
	(23,334)	(32,845)
Increase/(decrease) in cash during the year	**8,468**	5,679
Cash, beginning of year	**9,483**	3,804
Cash, end of year	**17,951**	9,483
Non-monetary transactions [Note 7]		
Securities received from debt financing and share exchange	**28,730**	2,222
Proceeds from share exchange	**27,642**	2,184
Net assets acquired from merger	-	6,815
Supplementary information:		
Dividends received*	**665**	172
Interest received*	**355**	436

** included in operating activities*

The accompanying notes are an integral part of these financial statements.

SCHEDULE OF INVESTMENT PORTFOLIO

[in $ thousands of Canadian dollars except number of shares or par value $]

As at August 31, 2015

Marketable securities

Par Value $	Issuer	Average Cost $	Fair Value $
Equities			
165,000	Manulife Financial Corporation†	3,501	3,528
		3,501	3,528
Total marketable securities		**3,501**	**3,528**

Venture investments

Investee companies	Number of shares (or par value $)	Debt at cost $	Equity at cost $	Total $
2203077 Ontario Limited, Promissory Note, 5%, due May 31, 2017	$61,469	58	-	58
2210961 Ontario Limited, Loan, 6%, due April 19, 2018	$5,633,057	3,187	-	3,187
2210961 Ontario Limited, Loan, 6%, due October 17, 2015	$125,000	125	-	125
2210961 Ontario Limited, Common	50,000	-	-	-
Active Exhaust Corporation, Demand Subordinated Debenture, 14%	$2,000,000	2,000	-	2,000
Active Exhaust Corporation, Class B Common	502,766	-	822	822
Aegera Oncology Inc., Rights	12,605,118	-	12,605	12,605
Aimetis Corporation, Class A Preferred	1,666,667	-	2,500	2,500
AppZero Software Corporation, Common	1,096,138	-	874	874
AppZero Software Corporation, Class A Preferred	1,988,252	-	2,217	2,217
Axela Inc., Demand Debenture, 8%	$12,865,533	11,567	-	11,567
Axela Inc., Demand Debenture, 12%	$15,637,046	-	-	-
Axela Inc., Demand Debenture, 15%	$11,463,030	-	-	-
Axela Inc., Demand Debenture, 20%	$5,888,024	-	-	-
Axela Inc., Convertible Debenture, 12%	$2,500,000	2,511	-	2,511
Axela Inc., Convertible Debenture, 12%, due January 13, 2016	$3,300,000	3,300	-	3,300
Axela Inc., Convertible Debenture, 12%, due March 16, 2016	$7,500,000	7,500	-	7,500
Axela Inc., Common	1,313,244	-	-	-
Axela Inc., Class A Series 1 Preferred	13,442,856	-	-	-
Axela Inc., Class A Series 2 Preferred	606,647	-	-	-
Axela Inc., Class A Series 3 Preferred	2,065,936	-	-	-
Axela Inc., Class A Preferred	7,858,299	-	-	-
Axela Inc., Class A Series 1 Warrants, $0.00001, expiry June 12, 2016	3,754,874	-	-	-
bitHeads Inc., Demand Promissory Note, Prime +1/2%	$150,000	113	-	113
bitHeads Inc., Class A Preferred	9,300,000	-	1,500	1,500
bitHeads Inc., Class B Preferred	7,489,528	-	842	842
Black Bull Resources Inc., Common†	1,550,000	-	6	6

SCHEDULE OF INVESTMENT PORTFOLIO [Cont'd]

[in $ thousands of Canadian dollars except number of shares or par value $]

Venture investments (cont.'d.)

Investee companies	Number of shares (or par value $)	Debt at cost $	Equity at cost $	Total $
BTI Systems Inc., Common*	15,424,968	-	1,377	1,377
BTI Systems Inc., Class A Preferred*	2,028,039	-	1,327	1,327
BTI Systems Inc., Class B Preferred*	25,702,156	-	9,578	9,578
BTI Systems Inc., Class C Preferred*	8,325,969	-	1,831	1,831
BTI Systems Inc., Class D Preferred*	3,281,576	-	1,290	1,290
Clek Inc., Class B Common*	2,681,674	-	5,458	5,458
CounterPath Corporation, Common†	6,274,709	-	9,376	9,376
Embotics Corporation, Convertible Debenture, 12%, due August 29, 2016	$500,000	500	-	500
Embotics Corporation, Convertible Debenture, 12%, due July 26, 2016	$500,000	500	-	500
Embotics Corporation, Class A Preferred	395,958	-	3,579	3,579
Embotics Corporation, Class B-2 Preferred	640,306	-	2,500	2,500
Embotics, Class B-2 purchase warrants	58,203	-	-	-
Epocal Inc., Rights*	2,827,341	-	-	-
Fidelity PAC Metals Ltd., Demand Promissory Note, 6%	$285,623	286	-	286
Fidelity PAC Metals Ltd, Common	2,060,000	-	2,060	2,060
Fusebill Inc., Convertible Debenture, 12%, due June 30, 2016	$350,000	350	-	350
Fusebill Inc., Class A Preferred	1,874,761	-	900	900
Fusebill Inc., Common	694,580	-	300	300
Greenfield Ethanol Inc., Common	497,682	-	13,687	13,687
Greenfield Ethanol Inc., Special	123,645	-	3,400	3,400
Interface Biologics Inc., Class A Preferred	10,882,956	-	17,473	17,473
Ivey CSBIF I Inc. Class A	250,000	-	2,500	2,500
Ivey CSBIF II Inc. Class A	250,000	-	2,500	2,500
Masstech Innovations Inc., Demand Promissory Note, 10%	$1,146,473	1,146	-	1,146
Masstech Innovations Inc., Common	100	-	-	-
Mist Mobility Integrated Systems Technology Inc., Demand Promissory Note, 12%	$14,000,000	12,950	-	12,950
Mist Mobility Integrated Systems Technology Inc., Demand Debenture, 15%	$750,000	750	-	750
Mist Mobility Integrated Systems Technology Inc., Demand Subordinated Debenture, 5%	$2,250,000	2,250	-	2,250
Mist Mobility Integrated Systems Technology Inc., Common	6,969,216	-	2,250	2,250
Nakina Systems Inc., Demand Convertible Debenture, 15%*	$4,298,979	4,458	-	4,458
Nakina Systems Inc., Convertible Promissory Note, 18%, due March 31, 2015*	$3,614,794	3,836	-	3,836
Nakina Systems Inc., Class A Common*	6,168,948	-	-	-
Nakina Systems Inc., Class A Preferred*	10,909,081	-	-	-

SCHEDULE OF INVESTMENT PORTFOLIO [Cont'd]

[in $ thousands of Canadian dollars except number of shares or par value $]

Venture investments (cont.'d.)

