



COVINGTON FUND II INC.

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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 Canadian generally accepted accounting principles using information available to October 31, 2013 and management's best estimates and judgments.

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 in relation 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 Accountants and Licensed Public Accountants, on behalf of the shareholders. The auditors' report outlines the scope of their audit and their opinion on the financial statements.



Scott D. Clark
President & CEO,
Covington Capital Corporation



Lisa Low
Chief Financial Officer,
Covington Capital Corporation

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 statement of investment portfolio as at August 31, 2013, the statements of financial position as at August 31, 2013 and 2012 and the statements of operations, changes in net assets and cash flows for the years then ended, 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 Canadian generally accepted accounting principles, 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

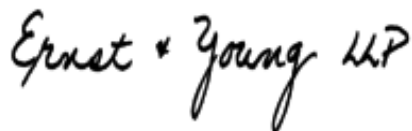
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable 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, 2013 and 2012, and the results of its operations, and the changes in its net assets and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Licensed Public Accountants

Toronto, Canada
October 31, 2013

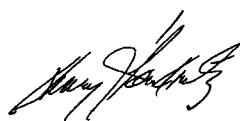
COVINGTON FUND II INC.

STATEMENTS OF FINANCIAL POSITION

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

As at August 31,	2013	2012
	\$	\$
ASSETS AND LIABILITIES		
Assets		
Cash	3,804	12,546
Marketable securities, at fair value	703	38,073
Venture investments, at fair value	279,636	211,863
Accounts receivable and prepaid expenses	10,772	10,804
Interest receivable	1	88
Subscriptions receivable	-	8
	294,916	273,382
Liabilities		
Accounts payable and accrued liabilities	4,668	3,315
Contingent incentive participation amount payable [Note 6]	13,545	1,305
Redemptions payable	2	9
	18,215	4,629
Net assets, at fair value	276,701	268,753
Net assets, at fair value per Series		
Series I	\$152,237	\$145,512
Series II	\$124,464	\$123,241
Class A Shares outstanding [Note 4]		
Series I	17,673,307	19,463,229
Series II	14,966,676	16,845,039
Net assets, per Class A Share [Note 3]		
Series I	\$ 8.61	\$ 7.48
Series II	\$ 8.32	\$ 7.32

On behalf of the Board of Directors:



Henry J. Pankratz
Director



Terrence B. Kulka
Director

See accompanying notes.

COVINGTON FUND II INC.

STATEMENTS OF OPERATIONS

[in \$ thousands except per share amounts]

For the years ended August 31,	2013	2012
	\$	\$
INCOME		
Interest on venture investments	1,964	2,247
Dividend income	175	563
Interest on marketable securities	102	521
Other income	52	8
Escrow recovery	-	1,622
Redemption fee income [Note 4]	-	4,242
	2,293	9,203
EXPENSES		
Contingent incentive participation amount [Note 6]	12,649	3,368
VenGrowth contract amount [Note 6]	3,731	4,268
Investment advisor fees [Note 6]	3,598	4,117
Harmonized Sales Taxes	2,506	1,446
Capital maintenance payment [Note 6]	1,620	2,479
Service fees [Note 6]	1,283	1,455
Fund administrator fees [Note 6]	1,199	2,589
Shareholder communications	652	583
Co-Sponsor fees [Note 6]	426	488
Directors' fees	397	346
Audit fees	342	411
Net escrow loss	117	-
Legal fees	80	73
Custody fees	61	105
Other	31	115
Independent Review Committee	24	23
Capital tax (recovery)	-	(3)
	28,716	21,863
Loss for the year	(26,423)	(12,660)
Realized and unrealized gain/(loss) on investments		
Realized gain on sale of investments	7,332	11,411
Realized gain on foreign exchange	1,132	1,005
Change in unrealized appreciation/(depreciation) of foreign currency	46	(46)
Change in unrealized appreciation/(depreciation) of marketable securities	40	(14)
Change in unrealized appreciation/(depreciation) of venture investments	54,579	(24,055)
Realized and unrealized gain/(loss) on investments	63,129	(11,699)
Results of operations for the year	36,706	(24,359)
Results of operations for the year per Series:		
Series I	\$ 20,228	\$ (13,195)
Series II	\$ 16,478	\$ (11,164)
Results of operations for the year per Class A Share		
(based on weighted average number of shares outstanding)		
Series I	\$ 1.10	\$ (0.64)
Series II	\$ 1.04	\$ (0.63)

See accompanying notes.

COVINGTON FUND II INC.