Investee companies	Number of shares (or par value $)	Debt at cost $	Equity at cost $	Total $
Nakina Systems Inc., Class B Preferred*	8,271,130	-	-	-
Nakina Systems Inc., Class C Preferred*	39,167,338	-	4,645	4,645
Nakina Systems Inc., Warrants*	13,705,577	-	445	445
Nakina Systems Inc., Class C Warrants, expiry June 20, 2017*	225,000	-	-	-
Nakina Systems Inc., Class C Warrants, expiry October 17, 2019*	77,737,500	-	-	-
Opko Health Inc., Common*†	488,245	-	10,637	10,637
OTYC Holdings Inc., Class D Preferred	43,298,618	-	6,820	6,820
OTYC Holdings Inc., Milestones	17,301,627	-	-	-
PowerBand Global Inc., Common	60,077	-	2,969	2,969
PowerBand Global Inc., Demand Promissory Note, 7%	$3,512,997	3,513	-	3,513
PowerBand Global Inc., Demand Promissory Note, 12%	$6,903,763	6,904	-	6,904
PowerBand Global Inc., Demand Debenture, 24%	$2,063,376	2,063	-	2,063
Roll-Tite Corporation, Demand Loan, 10%	$1,000,000	1,000	-	1,000
Roll-Tite Corporation, Demand Loan, 20%	$227,512	227	-	227
Roll-Tite Corporation, Common	85,000	-	-	-
Signal Hill Equity Partners II, LP	2,720,918	-	1,475	1,475
Simex Inc., Series A Preferred	58,871	-	-	-
Spartan Bioscience Inc., Common	2,010,000	-	231	231
Starburst Holdings Limited, Common	20	-	2,160	2,160
Trilliant Inc., Common	2,261,314	-	-	-
VG Mezzanine I Limited Partnership	13,590	-	3,177	3,177
WireIE Holdings International Inc., Secured Convertible Debenture, 10%, due March 13, 2018	$4,750,000	4,750	-	4,750
WireIE Holdings International Inc., Demand Promissory Note, 12%	$3,750,000	3,750	-	3,750
WireIE Holdings International Inc., Common	28,244,887	-	8,061	8,061
WireIE Holdings International Inc., Preferred	1,000,000	-	-	-
Total venture investments, at cost		79,594	143,372	**222,966**
Unrealized appreciation/(depreciation) of venture investments				(29,516)
Venture investments, at fair value				**193,450**
Total investments, at fair value				**196,978**
Other assets, net of liabilities				17,610
Net assets attributable to holders of redeemable shares				**214,588**

* *Investment made and tracked in US dollars.*

† *Indicates a publicly traded security.*

The accompanying notes are an integral part of these financial statements.

SCHEDULE OF INVESTMENT PORTFOLIO [Cont'd]

[in $ thousands of Canadian dollars except percentages and number of companies]

As at August 31, 2015	Number of companies	Cost of investments $	% Total venture investments at cost %	Fair value of investments $	% Total venture investments at fair value %
Stage of Development					
Start-Up/Early	5	42,894	19.2	34,676	18.0
Expansion	21	140,994	63.2	121,936	63.0
Later	8	39,078	17.6	36,838	19.0
	34	**222,966**	**100.0**	**193,450**	**100.0**
Industry Class					
Biotechnology/Health Sciences	7	72,644	32.6	51,005	26.4
Retail	2	4,506	2.0	4,491	2.3
Financial Services	4	9,652	4.3	9,470	4.9
Technology	15	94,186	42.3	84,354	43.6
Manufacturing	6	41,978	18.8	44,130	22.8
	34	**222,966**	**100.0**	**193,450**	**100.0**
As at August 31, 2014					
Stage of Development					
Start-Up/Early	5	39,789	17.0	37,052	15.3
Expansion	26	151,130	64.6	165,637	68.3
Later	14	42,936	18.4	39,826	16.4
	45	**233,855**	**100.0**	**241,515**	**100.0**
Industry Class					
Biotechnology/Health Sciences	11	75,125	32.1	72,272	29.8
Retail	2	4,506	1.9	4,707	2.0
Financial Services	7	20,123	8.6	17,292	7.1
Technology	19	95,538	40.9	106,272	43.8
Manufacturing	6	38,563	16.5	41,972	17.3
	45	**233,855**	**100.0**	**241,515**	**100.0**
As at September 1, 2013					
Stage of Development					
Start-Up/Early	8	33,632	12.8	33,714	12.1
Expansion	22	186,329	70.6	211,019	75.8
Later	9	43,822	16.6	33,807	12.1
	39	**263,783**	**100.0**	**278,540**	**100.0**
Industry Class					
Biotechnology/Health Sciences	10	131,234	49.8	156,343	56.1
Retail	2	4,506	1.7	3,851	1.4
Financial Services	6	16,929	6.4	14,934	5.4
Technology	16	74,060	28.1	73,957	26.5
Manufacturing	5	37,054	14.0	29,455	10.6
	39	**263,783**	**100.0**	**278,540**	**100.0**

The accompanying notes are an integral part of these financial statements.

AUGUST 31, 2015

[In $ thousands of Canadian dollars except per share amounts and number of shares]

1. CORPORATE STATUS AND ACTIVITIES

Covington Fund II Inc. (the "Fund"), originally incorporated under the laws of Ontario on September 20, 1999, was continued under the Canada Business Corporations Act effective November 29, 2010. The Fund is registered as a Labour-Sponsored Investment Fund Corporation ("LSIF") under the Community Small Business Investment Funds Act (Ontario) (the "Ontario Act") and as a Labour-Sponsored Venture Capital Corporation ("LSVCC") under the Income Tax Act (Canada) (the "Act"). The address of the Fund's registered office is 87 Front Street East, Suite 400, Toronto, Ontario M5E 1B8. These financial statements were authorized for issue by the Fund's Board of Directors on November 19, 2015.

The investment objective of the Fund is to earn long term capital appreciation on part of its investment portfolio and current yield and early return of capital on the remainder of its investment portfolio.

The Manager of the Fund is Covington Capital Corporation ("Covington" or the "Manager"). The administrator of the Fund is CI Investments Inc. (the "Fund Administrator"). The Fund has two Co-Sponsors, the Canadian Police Association ("CPA") and the Association of Canadian Financial Officers ("ACFO") (the "Co-Sponsors").

The Fund is currently closed to new subscriptions. Redemptions of the Fund have been temporarily halted. See Note 14.

2. BASIS OF PRESENTATION AND ADOPTION OF IFRS

These financial statements have been prepared in compliance with International Financial Reporting Standards ("IFRS") published by the International Accounting Standards Board ("IASB"). The Fund adopted this basis of accounting in 2015 as required by Canadian securities legislation and the Canadian Accounting Standards Board. Previously, the Fund prepared its financial statements in accordance with Canadian Generally Accepted Accounting Principles as defined in Part V of the Chartered Professional Accountants ("CPA") of Canada Handbook – Accounting ("Canadian GAAP"). The comparative information has been restated from Canadian GAAP to comply with IFRS. The Fund has consistently applied the accounting policies used in the preparation of its opening IFRS statement of financial position at September 1, 2013 and throughout all periods presented, as if these policies had always been in effect. Note 12 discloses the impact of the transition to IFRS on the Fund's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Fund's financial statements for the year ended August 31, 2014 prepared under Canadian GAAP.

The financial statements have been prepared on a going concern basis using the historical-cost convention. However, the Fund is an investment entity and primarily all financial assets and financial liabilities are measured at fair value in accordance with IFRS. Accordingly, the Fund's accounting policies for measuring the fair value of investments and derivatives are consistent with those used in measuring the Net Asset Value for transactions with unitholders. In applying IFRS, these financial statements include estimates and assumptions made by management that affect the reported amounts of assets, liabilities, income, and expenses during the reporting periods. However, existing circumstances and assumptions may change due to market changes or circumstances arising beyond the control of the Fund. Such changes are reflected in the assumptions when they occur.