STATEMENTS OF CHANGES IN NET ASSETS

[in \$ thousands]

For the years ended August 31,	2013	2012
	\$	\$
Net assets, beginning of year	268,753	40,617
INVESTMENT ACTIVITIES		
Results of operations for the year	36,706	(24,359)
CAPITAL TRANSACTIONS [Note 4]		
Class A Shares, Series I		
Proceeds from issuance of Class A Shares	13	209
Proceeds from issuance of Class A shares due to merger	-	150,252
Amounts paid for Class A Shares redeemed	(14,084)	(34,538)
Class A Shares, Series II		
Proceeds from issuance of Class A shares due to merger	-	154,687
Amounts paid for Class A Shares redeemed	(14,687)	(18,115)
Net assets, end of year	276,701	268,753
Realized gain/(loss) on sale of investments		
Marketable securities		
Bonds, at cost, beginning of year	7,504	-
Bonds purchased during the year	-	13,500
	7,504	13,500
Amortization of bond premium	(210)	(436)
Bonds, at cost, end of year	-	7,504
Cost of bonds sold	7,294	5,560
Proceeds from sale of bonds	7,294	5,560
Realized gain/(loss) on sale of bonds	-	-
Equities, at cost, beginning of year	689	689
Equities purchased during the year	-	-
	689	689
Equities, at cost, end of year	689	689
Cost of equities sold	-	-
Proceeds from sale of equities	-	-
Realized gain/(loss) on sale of equities	-	-
Venture investments		
Venture investments, at cost, beginning of year	250,589	54,397
Venture investments purchased during the year	104,321	256,424
Venture investments repaid during the year	(6,186)	(8,827)
	348,724	301,994
Venture investments, at cost, end of year	263,783	250,589
Cost of venture investments sold	84,941	51,405
Proceeds from sale of venture investments	92,273	62,816
Realized gain on sale of venture investments	7,332	11,411
Realized gain on sale of investments	7,332	11,411

See accompanying notes.

COVINGTON FUND II INC.

STATEMENTS OF CASH FLOWS

[in \$ thousands]

For the years ended August 31,	2013 \$	2012 \$
Operating activities		
Results of operations for the year	36,706	(24,359)
Items not affecting cash		
Realized gain on sale of investments	(7,332)	(11,411)
Amortization of premium on bonds	210	436
Change in unrealized (appreciation)/depreciation of investments	(54,619)	24,069
Fee income from venture investments [Note 5]	(609)	(403)
Change in non-cash working capital		
Change in other assets and liabilities	13,712	(12,269)
	(11,932)	(23,937)
Financing activities		
Net proceeds from issuance of Class A Shares, Series I and II	21	209
Net proceeds from issuance of Class A Shares due to merger, Series I and II	-	33,841
Amounts paid for Class A Shares redeemed, Series I and II	(28,778)	(52,653)
	(28,757)	(18,603)
Investing activities		
Purchase of venture investments	(28,765)	(41,480)
Net proceeds/(purchase) from short term investments	29,906	36,605
Repayment of venture debt	6,186	8,827
Proceeds from sale of bonds	7,294	5,560
Proceeds from sale of venture investments	17,326	44,412
	31,947	53,924
Increase/(decrease) in cash during the year	(8,742)	11,384
Cash, beginning of year	12,546	1,162
Cash, end of year	3,804	12,546
Non-monetary transactions [Note 5]		
Securities received from debt financing and share exchange	75,556	18,807
Proceeds from share exchange	74,947	18,404
Net assets acquired on merger	-	271,099

See accompanying notes.

COVINGTON FUND II INC.
STATEMENT OF INVESTMENT PORTFOLIO

[in \$ thousands except number of shares, percentage or [par value \$]]

As at August 31, 2013
Marketable securities

Par value \$	Issuer	Coupon rate %	Maturity date	Average cost \$	Fair value \$
Equities					
20,875	Manitoba Telecom Services Inc.			689	703
Total marketable securities				689	703

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*	\$104,854	108	-	108
2210961 Ontario Limited, Loan, 6%, due April 19, 2018	\$6,358,056	3,911	-	3,911
2210961 Ontario Limited, Common	50,000	-	-	-
Active Exhaust Corporation, Subordinated Debenture, 14%, due April 30, 2014	\$2,000,000	2,000	-	2,000
Active Exhaust Corporation, Class B Common	502,766	-	822	822
Adventus Remediation Tech. Inc., Common	709,942	-	-	-
Adventus Remediation Tech. Inc., Class A Preferred	6,990,523	-	1,365	1,365
Aegera Oncology Inc., Rights	12,605,118	-	12,605	12,605
Affinium Pharmaceuticals Inc., Class A Exchangeable	1,645,000	-	1,445	1,445
Affinium Pharmaceuticals Inc., Common Exchangeable	305,525	-	-	-
AppZero Software Corporation, Common	872,864	-	867	867
AppZero Software Corporation, Convertible Debenture, 8%, due December 31, 2013	\$1,017,200	1,017	-	1,017
AppZero Software Corporation, Convertible Debenture, 8%, due June 30, 2014	\$500,000	500	-	500
AppZero Software Corporation, Warrants, \$0.001, expiry June 6, 2014	143,412	-	8	8
AppZero Software Corporation, Warrants, \$0.001, expiry January 22, 2016	24,329	-	-	-
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%, due July 15, 2015	\$2,500,000	2,511	-	2,511

STATEMENT OF INVESTMENT PORTFOLIO [Cont'd]

[in \$ thousands 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 \$
Axela Inc., Convertible Debenture, 12%, due January 13, 2016	\$1,000,000	1,000	-	1,000
Axela Inc., Convertible Debenture, 12%, due March 16, 2016	\$5,450,000	5,450	-	5,450
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	-	-	-
Axela Inc., Class A Series 2 Warrants, \$1.27, expiry February 16, 2015	486,573	-	-	-
Axela Inc., Class A Series 3 Warrants, \$2.01, expiry April 20, 2014	23,002	-	-	-
Axela Inc., Class A Series 3 Warrants, \$2.01, expiry July 17, 2015	19,782	-	-	-
bitHeads Inc., Class B Preferred	7,464,010	-	821	821
BPS Resolver Inc., Demand Promissory Note, 18%	\$4,893,750	4,833	-	4,833
BPS Resolver Inc., Common	2,402,207	-	1,263	1,263
BPS Resolver Inc., Preferred	1,875,000	-	1,406	1,406
BTE Technologies Inc., Common*	7,831	-	2,128	2,128
BTI Systems Inc., Common*	15,424,969	-	1,377	1,377
BTI Systems Inc., Class A Preferred*	2,028,039	-	1,327	1,327
BTI Systems Inc., Class B Preferred*	25,702,108	-	9,578	9,578
BTI Systems Inc., Class C Preferred*	8,325,969	-	1,831	1,831
Clek Inc., Demand Promissory Note, 12%	\$500,000	514	-	514
Clek Inc., Class B Common	1,464,765	-	2,549	2,549
CounterPath Corporation, Common+	2,157,691	-	5,207	5,207
CounterPath Corporation, Warrants, USD\$3.25, expiry June 19, 2014+	300,000	-	-	-
EGL Financial Holdings Inc., Common+	1,770,848	-	11,997	11,997
Embotics Corporation, Demand Promissory Note, 12%	\$400,000	400	-	400
Embotics Corporation, Class A Preferred	197,888	-	1,790	1,790
Embotics Corporation, Class B Preferred	582,031	-	2,500	2,500
Epocal Inc., Rights*	2,827,341	-	-	-
Espial Group Inc., Common+	1,894,414	-	2,387	2,387
Fidelity PAC Metals Ltd., Demand Promissory Note, 6%	\$285,623	286	-	286
Fidelity PAC Metals Ltd., Common	2,060,000	-	2,060	2,060

COVINGTON FUND II INC.
STATEMENT OF INVESTMENT PORTFOLIO [Cont'd]

[in \$ thousands 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 \$
Fusebill Inc., Class A Preferred	1,874,761	-	900	900
Fusebill Inc., Common	694,580	-	300	300
Greenfield Specialty Alcohols Inc., Common	497,682	-	13,687	13,687
Greenfield Specialty Alcohols Inc., Special	123,645	-	3,400	3,400
Interface Biologics Inc., Class A Preferred	9,043,776	-	15,241	15,241
Ivey CSBIF I Inc. Class A	250,000	-	2,500	2,500
Ivey CSBIF II Inc. Class A	250,000	-	2,500	2,500
Mist Mobility Integrated Systems Technology Inc., Demand Promissory Note, 12%	\$10,200,000	9,150	-	9,150
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	3,690,136	-	2,250	2,250
Nakina Systems Inc., Demand Convertible Debenture, 15%*	\$3,249,765	3,407	-	3,407
Nakina Systems Inc., Demand Promissory Note, 18%*	\$1,300,000	1,294	-	1,294
Nakina Systems Inc., Convertible Debenture, 15%, due December 31, 2013*	\$1,050,000	1,051	-	1,051
Nakina Systems Inc., Class A Common*	6,168,948	-	-	-
Nakina Systems Inc., Class A Preferred*	10,909,081	-	-	-
Nakina Systems Inc., Class B Preferred*	8,271,130	-	-	-
Nakina Systems Inc., Class C Preferred*	39,167,338	-	4,643	4,643
Nakina Systems Inc., Warrants*	13,705,577	-	444	444
NeurAxon Inc., Convertible Debenture, 10%, due March 23, 2019*	\$144,621	143	-	143
NeurAxon Inc., Common*	8,958	-	1	1
NeurAxon Inc., Series I Class A Preferred*	1,013,260	-	758	758
NeurAxon Inc., Series I Class B Preferred*	680,997	-	510	510
OPKO Health Inc., Common*+	8,227,449	-	58,351	58,351
OTYC Holdings Inc., Class B Preferred	14,496,425	-	124	124
OTYC Holdings Inc., Class C Preferred	4,189,769	-	553	553
OTYC Holdings Inc., Class D Preferred	43,298,618	-	6,820	6,820
OTYC Holdings Inc., Milestones	17,301,627	-	-	-