These financial statements are presented in Canadian dollars, which is the Fund's functional currency.

3. SIGNIFICANT ACCOUNTING POLICIES

Financial instruments

The Fund recognizes financial instruments at fair value upon initial recognition, inclusive of transaction costs in the case of financial instruments measured at amortized cost. Purchases and sales of financial assets are recognized at their trade date. The Fund's investments and liabilities are measured at fair value through profit or loss ("FVTPL"). The Fund's obligations for net assets attributable to holders of redeemable shares are presented at the redemption amount. All other financial assets and liabilities, such as accounts receivable, receivables for venture investments sold, income receivables, accounts payable, accrued expenses, incentive participation amounts payable and redemptions payable, are measured at amortized cost, which approximates fair value. Under this method, financial assets and liabilities reflect the amount required to be received or paid, discounted, when appropriate, at the contract's stated rates of interest.

AUGUST 31, 2015

[In $ thousands of Canadian dollars except per share amounts and number of shares]

3. SIGNIFICANT ACCOUNTING POLICIES *(Cont'd)*

Valuation of investments

At the financial reporting date, all investments having quoted market values and which are publicly traded on a recognized stock exchange, and are not otherwise restricted, are valued based on the last traded market price for financial assets and financial liabilities where the last traded price falls within the day's bid-ask spread. In circumstances where the last traded price is not within the bid-ask spread, the Manager determines the point within the bid-ask spread that is most representative of fair value based on the existing market conditions.

Fixed income securities, debentures or other debt instruments including short-term investments are valued at the quotation price from recognized investment dealers.

Venture investments in securities not having quoted market values or in restricted securities are recorded at estimated fair value ("FV"). The fair values of the venture investments are determined by the Manager using an appropriate valuation methodology after considering: the history and nature of the business; operating results and financial conditions; the general economic, industry and market conditions; capital market and transaction market conditions; independent valuations of the business; contractual rights relating to the investment; comparable company trading and transaction multiples, where applicable, and other pertinent considerations.

For warrants that are not traded on a recognized securities exchange, no market value is readily available. When there are sufficient and reliable observable market inputs, a valuation technique is used.

The process of valuing venture investments for which no published market exists is subject to inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for the investments.

Financial assets and liabilities at fair value

The Fund carries its investment in equity and debt as financial assets or financial liabilities at FVTPL. This has two sub-categories: (1) financial assets or financial liabilities held for trading; and (2) those designated as FVTPL at inception.

(1) Financial assets and financial liabilities held for trading: a financial asset or financial liability is classified as held for trading ("HFT") if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term or if on initial recognition, it is part of a portfolio of identifiable financial instruments that are managed together and for which there is evidence of a recent actual pattern of short term profit taking.

(2) Financial assets and financial liabilities designated as FVTPL: a financial asset or financial liability is designed as FVTPL at inception are financial instruments that are not classified as HFT but are managed and their performance is evaluated on a fair value basis in accordance with the Fund's documented investment strategy. The Fund's investments are designated as FVTPL.

Investment entity

Under Investment Entities – Amendments to IFRS 10, the Fund has determined that it meets the definition of an investment entity under IFRS 10, Consolidated Financial Statements, in that it obtains funds from one or more investors for the purpose of providing them with investment management services, commits to its investors that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both, and measures and evaluates the performance of substantially all of its investments on a fair value basis. Consequently, the Fund measures investments in other entities over which it has control, at FVTPL, and consolidates only those subsidiaries that provide services related to the Fund's investment activities, if any.

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[In $ thousands of Canadian dollars except per share amounts and number of shares]

3. SIGNIFICANT ACCOUNTING POLICIES *(Cont'd)*

Subsidiaries, associates, joint ventures and structured entities

Subsidiaries are entities, including investments in other investment entities, over which a Fund has control. A Fund controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity, and has the ability to affect those returns through its power over the entity. Associates and joint ventures are investments over which a Fund has significant influence or joint control. A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factors in deciding who controls the entity, or when voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

IFRS 10, Consolidated Financial Statements, establishes principles for consolidation when one entity controls another but allows an exemption for the consolidation of subsidiaries of investment entities and requires such entities to recognize all subsidiaries at fair value through profit and loss. IAS 28, Investment in Associates, also allows investments in associates that are held by investment entities to be recognized and measured at fair value through profit and loss and to be accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement and IFRS 13, Fair Value Measurement, with changes in fair value recognized in the statements of comprehensive income in the period of change. As such, investments that are held as part of the Fund's investment portfolio are carried on the statements of financial position at fair value even though the Fund may have control or significant influence over those companies. Investments in unconsolidated structured entities, if any, have been designated at fair value through profit or loss.

Income recognition and security holder transactions

Interest and income for distribution purposes and other income are recorded on an accrual basis. Dividend income is recognized on the ex-dividend date. Investment transactions are accounted for on a trade date basis and gains and losses from such transactions are calculated based on average cost excluding transaction costs. Net realized and unrealized gains (losses) on investments include the related foreign exchange gains and losses in the Statements of Comprehensive Income.

Commissions and other portfolio transaction costs

Transaction costs, such as brokerage commissions, if any, incurred in the purchase and sale of securities are included in "Trade commissions and other" in the Statements of Comprehensive Income.

Allocation of income and expenses

The Fund allocates income, expenses, realized and unrealized gains (losses) on the following basis: Income, realized and unrealized gains (losses) are apportioned on a weekly basis based on the net asset value ("NAV") of the respective Series to the total net asset value of the Fund as at the most recent valuation date.

Expenses are categorized and tracked as expenses directly attributable to a specific Series ("direct expenses") and those that are common expenses of the Fund. Direct expenses of a particular Series are recorded as a direct expense to that Series. Common expenses are allocated to each Series in a consistent manner as the income allocation described above.

Foreign currency translation

The Fund holds certain venture investments where the original purchase price was stated in US dollars. The cost is converted to Canadian dollars at the exchange rate in effect at the time of purchase and this amount becomes the historical cost of the investment. When a venture investment was purchased in US dollars, the fair value of these investments are adjusted weekly for the change in the exchange rate.

Increase (decrease) in net assets attributable to holders of redeemable shares

Increase (decrease) in net assets attributable to holders of redeemable shares per series of Class A share in the Statements of Comprehensive Income is calculated by dividing the increase (decrease) in net assets attributable to holder of redeemable shares per series by the weighted average number of shares outstanding for the relevant series of Class a Share during the period.

AUGUST 31, 2015

[In $ thousands of Canadian dollars except per share amounts and number of shares]

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of financial statements requires the Manager to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and the differences could be material.

The most significant accounting judgements and estimates that the Fund has made preparing the financial statements are:

(1) Fair value of venture investments in securities not having quoted market values – The Fund holds some investments that are not quoted on a recognized stock exchange. Such unlisted securities may be valued based on price quotations from recognized investment dealers, or if not available, determined by the Manager using valuation methodologies and considerations as described in Note 3. The process of valuing venture investments for which no published market exists is subject to inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for the investments.