COVINGTON FUND II INC.
STATEMENT OF INVESTMENT PORTFOLIO [Cont'd]

[in \$ thousands 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 \$
PowerBand Global Inc., Common	41,511	-	2,092	2,092
PowerBand Global Inc., Demand Promissory Note, 7%	\$2,000,000	2,000	-	2,000
PowerBand Global Inc., Demand Promissory Note, 12%	\$3,751,000	3,751	-	3,751
PowerBand Global Inc., Demand Promissory Note, 18%	\$500,000	500	-	500
PowerBand Global Inc., Debenture, 24%, due October 2, 2014	\$1,563,676	1,563	-	1,563
Roll-Tite Corporation, Demand Loan, 10%	\$1,000,000	1,000	-	1,000
Roll-Tite Corporation, Demand Loan, 20%	\$1,477,512	1,478	-	1,478
Roll-Tite Corporation, Common	85,000	-	-	-
Sandvine Corporation, Common+	3,822,597	-	6,230	6,230
Signal Hill Equity Partners II, LP	1,801,041	-	1,250	1,250
Spartan Bioscience Inc., Common	201,000	-	30	30
Starburst Holdings Limited, Common	19	-	2,160	2,160
Stem Cell Therapeutics Corporation, Common+	3,122,267	-	847	847
Stem Cell Therapeutics Corporation, Warrants, exercise price \$0.40, expiry March 15, 2018	1,694,880	-	-	-
TNR Doors Inc., Debenture, 12%, due February 27, 2014	\$25,867	26	-	26
VG Mezzanine I Limited Partnership	13,590	-	3,177	3,177
WireE Holdings International Inc., Secured Convertible Debenture, 10%, due March 13, 2018	\$2,500,000	2,500	-	2,500
WireE Holdings International Inc., Common	14,826,857	-	4,722	4,722
Total venture investments, at cost		64,960	198,823	263,783
Unrealized appreciation of venture investments				15,853
Venture investments, at fair value				279,636
Total investments, at fair value				280,339
Liabilities, net of other assets				(3,638)
Net assets, at fair value				276,701

* Investment made and tracked in \$US dollars.

+ Indicates a publicly traded security.

See accompanying notes.

COVINGTON FUND II INC.
STATEMENT OF INVESTMENT PORTFOLIO [Cont'd]

[in \$ thousands except percentages and number of companies]

As at August 31, 2013

	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	33,537	12.7	34,053	12.2
Expansion	27	208,463	79.0	230,856	82.5
Later	7	21,783	8.3	14,727	5.3
	39	263,783	100.0	279,636	100.0

Industry Class

Biotechnology	7	32,861	12.5	28,706	10.3
Retail	2	4,506	1.7	3,851	1.4
Health Sciences	3	98,373	37.3	128,914	46.1
Financial Services	6	16,929	6.4	14,934	5.3
Technology	16	74,060	28.1	73,776	26.4
Manufacturing	5	37,054	14.0	29,455	10.5
	39	263,783	100.0	279,636	100.0

As at August 31, 2012

	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	7	50,601	20.2	45,801	21.6
Expansion	28	172,143	68.7	147,455	69.6
Later	7	27,845	11.1	18,607	8.8
	42	250,589	100.0	211,863	100.0

Industry Class

Biotechnology	9	59,012	23.5	37,931	17.9
Entertainment/Retail	2	4,506	1.8	3,991	1.9
Health Sciences	5	77,292	30.9	76,407	36.1
Financial Services	5	12,843	5.1	9,938	4.7
Technology	16	66,289	26.5	58,350	27.5
Manufacturing	5	30,647	12.2	25,246	11.9
	42	250,589	100.0	211,863	100.0

See accompanying notes.

AUGUST 31, 2013

[In \$ thousands 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 is a prescribed Labour-Sponsored Venture Capital Corporation (“LSVCC”) under the Income Tax Act (Canada) (the “Act”).

The Investment/Fund Advisor 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”).

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 the 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.

2. SIGNIFICANT ACCOUNTING POLICIES**Basis of presentation**

These financial statements have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”).

Valuation of investments

The net assets of an investment fund for financial reporting purposes (“Net Assets” or “net assets for GAAP purposes”) are required to be reported at fair value in accordance with the Canadian Institute of Chartered Accountants Handbook Section 3855, “Financial Instruments – Recognition and Measurement” (“Section 3855”). The fair values of investments as at the financial reporting date are determined as follows:

(a) Marketable securities

Short-term investments maturing less than 365 days from acquisition are classified as held for trading and are valued at closing bid prices.

Bonds are also classified as held for trading and are valued on the basis of closing bid prices. The difference between the fair value and the average cost of the bonds is recorded as unrealized appreciation (depreciation) of marketable securities.

(b) Venture investments

The Fund’s venture portfolio is classified as held for trading.

Venture investments having quoted market values and which are publicly traded on a recognized stock exchange, and are not otherwise restricted or thinly-traded securities are valued based on closing bid prices. If no bid price is reported, the most recent closing price is used.

AUGUST 31, 2013

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

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Venture investments for which no quoted market value exists, or venture investments in restricted or thinly-traded securities, are recorded at estimated fair value. The fair values of the 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; if no such market inputs are available, the warrants are valued at intrinsic value, which is equal to the higher of the closing bid price of the underlying security less the exercise price of the warrant, or nil.

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 which would have been used had a ready market existed for those investments.

The Canadian Securities Administrators ("CSA") have issued National Instrument 81-106 ("NI 81-106"), which requires the Fund's financial statements to be prepared in accordance with GAAP. While Section 3855 defines specific measurement parameters for fair valuation of financial instruments that are traded in active markets, NI 81-106 allows net asset values of investment funds to be calculated using the fair value of the Fund's assets and liabilities. NI 81-106 has been amended to allow the Net Asset Value ("NAV" or "net assets for pricing purposes") of an investment fund to be calculated in a manner that is not in accordance with GAAP for other than financial statement purposes. The adoption of Section 3855 therefore, results in a different valuation method for determining the Fund's net assets as described in the Fund's valuation methodologies above. Consequently, the Fund has applied Section 3855 for financial statement reporting purposes only.

NI 81-106 Section 14.2 requires investment funds to calculate weekly NAV for the purchase and redemption of units based on the fair value of the investment fund's assets and liabilities. The fair value of investments for the purpose of calculating weekly NAV is determined as follows:

For short-term investments, bonds, and venture investments having quoted market values and that are publicly traded on a recognized stock exchange and are not otherwise restricted or thinly traded, the most recent closing price is used. All other financial instruments are valued as otherwise stated.

A reconciliation between the Net Assets and NAV is provided in Note 3.

Transaction costs

Section 3855 also requires that transaction costs, such as brokerage commissions, incurred in the purchase and sale of securities be charged to net income. The Fund expensed these transaction costs as disclosed in Note 6.

Accounts receivable, other assets and liabilities

Other assets, such as accounts receivable, receivables for venture investments sold and income receivables, are classified as loans and receivables and are recorded at cost or amortized cost, which approximates fair value. Other liabilities such as accounts payable, accrued expenses and contingent incentive participation amount payable are classified as other financial liabilities and recorded at cost or amortized cost, which approximates fair value.

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

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd.)

Income recognition and security holder transactions

Interest 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. Net realized and unrealized gain (loss) on investments includes the related foreign exchange gains and losses.

Allocation of income and expenses

The Fund allocates income, expenses, realized gains (losses) and unrealized gains (losses) on the following basis: Income and realized and unrealized gains (losses) are apportioned on a weekly basis based on the net asset value for pricing purposes 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.

Use of estimates

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

3. RECONCILIATION OF NET ASSETS

In \$ per unit as at August 31, 2013	Class A, Series I	Class A, Series II
Net asset value per Class A Share for pricing purposes	\$ 8.58	\$ 8.28
Section 3855 Adjustment	0.03	0.04
Net assets per Class A Share for GAAP purposes	\$ 8.61	\$ 8.32
In \$ per unit as at August 31, 2012		
Net asset value per Class A Share for pricing purposes	\$ 7.50	\$ 7.34
Section 3855 Adjustment	(0.02)	(0.02)
Net assets per Class A Share for GAAP purposes	\$ 7.48	\$ 7.32

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

4. SHAREHOLDERS' EQUITY

The Net Assets per Class A Share is reconciled between net assets under GAAP and net asset value for pricing purposes arising from the adoption of Section 3855 as described in Note 2.