(2) Classification and measurement of investments and application of the fair value option – In classifying and measuring the financial instruments held by the Fund, the Manager is required to make significant judgements about whether or not the business of the Fund is to invest on a total return basis for the purpose of applying the fair value option for financial assets under IAS 39, Financial Instruments – Recognition and Measurement. The most significant judgement includes the determination that the fair valuation option can be applied to the Fund's investments.

5. UNCONSOLIDATED SUBSIDIARIES, ASSOCIATES AND STRUCTURED ENTITIES

The Fund meets the definition of an investment entity. Therefore, it does not consolidate its subsidiaries but rather, recognizes them as investments at fair value through profit and loss. The following represent the Fund's interest in unconsolidated subsidiaries, associates and structured entities and related ownership percentages:

		Proportion of ownership and voting rights		
Name	**Relationship**	**August 31, 2015**	**August 31, 2014**	**September 1, 2013**
2210961 Ontario Ltd.	Subsidiary	50%	50%	50%
Axela Inc.	Subsidiary	78%	78%	78%
Bitheads Inc.	Associate	24%	20%	9%
Clek Inc.	Associate	36%	24%	19%
Emobtics Inc.	Associate	27%	26%	21%
Fidelity PAC Metals Ltd.	Subsidiary	50%	50%	50%
Interface Biologics Inc.	Associate	45%	56%	56%
Ivey CSBIF I Inc.	Subsidiary	53%	53%	53%
Ivey CSBIF II Inc.	Subsidiary	53%	53%	53%
Masstech Innovations Inc.	Subsidiary	100%	-	-
Mist Mobility Integrated Systems Technology Inc.	Associate	30%	30%	30%
Nakina Systems Inc.	Associate	36%	36%	36%
OTYC Holdings Inc.	Associate	32%	32%	32%
Powerband Global Inc.	Associate	27%	27%	19%
Roll-Tite Inc.	Subsidiary	85%	85%	85%
VG Mezzanine I Limited Partnership	Associate	36%	36%	36%
WireIE Holdings International Inc.	Subsidiary	69%	69%	42%

The entities listed above are incorporated in Canada and have their principal place of business in Canada.

AUGUST 31, 2015

[In $ thousands of Canadian dollars except per share amounts and number of shares]

5. UNCONSOLIDATED SUBSIDIARIES, ASSOCIATES AND STRUCTURED ENTITIES *(Cont'd)*

Restrictions

The Fund may receive income in the form of dividends or interest from its investments in unconsolidated subsidiaries. While there are no significant restrictions on the transfer of funds from these entities to the Fund, they may be subject to Board of Directors approvals at the subsidiary level as required in any of the subsidiaries' shareholder agreements or other documents.

Commitments

The Fund has provided a guarantee to 2210961 Ontario Limited in the amount of up to $2,536 in support of a credit facility. Should the guarantee be drawn, the amount would be recorded as a follow-on investment in the company.

The Fund has provided a guarantee to Axela Inc. in the amount of up to $3,090 in support of a credit facility. Should the guarantee be drawn, the amount would be recorded as a follow-on investment in the company.

The Fund has provided a guarantee to Masstech Innovations Inc. in the amount of up to $484 in support of a credit facility. Should the guarantee be drawn, the amount would be recorded as a follow-on investment in the company.

The Fund has provided a guarantee to WireIE International Holdings Inc. in the amount of up to $16,000 in support of a credit facility. Should the guarantee be drawn, the amount would be recorded as a follow-on investment in the company.

Additionally the Fund has provided guarantees totalling $3,417 to associates. Should the guarantees be drawn, the amounts would be recorded as follow-on investments.

Support

During the year, the Fund completed follow-on financings to support its unconsolidated subsidiaries as follows:

Company	Financings completed
Axela Inc.	$2,100 (2014- $2,250) in a 12% convertible debenture due March, 2016
WireIE International Inc	$3,750 (2014-$7,289) including an acquisition from an existing shareholder) in a 12% demand prom note
2210961 Ontario Ltd	$ NIL (2014 - $250) in a 6% senior secured demand loans).
Masstech Innovations Inc.	$1,147 (2014 - $NIL) in 10% demand promissory notes

6. REDEEMABLE SHARES

The Fund has specific capital requirements and restrictions as outlined in the Fund's annual information form. The Fund's Statements of Changes in Net Assets Attributable to Holders of Redeemable Shares identify changes in the Fund's capital during the period. The Manager manages the capital of the Fund in accordance with the Fund's investment objective; including managing its liquidity in order to meet redemptions. The Fund is authorized to issue an unlimited number of Class A Shares in an unlimited number of series.

The Fund is registered as an LSIF under the Ontario Act, is an LSVCC under the Act and is required to invest a portion of capital raised in eligible small and medium sized Canadian businesses. Eligible businesses are generally privately owned and are characterized as having less than $50 million in assets and less than 500 employees. In order to be classified as eligible investments, there are restrictions under the Act on the size, nature, and timing of the investments as outlined in the Fund's annual information form. These restrictions, if not met, could have negative impacts as the Fund could be levied with penalty taxes and ultimately have its LSIF status revoked. As at December 31, 2014, the Fund was in compliance with these restrictions related to both the Act and Ontario Act.

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[In $ thousands of Canadian dollars except per share amounts and number of shares]

6. REDEEMABLE SHARES *(Cont'd)*

The following is a description of the authorized and issued share capital:

Unlimited number of Class A Shares, issuable from treasury, discretionary dividend entitlement, voting, restrictions on transfer and redemption, entitled to elect two directors.

25,000 Class B shares issuable only to the Co-Sponsors of the Fund, no dividend entitlement, voting entitled to elect remainder of directors.

Unlimited number of Class C shares, issuable in series. None issued or outstanding.

100 Class D Shares, voting, no dividend entitlement, redeemed upon issuance of Class B shares. None outstanding.

Issued and Outstanding of Class A Shares

The following shares were issued and redeemed during the years indicated:

For the year ended August 31, 2015	Class A, Series I	Class A, Series II
Balance, beginning of year	16,824,904	12,747,483
Redeemed during the year	(1,169,016)	(1,580,975)
Balance, end of year	15,655,888	11,166,508

For the year ended August 31, 2014	Class A, Series I	Class A, Series II
Balance, beginning of year	17,673,307	14,966,676
Issued pursuant to merger	750,460	-
Issued during the year	3,738	-
Redeemed during the year	(1,602,601)	(2,219,193)
Balance, end of year	16,824,904	12,747,483

Redemption of Class A Shares

A shareholder may redeem all or part of the Class A Shares held at the NAV per Class A Share, subject to certain restrictions. One of these restrictions provides that the Fund is not required to redeem Class A Shares, in any financial year having an aggregate redemption price exceeding 20% of the NAV of the Fund as at the last day of the preceding fiscal year. The Fund cannot guarantee that it will be able to honour all redemption requests on the day in which they are made. Some of the Fund's investments are held in non-liquid securities. As such, if all shareholders were to redeem their shares at the same time, the Fund may need to liquidate these investments at lower values than currently ascribed and shareholders may not receive the NAV ascribed. The redemption of Class A Shares may be suspended in certain circumstances as permitted by applicable securities law.