The Fund has specific capital requirements and restrictions as outlined in the Fund's prospectus. The Fund's Statements of Changes in Net Assets identify changes in the Fund's capital during the year. 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. Class A Shares issued and outstanding represent the capital of the Fund. 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 a prescribed 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 prospectus. 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, 2012, the Fund was in compliance with these restrictions related to both the Act and Ontario Act.

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.

100 Class D Shares.

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

4. SHAREHOLDERS' EQUITY (cont'd.)

Issued and Outstanding Class A Shares

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

For the year ended August 31, 2013	Class A, Series I	Class A, Series II
Balance, beginning of year	19,463,229	16,845,039
Issued during the year	1,704	-
Redeemed during the year	(1,791,626)	(1,878,363)
Balance, end of year	17,673,307	14,966,676

For the year ended August 31, 2012	Class A, Series I	Class A, Series II
Balance, beginning of year	5,110,790	-
Issued during the year	26,176	-
Issued pursuant to merger	18,591,431	19,140,135
Redeemed during the year	(4,265,168)	(2,295,096)
Balance, end of year	19,463,229	16,845,039

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.

At the time of merger, shareholders of the Merged 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 Merged 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.

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 calculated as 0.75% of the redemption amount times the number

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2013

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

4. SHAREHOLDERS' EQUITY (cont'd.)

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

The following shares were issued to the Co-Sponsors as follows:

For the year ended August 31, 2013	Canadian Police Association	Association of Chief Financial Officers	For the year ended August 31, 2012	Canadian Police Association	Association of Chief Financial Officers
Balance, beginning of year	100	99	Balance, beginning of year	100	-
Issued during the year	-	-	Issued during the year	-	99
Balance, end of year	100	99	Balance, end of year	100	99

5. NON-MONETARY TRANSACTIONS

Included in interest from the venture portfolio of the Fund for the year ended August 31, 2013 is \$609 of accrued interest (2012 – \$403) earned as a result of various debt refinancing activities. The Fund 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, 2013, the Fund exchanged securities with a cost base of \$35,378 (2012 - \$18,807) for new debt or equity instruments with a fair value of \$74,947 (2012 - \$18,807). As a result of these transactions, the Fund realized a gain/(loss) of \$39,569 (2012 - nil) on this series of non-monetary transactions.

6. FEES AND EXPENSES

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

Effective September 2, 2011, the Fund has entered into certain agreements for the following annual fee rates, which, unless otherwise stated, are paid out monthly based on the average net asset value of the Fund:

Investment advisory and marketing services	1.35%
Co-Sponsor fees	0.16% (0.11% to the ACFO and 0.05% to the CPA)
Fund administration (CI)*	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

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

6. FEES AND EXPENSES (cont'd.)

*Prior to May 22, 2012, the fund administration function was performed by both CI Investments (for the Fund and NGBE) and CIBC Mellon (for the Merged Funds with the exception of NGBE).

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). 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 IPA accruals is summarized below:

	Expensed Year ended August 31, 2013	Expensed Year ended August 31, 2012	Accrued As at August 31, 2013	Accrued As at August 31, 2012	Paid Year ended August 31, 2013	Paid Year ended August 31, 2012
	\$	\$	\$	\$	\$	\$
Fund II	12,649	3,368	13,545	1,305	409	2,344

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 the Fund's Independent Review Committee ("IRC") also serve other LSIFs managed by Covington. The IRC members each receive total remuneration across all of the Funds of \$15/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 \$4 (2012-\$nil).

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 merger 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

NOTES TO FINANCIAL STATEMENTS

AUGUST 31, 2013

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

6. FEES AND EXPENSES (cont'd.)

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 Merged Funds (excluding NGBE) Series C shares. These are for finance and administration costs related to sales commission financing and terminate after the eighth anniversary of the date of original share issuance and (3) 35% of any IPA paid up to July 2013 and 50% of any IPA paid thereafter.

7. RELATED PARTY TRANSACTIONS

Included in accounts payable and accrued liabilities for the Fund as at August 31, 2013 is \$347 (2012 – \$358) due to Covington for investment/fund advisory fees.