On September 2, 2011, the Fund merged (the "Merger") with the New Generation Biotech (Equity) Fund Inc. ("NGBE"), The Vengrowth Investment Fund Inc., The Vengrowth II Investment Fund Inc., The Vengrowth III Investment Fund Inc., The Vengrowth Advanced Life Sciences Fund Inc., and The Vengrowth Traditional Industries Fund Inc. (collectively the "Merged Funds"). Pursuant to this transaction, the Fund acquired all of the assets and assumed the liabilities of the Merged Funds at fair value in exchange for units of the Fund based on the exchange ratio established on closing. At the time of the Merger, shareholders of the Merging Funds receiving Class A Shares, Series I or Series II had an option to redeem shares received pursuant to the merger. These redemptions were subject to a 15% redemption fee payable as income to the Fund.

Class A Shares, Series I and Series II issued pursuant to the merger to shareholders of the Merging Funds that did not redeem at the time of the transaction, are subject to additional redemption restrictions. Shareholders are able to redeem 15% per year of the shares they received on the effective date of the merger without redemption fees. This 15% restriction is in effect for four years and is not cumulative from one year to the next.

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[In $ thousands of Canadian dollars except per share amounts and number of shares]

6. REDEEMABLE SHARES *(Cont'd)*

For Class A Shares, Series I, a redemption fee is charged in the amount of up to 6% of the redemption price calculated as 0.75% of the redemption amount times the number of years or part years remaining until the eighth anniversary date of issue.

For Class A Shares, Series II, the redemption fee charged is dependent upon the origination of the Shares. For Class A Shares, Series II issued as transaction shares on account of former holders of the Merged Funds Series A or Series B, a redemption fee of up to 6% of the offering price is calculated as 0.75% of the redemption amount times the number of years or part years remaining until the eighth anniversary date of issue. For Class A Shares, Series II issued as transaction shares on account of former holders of the Merging Funds Series C shares, a redemption fee of up to 10% of the offering price calculated as 1.25% of the redemption amount times the number of years or part years remaining until the eighth anniversary date of issue.

Class B Shares

There are 199 Class B shares issued and outstanding to the Co-Sponsors (100 to the Canadian Police Association and 99 to the Association of Canadian Financial Officers). No Class B shares have been issued or redeemed in the years ended August 31, 2015 or 2014.

7. NON-MONETARY TRANSACTIONS

Included in interest from the venture portfolio of Fund II for the year ended August 31, 2015 is $1,088 of accrued interest (2014 - $38) earned as a result of various debt refinancing activities. Fund II did not receive cash but recorded the interest income at fair value in accordance with the provisions of the debt instruments that were converted within the venture investment portfolio.

During the year ended August 31, 2015 the Fund exchanged securities with a cost base of $27,642 (2014- $2,184) for new debt or equity instruments with a fair value of $28,730 (2014 - $2,222).

8. FEES AND EXPENSES

The Fund has entered into various agreements for the provision of management services including: fund management, sponsor, administration (including transfer agency), dealer and custodial services. Under the terms of certain of these agreements, the Fund may be required to pay fees based on the net asset value of the Fund.

The Fund has entered into agreements for the following annual fee rates, which, unless otherwise stated, are paid monthly based on the average net asset value of the Fund:

Fund management	1.35%
Co-Sponsor fees	0.16% (0.11% to the ACFO and 0.05% to the CPA)
Fund administration	0.45%
Dealer service fees	0.50% on Class A Shares, Series I and 0.50% on certain Class A Shares, Series II after the eighth year of issue

Covington is entitled to an incentive participation amount (the "IPA") based on the performance of the Fund. Before any payment, the Fund must satisfy the following criteria: (i) The Fund must earn sufficient income to generate a rate of return on the eligible investment portfolio greater than the average of the 5-year GIC rate of the five major banks plus 2% on an annualized basis; (ii) for a particular investment, the Fund must earn a cumulative investment return at an average annual rate in excess of 12% since investment; and (iii) the Fund must fully recoup an amount equal to all principal invested in the particular investment (including for assets from the Merged Funds, the amounts invested by the predecessor Merged Fund).

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[In $ thousands of Canadian dollars except per share amounts and number of shares]

8. FEES AND EXPENSES *(Cont'd)*

If these performance criteria as outlined in the Fund's offering documents and/or annual information form have been met, the Fund records Conditional IPA. Conditional IPA represents a provisional estimate of what would be payable to the manager if the entire venture portfolio of the Series were disposed of at fair value as at the reporting date whereas IPA payable is based on actual realized transactions. Conditional IPA was formerly referred to as "Contingent IPA" prior to the adoption of IFRS by the Fund.

Subject to all of the above, the Fund pays an IPA of 15% of all income earned from the particular investment acquired from the Merged Funds since the date the investment was acquired by the Fund. For the purposes of future IPA payments, the Merged Funds' portfolio assets will be tracked with a hurdle that will have a cost equal to the fair value on September 2, 2011. With respect to the pre-merger Fund assets and any new investments (other than follow-on investments), the Fund will pay a 20% IPA if both the portfolio and specific investments achieve the criteria (i), (ii), and (iii) above.

The movement of Conditional IPA accruals or IPA payable is summarized below:

Expensed Year ended August 31, 2015 $	Expensed Year ended August 31, 2014 $	**Accrued As at August 31, 2015 $**	Accrued As at August 31, 2014 $	**Paid Year ended August 31, 2015 $**	Paid Year ended August 31, 2014 $
1,421	2,015	**3,940**	6,831	**4,312**	8,729

Directors of the Fund are entitled to receive an annual fee of $50 each plus reimbursement of expenses incurred to attend meetings.

Members of the Funds' Independent Review Committee ("IRC") also serve another LSIF managed by Covington. The IRC members each receive total remuneration across all Funds of $15 per year, plus a per meeting fee of $2 for the Chairperson and $1.5 per meeting for each of the other two members. The annual fee is allocated across all of the Funds served by the IRC whereas per meeting fees are borne by the particular fund for which the meeting is called, if any.

During the course of the Fund's investment activities, the Fund may pay commissions and other transaction costs to dealers in connection with purchases and sales of investments. During the year, the Fund paid commissions of $192 (2014 - $456).

VenGrowth contract amount

Upon completion of the merger transaction on September 2, 2011, the Fund acquired the assets of the VenGrowth Funds including: venture assets, vendor rights, reserves, and all other assets of such funds. Included in the acquisition were commitments to the VenGrowth Managers for the elimination of existing management agreements in connection with the disposal of their business. Payment of these amounts were approved by shareholders of both the Fund and the Merged Funds pursuant to the transaction and were structured such that no incremental costs were borne by the shareholders beyond those that existed prior to the merger.

The structure results in the following payments by the Fund to the VenGrowth Managers: (i) 1.4% per annum of the net asset value of the Fund paid on a monthly basis; (2) capital maintenance payments of 1.15% per annum paid monthly of the issue cost on all Class A transaction shares issued for the Merged Funds (excluding NGBE) Series A,B,E and F issued after December 31, 2003 and 1.65% per annum paid monthly of the issue cost on Class A transaction shares issued for Merging Funds (excluding NGBE) Series C shares. These are for finance and administration costs related to sales commission financing and terminate after the eigth anniversary of that date of original share issuance and (3) 50% of any IPA paid during the year.

9. RELATED PARTY TRANSACTIONS

Included in accrued expenses for Fund II as at August 31, 2015 is $252 (August 31, 2014 - $346 and September 1, 2013 - $347) due to Covington for investment/fund advisory fees.