During the year, the Fund completed partial acquisitions of four investee companies from other LSIFs managed by Covington. Two of the acquisitions were from Covington Strategic Fund for a total cost of \$2,995 and two from Covington Venture Fund Series I, II, III, IV, V for a cost of \$4,159.

Because these transactions occurred between funds under common management, they were reviewed by the Board of Directors or each participating Fund and the IRC of the Funds. A third party valuation consultant was retained to research and provide external data on transactions in the broader marketplace.

8. 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 Funds are redeemed or capital gains dividends are paid or deemed to be paid by the Funds to their shareholders. A portion of the income taxes payable on dividend income earned by the Funds 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 Funds will be subject to defined taxes and penalties. As at December 31, 2012, the Fund was in compliance with both requirements set out in the Tax Act and the Ontario Act.

The Fund has capital losses of \$61,112 and non-capital losses of \$31,462 available to offset future taxable capital gains and income respectively. The benefit, if any, of these losses has not been recognized in these financial statements. If not utilized, the non-capital losses will expire as follows: 2014 - \$716, 2026 - \$3,925, 2027 - \$5,268, 2028 - \$3,768, 2031 - \$1,846, 2032 - \$6,874; and 2033 \$9,065. 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 make 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.

9. COMMITMENTS AND GUARANTEES

The Fund has entered into commitments to fund up to \$1,600 in two additional investee companies. The Fund has provided guarantees in favour of five investee companies of the Fund for amounts of up to \$22,677 for operating credit facilities. Should the guarantees be drawn, the amounts would be recorded as follow-on investments in the investee companies.

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

10. 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 of 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 as follows:

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 (i.e. as prices) or indirectly (i.e. 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.

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, 2013 with comparatives as at August 31, 2012:

Financial Instruments at fair value				
	Level 1	Level 2	Level 3	Total
August 31, 2013	\$	\$	\$	\$
Marketable securities	703	-	-	703
Venture investments	113,355	-	166,281	279,636
Total financial assets	114,058	-	166,281	280,339

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

10. FINANCIAL INSTRUMENTS (cont'd.)

Financial Instruments at fair value				
	Level 1	Level 2	Level 3	Total
August 31, 2012	\$	\$	\$	\$
Marketable securities	711	37,362	-	38,073
Venture investments	28,931	-	182,932	211,863
Total financial assets	29,642	37,362	182,932	249,936

During the year ended August 31, 2013, there were no significant transfers between Level 1 and Level 2 of the fair value hierarchy in any of the Fund's assets.

The following is a reconciliation of Level 3 fair value measurements from August 31, 2012 to August 31, 2013 (and August 31, 2011 to August 31, 2012):

	2013	2012
	\$	\$
Level 3 balance, beginning of year	182,932	24,987
New investments	44,271	53,991
Assets acquired on merger	-	187,520
Disposals or sales	(92,923)	(45,881)
Net transfers into and/or out of Level 3	-	-
Change in unrealized gains/(losses)	28,232	(23,333)
Net realized gains/(losses)	3,769	(14,352)
Level 3 balance, end of year	166,281	182,932
Total change in unrealized gains and losses during the year included in the Statement of Operations for assets held at end of year	54,579	(24,055)

Risk management

The Fund's activities expose it to a variety of financial risks: valuation and other market risk (which includes foreign 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. The committee is independent from the Manager and are responsible for considering the appropriateness of the valuation policies adopted by the Fund and the Manager.

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

10. FINANCIAL INSTRUMENTS (cont'd.)

(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 2.

Included in the Statements of Operations 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, 2013 and 2012 as follows:

August 31, 2013		August 31, 2012	
Fair value of privately held investments	Decrease/Increase in net assets	Fair value of privately held investments	Decrease/Increase in net assets
\$	%	\$	%
166,281	-1.93% to +2.45%	182,932	-1.85% to + 6.39%

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 Funds' investments may actually be sold.

(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. 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, 2013 and 2012 as follows:

As at	August 31, 2013		August 31, 2012	
	USD Financial instruments denominated in CAD:	Impact of a +/- 2% change in CAD relative to USD on the Net Assets of the Fund:	USD Financial instruments denominated in CAD:	Impact of a +/- 2% change in CAD relative to USD on the Net Assets of the Fund:
	\$	\$	\$	\$
	115,880	-2,268 to + 2,268	46,782	-925 to +925

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10. FINANCIAL INSTRUMENTS (cont'd.)