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[In $ thousands of Canadian dollars except per share amounts and number of shares]

10. INCOME TAXES

Under the Act, no income taxes are payable by the Fund on dividends received from Canadian corporations, and income taxes payable on capital gains will be fully refundable on a formula basis when shares of the Fund are redeemed or capital gains dividends are paid or deemed to be paid by the Fund to its shareholders. A portion of the income taxes payable on dividend income earned by the Fund is also refundable on payment or on a deemed payment of dividends to the shareholders.

Both the Act and the Ontario Act set minimum levels of venture investments for the Fund. If the minimum level of qualifying venture investments is not met as at the calendar year end, the Fund will be subject to defined taxes and penalties. As at December 31, 2014, the Fund is in compliance with both requirements set out in the Tax Act and the Ontario Act.

The Fund has capital losses of $NIL and non-capital losses of $60,493 available to offset future taxable capital gains and income respectively. The benefit, if any, of these losses have not been recognized in these financial statements. If not utilized, the non-capital losses will expire as follows: 2035 - $10,636; 2034 - $21,151; 2033 - $9,065; 2032 - $6,874; 2031 - $1,846; 2028 - $3,768; 2027 - $5,268; and 2026 - $1,885. Capital losses can be carried forward indefinitely.

The tax amounts reflected in these financial statements are based on management's best estimate of the amounts that will ultimately be assessed. This determination is based on numerous factors such as the pace at which the Fund makes qualifying venture investments, the amount of share capital raised and redeemed, and the net income and undistributed net realized gains (losses) on sale of investments by the Fund. Should actual events not agree with the estimates made by management of the Fund, material adjustments to the tax amounts may be required.

11. FINANCIAL INSTRUMENTS

Fair value hierarchy

The following describes the three-level hierarchy for fair value measurements based on transparency of inputs to the valuating of an asset or liability as at the measurement dates. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3). The three levels of the fair value hierarchy are:

Level 1 – Quoted Prices in an Active Market

Unadjusted quoted prices in active markets for identical assets or liabilities. This level of the hierarchy includes listed equity securities on major exchanges, highly liquid temporary deposits with Canadian Banks, as well as term deposits, bank deposit notes and corporate bonds. The fair value of instruments that are quoted in active markets are determined using the quoted prices where they represent those at which regularly and recently occurring transactions take place.

Level 2 – Valuation Techniques with Observable Parameters

Inputs other than quoted prices included in Level 1 that are observable for the asset and liability either directly (ie. as prices) or indirectly (ie. derived from prices). Since the inputs may be observable inputs but the application of a valuation model is used, these financial instruments are considered Level 2.

Level 3 – Valuation Techniques with Significant Unobservable Parameters

Inputs that are not based on observable market inputs Level 3 instruments include equities, debentures, term loans and promissory notes issued by privately-held companies. As observable prices are not available for these securities, the Fund may use a variety of valuation techniques to derive the fair value.

If different levels of inputs are used to measure a financial instrument's fair value, the classification within the hierarchy is based on the lowest level input that is significant to the fair value measurement. These amendments have been made to address the need for increased consistency and comparability of fair value measurements, and to expand the disclosure surrounding fair value measurements and do not have any impact on the net assets of the Fund.

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[In $ thousands of Canadian dollars except per share amounts and number of shares]

11. FINANCIAL INSTRUMENTS *(Cont'd)*

Financial Instruments Carried at Fair Value

The following table classifies the carrying value of the Fund's financial instruments held at fair value across the fair value hierarchy as at August 31, 2015 with comparatives as at August 31, 2014 and September 1, 2013:

	Financial instruments at fair value			
August 31, 2015	**Level 1 $**	**Level 2 $**	**Level 3 $**	**Total $**
Marketable securities	3,528	-	-	3,528
Venture investments	10,802	-	182,648	193,450
Total financial assets	**14,330**	**-**	**182,648**	**196,978**
August 31, 2014				
Marketable securities	12,761	498	-	13,259
Venture investments	34,532	-	207,983	242,515
Total financial assets	47,293	498	207,983	255,774
September 1, 2013				
Marketable securities	703	-	-	703
Venture investments	112,259	-	166,281	278,540
Total financial assets	112,962	-	166,281	279,243

During the years ended August 31, 2015 and 2014, there were no transfers between Level 1 and Level 2 of the fair value hierarchy in any of the Funds' assets.

The following is a reconciliation of Level 3 fair value measurements:

	August 31, 2015 $	**August 31, 2014 $**
Level 3 balance, beginning of year	207,983	166,281
New investments	42,811	30,291
Assets acquired on merger	-	6,815
Disposals or sales	(34,589)	(9,398)
Net transfers into and/or out of Level 3	(20,244)	-
Change in unrealized gains/(losses)	(21,004)	13,189
Net unrealized gains/(losses)	7,691	805
Level 3 balance, end of year	**182,648**	207,983
Total change in unrealized gains and losses during the year included in the statement of operations for assets held at end of year	**(38,176)**	(6,097)

[In $ thousands of Canadian dollars except per share amounts and number of shares]

11. FINANCIAL INSTRUMENTS *(Cont'd)*

Risk management

The Fund's activities expose it to a variety of financial risks: valuation risk, market risk (which includes currency risk, interest rate risk and other price risk), liquidity risk and credit risk as described below. The Fund's overall risk management programs seek to minimize potential adverse effects on the Fund's financial performance through a regular program of monitoring the Fund's investment positions and updating the valuation of the private company portfolios. The value of investments within a portfolio can fluctuate daily as a result of changing economic and market conditions, prevailing interest rates and company specific news relating to portfolio investments.

The Fund has managed this risk through its Valuation Committee that reviews quarterly reports from the Manager on the investment portfolio as a whole and on determination of fair value for the venture investments including a discussion of significant events affecting the valuation of such investments. This committee is independent from the Manager and is responsible for considering the appropriateness of the valuation policies adopted by the Fund and the Manager.

(a) Valuation and other market risk

There is a risk of loss of capital associated with all venture investments of the Fund. Valuation risk is the risk that the estimated fair values of investments for which no quoted market value exists as determined by the Manager may differ from values that would have been used had a ready market existed for these investments. Other market risk is the risk that the value of the venture investments will fluctuate as a result of changes in market prices.

Among the assets held for trading by the Fund are venture investments for which no quoted market values exist.

These investments are in privately held companies whereby fair values are estimated by the Manager using valuation techniques as described in Note 3.

Included in the Statements of Comprehensive Income for the Fund are changes in unrealized gains or losses on venture investments for which the fair values have been estimated based on assumptions that may not be supported by observable market prices. The potential effect of changing the assumptions to reasonably possible alternative assumptions on the fair value of the venture investments could result in a decrease or increase in net assets as at August 31, 2015, August 31, 2014 and September 1, 2013 as follows:

August 31, 2015		August 31, 2014		September 1, 2013	
Fair value of privately held investments $	**Decrease/Increase in net assets**	Fair value of privately held investments $	Decrease/Increase in net assets	Fair value of privately held investments $	Decrease/Increase in net assets
182,648	**-5.50% to +2.41%**	207,983	-2.49% to +10.34%	166,281	-1.93% to +2.45%

AUGUST 31, 2015

[In $ thousands of Canadian dollars except per share amounts and number of shares]

11. FINANCIAL INSTRUMENTS *(Cont'd)*

The tables below summarize the significant unobservable inputs used in the fair value measurement of Level 3 financial instruments.