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:

As at August 31, 2013

Debt instruments by maturity date	Less than 1 year \$	1-3 years \$	3-5 years \$	Greater than 5 years \$
	34,905	10,524	5,332	451

As at August 31, 2012

Debt instruments by maturity date	Less than 1 year \$	1-3 years \$	3-5 years \$	Greater than 5 years \$
	45,980	13,585	2,757	324

(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 that are publicly traded on a recognized stock exchange. There is market price risk associated with the Fund since \$114,058 or 41% (2012 -\$24,670 or 9%) of Net Assets 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, 2013, if the S&P/TSX Index had increased or decreased by 10%, with all other variables held constant, Net Assets of the Fund would have increased or decreased by approximately \$9,859 (2012-\$1,867). 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.

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

10. FINANCIAL INSTRUMENTS (cont'd.)

The Fund is exposed to weekly redemptions and therefore management attempts to maintain a portion of its NAV in the form of marketable securities that can be readily disposed of. 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 may need to liquidate these investments at lower values than currently ascribed and shareholders may not receive the NAV ascribed.

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. Management, in conjunction with the Fund's Board of Directors has implemented a monitoring program and is currently able to balance shareholder value with the need for liquidity to honour redemptions.

(f) Credit risk

Credit risk is the risk that a debt security issuer 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 credit rating of "A" at the time of investment. Currently the Fund does not hold such debt in its portfolio.

As at August 31, 2013, the Fund does not hold any investment in debt instruments (excluding the venture portfolio listed in (a) above or cash equivalents and short-term marketable securities).

As at August 31, 2012, the Fund's investment in debt instruments (excluding the venture portfolio listed in (a) above or cash equivalents and short-term marketable securities) were:

Debt instruments by credit rating*:	AAA \$	AA \$	A \$	BBB \$	Total \$
	7,511	-	-	-	7,511

The Fund holds a portion of its investment portfolio in private debt instruments which can be considered high risk debt instruments. These instruments are not rated by any of the market bond rating services and are subject to valuation risk as described in part (a) above.

11. FUTURE ACCOUNTING STANDARDS

Conversion to International Financial Reporting Standards

Investment companies that are publicly accountable enterprises or investment funds to which National Instrument 81-106 Investment Fund Continuous Disclosure is applicable, are required to adopt International Financial Reporting Standards (IFRS) for the first time for interim and annual financial statements relating to annual periods beginning on or after January 1, 2014. As a result, the Fund will adopt IFRS beginning September 1, 2014 and publish the first financial statements, prepared in accordance with IFRS, for the semi-annual period ending February 28, 2015. The

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

2015 semi-annual and annual financial statements will include 2014 comparative financial information and an opening Statement of Net assets as at September 1, 2013, also prepared in accordance with IFRS.

Other than timing, the Manager has developed a transition plan to changeover to IFRS and meet the required timetable. Elements of the plan include:

Accounting Policies and Disclosure – As at August 31, 2013, the expected impact to the financial statements based on the Manager's assessment of the differences between current Canadian GAAP and IFRS are as follows:

- IFRS 13 Fair Value Measurement permits the use of mid-market prices or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread. As a result, net assets for financial reporting purposes (GAAP NAV) may be impacted and could align with the value used to price unitholder transactions (Transaction NAV), eliminating the need for a reconciliation.
- IFRS 10 Consolidated Financial Statements provides an exception to the consolidation requirements and requires investment entities to account for subsidiaries at fair value through profit or loss. Although not impacting current presentation, additional disclosure would be required relating to how the investment entity definition was met, information about each unconsolidated subsidiary, and details of financial and contractual arrangements.
- Units of the Fund are puttable instruments and are required to be presented as equity or liability depending on certain criteria. As a result, unitholders' equity may be required to be presented as a liability in the Statements of Net Assets with related distributions presented as an expense in the Statements of Operations. Alternatively, equity presentation would require additional disclosure of the components of equity.
- Other reclassifications, presentation differences and additional disclosures will also be required in the financial statements to comply with the new requirements under IFRS.

Operations – Management is assessing which operations of the Fund will be affected by the adoption of IFRS including current reporting and back office systems.

Impact on Net Asset Value – the Manager has determined that there is no expected impact on Net Asset Value for pricing of purchases and redemptions anticipated as a result of transition to IFRS.

Progress on the changeover plan will be reported in subsequent interim and annual financial statements until the adoption of IFRS is complete.

12. SUBSEQUENT EVENT

Subsequent to year end, the Fund entered into a agreement to acquire the net assets of Covington Strategic Capital Fund Inc., another LSIF managed by Covington. The approximate value of the net assets that will be acquired is \$6,600. The transaction is awaiting final regulatory approval.

CORPORATE INFORMATION

Fund Symbols

Covington Fund II Inc.

CIG912

CIG 961 - Closed

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Co-Sponsors

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