For the purposes of these tables, venture investments are broken down as debt and equity. With respect to equity investments, those investments that are expected to require further significant investment to reach cash flow break-even are classified as early stage, those which may require strategic follow-on financing to grow are classified as expansion stage, other equity investments are classified as later stage.

As at August 31, 2015

Description	Fair value $	Valuation technique	Unobservable inputs	Reasonable possible shift in value	Change in valuation +/- $
Debt	63,418	Estimated realizable value	Probability of collection	-11.36% to +0.19%	-7,260 to +118
Early stage equity	27,328	Last equity round	Discount rate	-0.00% to +0.00%	-
Expansion stage equity	51,922	Comparable trading multiples	Revenue multiple	-3.39% to +3.54%	-1,761 to +1,838
Later stage equity	30,510	Comparable trading multiples	EBITDA multiple	-5.60% to +6.35%	-1,708 to +1,938
Underlying funds	9,470	Net asset value per share	Net asset value per share	-11.99% to +13.39%	-1,136 to +1,268

As at August 31, 2014

Description	Fair value $	Valuation technique	Unobservable inputs	Reasonable possible shift in value	Change in valuation +/- $
Debt	61,806	Estimated realizable value	Probability of collection	-7.93% to +10.69%	-4,901 to +6,607
Early stage equity	34,942	Last equity round	Discount rate	-0.85% to +6.44%	-298 to +2,249
Expansion stage equity	68,356	Comparable trading multiples	Revenue multiple	-0.39% to +5.21%	-268 to +3,562
Later stage equity	34,352	Comparable trading multiples	EBITDA multiple	-0.87% to +36.3%	-300 to +12,469
Underlying funds	8,527	Net asset value per share	Net asset value per share	-8.39% to +23.36%	-716 to +1,992

As at September 1, 2013

Description	Fair value $	Valuation technique	Unobservable inputs	Reasonable possible shift in value	Change in valuation +/- $
Debt	50,761	Estimated realizable value	Probability of collection	-2.52% to +3.22%	-1,277 to +1,633
Early stage equity	29,295	Last equity round	Discount rate	-0.10% to +0.05%	-30 to +16
Expansion stage equity	49,902	Comparable trading multiples	Revenue multiple	-0.70% to +0.00%	-350 to Nil
Later stage equity	28,157	Comparable trading multiples	EBITDA multiple	-10.74% to +15.96%	-3,024 to +4,494
Underlying funds	8,166	Net asset value per share	Net asset value per share	-8.09% to +7.85%	-661 to +641

The process of valuing investments for which no published market exists is inevitably based on inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for the investments and may not reflect the prices at which the Fund's investments may actually be sold.

AUGUST 31, 2015

[In $ thousands of Canadian dollars except per share amounts and number of shares]

11. FINANCIAL INSTRUMENTS *(Cont'd)*

(b) Foreign currency risk

Foreign currency risk arises from venture investments that are denominated in a currency other than the Canadian dollar, which is the Fund's functional currency. Although the Manager has flexibility to manage the foreign currency risk by hedging its currency exposure, the Manager did not engage in currency hedging during the period due to the low volume of foreign currency transactions involved. Increases and decreases in the exchange rate between the Canadian currency and the foreign currency may increase or decrease the value of the foreign currency denominated investments within the Fund.

The Fund had exposure to US dollars ("USD") as at August 31, 2015, August 31, 2014 and September 1, 2013 as follows:

August 31, 2015		August 31, 2014		September 1, 2013	
USD Financial instruments denominated in CAD	**Impact of a +/-2% change in Canadian dollar relative to USD on the Net Assets of the Fund**	USD Financial instruments denominated in CAD	Impact of a +/-2% change in Canadian dollar relative to USD on the Net Assets of the Fund	USD Financial instruments denominated in CAD	Impact of a +/-2% change in Canadian dollar relative to USD on the Net Assets of the Fund
47,094	**-942 to +942**	55,844	-1,117 to +1,117	115,880	-2,268 to +2,268

In practice, the actual trading results may differ from this sensitivity analysis and the difference could be material.

(c) Interest rate risk

The value of debt securities will be affected by changes in applicable interest rates. If interest rates fall, the fair value of existing debt securities may increase due to the increase in yield. On the other hand, if interest rates rise, the yield of existing debt securities will decrease which will lead to a decrease in fair value. The magnitude of the change will generally be greater for long-term debt securities than short-term debt securities.

Interest rate risk also applies to convertible securities. The fair value of these securities varies inversely with interest rates, similar to other debt securities. However, since they may be converted into common shares, convertible securities are generally less affected by interest rate fluctuations than other debt securities. Below is a breakdown of debt instruments by maturity:

Debt instruments by maturity date	**Less than 1 year $**	**1-3 years $**	**3-5 years $**	**Greater than 5 years $**
As at August 31, 2015	**71,599**	**7,995**	**-**	**-**
As at August 31, 2014	59,891	9,410	5,867	-
As at September 1, 2013	47,774	10,524	6,519	143

[In $ thousands of Canadian dollars except per share amounts and number of shares]

11. FINANCIAL INSTRUMENTS *(Cont'd)*

(d) Other price risk

Other price risk is the risk that the fair value or future cash flows of the investments will fluctuate because of changes in market prices. In addition to venture investments for which no quoted market values exist, the Fund also holds investments which are publicly traded on a recognized stock exchange.

There is market price risk associated with the Fund since as at August 31, 2105 - $14,330 or 6.7% (August 31, 2104 - $47,293 or 18.2% and September 1, 2013 - $112,962 or 41.0%) of net assets attributable to holders of redeemable shares is invested in publicly-traded securities.

These securities are predominantly North American stocks; as a result, an overall downturn in the North American economy may have a negative impact on the value of the Fund's holdings. As at August 31, 2015, if the S&P/TSX Index had increased or decreased by 10%, with all other variables held constant, net assets attributable to holders of redeemable shares would have increased or decreased by approximately $1,062 (August 31, 2014 - $4,318 and September 1, 2013 - $10,003). In practice, actual trading results may differ from this analysis and the difference may be material.

(e) Liquidity risk

Liquidity risk is defined as the risk that a fund may not be able to settle or meet its obligations on time or at a reasonable price. Fair value of investments with low liquidity may have significant variances or impairments if a Fund is required to enter into a forced liquidation scenario.

The Fund is exposed to weekly redemptions and therefore management attempts to maintain a portion of the NAV in the form of marketable securities which can be disposed of readily. The Fund is not required to redeem Class A Shares, in any financial year having an aggregate redemption price exceeding 20% of the Net Asset Value of the Fund as at the last day of the preceding fiscal year. Many of the Fund's investments are held in non-liquid securities. As such, if all shareholders were to redeem their shares at the same time, the Fund would need to liquidate these investments in order to meet the redemption requests.

The Fund was initially launched in 1999. A large number of the Fund's units are currently eligible for redemption such that if all shareholders eligible for redemption were to do so, the Fund would not have sufficient liquid resources to honour all redemptions. In September 2015, the Fund announced a temporary halt to redemptions. See Note 14.

(f) Credit risk

Credit risk is the risk that a debt security issuer or counterparty cannot meet its financial obligations, such as making interest payments or principal repayments. Issuers that have suffered adverse changes in financial conditions may receive a low credit rating reflecting a high credit risk. A change in the credit rating of the debt security can affect its liquidity and may result in an impairment of its fair value. The Manager manages credit risk by investing the reserve portfolio of the Fund in high quality investment grade debt obligations with a minimum rating of "A" at the time of investment. Currently, the Fund does not hold such debt instruments in its portfolio.

The Fund holds a portion of is investment portfolio in private debt instruments which can be considered high risk debt instruments. As at August 31, 2015, the Fund had $79,594 (August 31, 2014 - $75,168 and September 1, 2013 - $64,960) invested in these assets. These instruments are not rated by any of the market bond rating services and are also subject to valuation risk as described in part (a) above.

In reality, the Fund cannot immediately liquidate 100% of its securities practically due to the lack of a ready market for private companies and more notably, without incurring discounts to fair values which would in turn, negatively impact the NAV of the Fund.

AUGUST 31, 2015

[In $ thousands of Canadian dollars except per share amounts and number of shares]

12. TRANSITION TO IFRS

The effect of the Fund's transition to IFRS is summarized below:

(a) Transition elections

The only voluntary exemption adopted by the Fund upon transition was the ability to designate a financial asset or financial liability at fair value through profit and loss upon transition to IFRS. All financial assets designated as FVTPL upon transition were previously carried at fair value under Canadian GAAP as required by Accounting Guideline 18, Investment companies.

(b) Mandatory exceptions to retrospective application

In accordance with the mandatory exceptions to retrospective restatement under IFRS 1, hindsight was not used to create or revise estimates at the transition date. Accordingly, estimates previously made under Canadian GAAP are consistent with those under IFRS.

(c) Classification of redeemable shares issued by the Fund

Under IFRS, IAS 32 Financial Instruments: Presentation, requires that shares of an entity which include a contractual obligation for the issuer to repurchase or redeem the shares for cash or another financial asset, be classified as a financial liability. The Fund's Class A Shares do not meet the criteria in IAS 32 for classification as equity, and have been accordingly reclassified as financial liabilities on transition to IFRS.

(d) Investment entity

The Fund has determined that it meets the definition of an "investment entity" under IFRS 10, Consolidated Financial Statements. As such, the Fund measures investments in other entities over which it has control, at FVTPL. Subsidiaries are entities, including investments in other investment entities, over which a fund has control. A fund controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity, and has the ability to affect those returns through its power over the entity. Associates and joint ventures are investments over which a fund has significant influence or joint control.

Investments that are held as part of the Fund's investment portfolio are carried on the Statements of Financial Position at fair value even though the Fund may have control or significant influence over those companies. Investments in subsidiaries are required to be carried at fair value in accordance with IFRS 10, Consolidated Financial Statements. IAS 28, Investment in Associates, allows investments in associates that are held by investment entities to be recognized and measured at FVTPL and to be accounted for in accordance with IFRS 13, Fair Value Measurement, with changes in fair value recognized in the statements of comprehensive income in the period of change.

IFRS 12, Disclosure of Interests in Other Entities provides the disclosure requirements for the Fund's investment in unconsolidated subsidiaries and associates as disclosed in Note 5.

(e) Revaluation of investments at FVTPL

Under Canadian GAAP, the Fund measured the fair values of its investments using the bid price for long positions and ask prices for short positions. Under IFRS, the Fund measures the fair values of its investments using the guidance in IFRS 13, Fair Value Measurement, which requires that if an asset or liability has a bid price and an ask price, then its fair value is to be based on a price within the bid-ask spread that is most representative of fair value. Under Canadian GAAP, the Fund was required to use bid prices for long positions and ask prices for short positions. As a result, upon adoption of IFRS, an adjustment to the carrying value of the Fund's investments as well as the Fund's net assets attributable to holders of redeemable shares has been made. The impact of this revaluation adjustment is summarized in part (f) below.

[In $ thousands of Canadian dollars except per share amounts and number of shares]

12. TRANSITION TO IFRS *(Cont'd)*

(f) Reconciliations of Canadian GAAP to IFRS

The transition from Canadian GAAP to IFRS has not had a significant impact on the financial statements of the Fund. There were changes to the presentation in the Statements of Financial Position and Statements of Comprehensive Income (previously Statements of Operations) as per below:

Equity	August 31, 2014	September 1, 2013
Equity as reported under Canadian GAAP	260,025	276,701
Revaluation of investments at FVTPL	564	(1,096)
Net assets attributable to holders of redeemable shares under IFRS	260,589	275,605

Comprehensive income	Year ended August 31, 2014
Comprehensive income as reported under Canadian GAAP	9,784
Revaluation of investments at FVTPL	1,660
Increase (decrease) in net assets attributable to holders of redeemable shares under IFRS	11,444

13. ACCOUNTING STANDARDS ISSUED BUT NOT YET ADOPTED

IFRS 9, Financial Instruments ("IFRS")

The final version of IFRS 9, Financial Instruments was issued by IASB in July 2014 and will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 introduces a model for classification and measurement, a single, forward-looking "expected loss" impairment model and a substantially reformed approach to hedge accounting. The new single, principle based approach for determining the classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. The new model also results in a single impairment model being applied to all financial instruments, which will required more timely recognition of expected credit losses. It also includes changes in respect of an entity's own credit risk in measuring liabilities elected to be measured at fair value, so that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognized in profit or loss. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, however is available for early adoption. In addition, the entity's own credit changes can be early applied in isolation without otherwise changing the accounting for financial instruments. The Fund is in the process of assessing the impact of IFRS 9.

14. SUBSEQUENT EVENT

On September 8, 2015, the Fund announced a temporary halt to redemptions of the Fund as a result of significant and increasing redemption requests since the Fund reached the fourth anniversary of the Merger with Vengrowth Funds and NGBE in 2011. Pursuant to the Merger transaction, certain shares were subject to redemption restrictions which expired on September 2, 2015. The decision to halt was taken given the magnitude of redemption requests had the potential to eliminate the liquidity required to operate the Fund in an efficient manner. It was concluded that the temporary halt was necessary in order to maximize the returns to all shareholders and in the best interests of the Fund. It is expected that the Fund will re-open for redemptions in the December 2015 to March 2016 period at which time the Fund anticipates that it will resume honouring redemptions up to 20% of the Net Asset Value of the Fund in the current financial year as described in the Fund's prospectus.

Fund Symbols	**Covington Fund II Inc.** CIG912 - Closed CIG 961 - Closed
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Co-Sponsors	**Canadian Police Association** 141 Catherine Street, Suite 100 Ottawa, ON K2P 1C3
	Association of Canadian Financial Officers 400-2725 Queensview Drive Ottawa, ON K2B 0A1
Auditor	**Ernst & Young LLP** Ernst & Young Tower P.O. Box 251 Toronto-Dominion Centre Toronto, ON M5K 1J7
Administrator, Transfer Agent and Registrar	**CI Investments Inc.** 15 York Street, 2nd Floor Toronto, ON M5J 0A3 Customer Service: 1 888 746 4751

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