

Interim Condensed Consolidated Financial Statements of

# **MEDICAL FACILITIES CORPORATION**

For the three months ended March 31, 2016  
(Unaudited)  
(In U.S. dollars)

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# MEDICAL FACILITIES CORPORATION

Interim Consolidated Balance Sheets  
(In thousands of U.S. dollars)  
(Unaudited)

	Note	March 31, 2016 \$	December 31, 2015 \$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		65,797	57,969
Short-term investments		8,015	12,975
Accounts receivable		40,059	48,754
Supply inventory		5,705	6,031
Prepaid expenses and other		4,090	4,160
<b>Total current assets</b>		<b>123,666</b>	<b>129,889</b>
<b>Non-current assets</b>			
Deferred income tax assets		18,112	18,286
Property and equipment		61,559	61,121
Goodwill	4	106,796	102,714
Other intangibles		67,181	70,103
Other assets	13.1	847	839
<b>Total non-current assets</b>		<b>254,495</b>	<b>253,063</b>
<b>TOTAL ASSETS</b>		<b>378,161</b>	<b>382,952</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Current liabilities</b>			
Interest payable		419	-
Dividends payable		2,241	2,107
Accounts payable		13,886	19,035
Accrued liabilities		13,856	14,307
Income tax payable		143	849
Current portion of long-term debt		10,176	7,848
<b>Total current liabilities</b>		<b>40,721</b>	<b>44,146</b>
<b>Non-current liabilities</b>			
Long-term debt		28,778	27,580
Deferred income tax liabilities		1,188	4,249
Convertible debentures		34,382	30,614
Exchangeable interest liability	12.2	72,325	61,681
<b>Total non-current liabilities</b>		<b>136,673</b>	<b>124,124</b>
<b>Total liabilities</b>		<b>177,394</b>	<b>168,270</b>
<b>Equity</b>			
Share capital		397,522	398,166
Deficit		(244,568)	(232,312)
<b>Equity attributable to owners of the Corporation</b>		<b>152,954</b>	<b>165,854</b>
<b>Non-controlling interest</b>		<b>47,813</b>	<b>48,828</b>
<b>Total equity</b>		<b>200,767</b>	<b>214,682</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>378,161</b>	<b>382,952</b>

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Interim Consolidated Statements of Changes in Equity

(In thousands of U.S. dollars)

(Unaudited)

	Attributable to Owners of the Corporation			Non-controlling Interest	Total Equity
	Share Capital \$	Deficit \$	Total \$	\$	\$
<b>2016</b>					
Balance at January 1, 2016	398,166	(232,312)	165,854	48,828	214,682
Net income (loss) for the period	-	(5,786)	(5,786)	6,545	759
Dividends to owners of the Corporation	-	(6,470)	(6,470)	-	(6,470)
Distributions to non-controlling interest	-	-	-	(9,242)	(9,242)
Acquisition of Integrated Medical Delivery, L.L.C.	4	-	-	1,682	1,682
Purchase of common shares under normal course issuer bids	6	(644)	(644)	-	(644)
<b>Balance at March 31, 2016</b>	<b>397,522</b>	<b>(244,568)</b>	<b>152,954</b>	<b>47,813</b>	<b>200,767</b>
<b>2015</b>					
Balance at January 1, 2015	400,467	(252,110)	148,357	51,723	200,080
Net income for the period	-	11,257	11,257	7,532	18,789
Dividends to owners of the Corporation	-	(6,978)	(6,978)	-	(6,978)
Distributions to non-controlling interest	-	-	-	(10,434)	(10,434)
Purchase of common shares under normal course issuer bids	6	(160)	(160)	-	(160)
<b>Balance at March 31, 2015</b>	<b>400,307</b>	<b>(247,831)</b>	<b>152,476</b>	<b>48,821</b>	<b>201,297</b>

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Interim Consolidated Statements of Comprehensive Income  
(In thousands of U.S. dollars, except per share amounts)  
(Unaudited)

	Note	Three Months Ended March 31,	
		2016 \$	2015 \$
<b>Facility service revenue</b>		<b>75,945</b>	<b>72,245</b>
<b>Operating expenses</b>			
Salaries and benefits		22,076	19,158
Drugs and supplies		22,225	19,488
General and administrative expenses		11,748	11,324
Depreciation of property and equipment		2,150	2,348
Amortization of other intangibles		2,922	3,745
		<b>61,121</b>	<b>56,063</b>
<b>Income from operations</b>		<b>14,824</b>	<b>16,182</b>
<b>Finance costs</b>			
Increase (decrease) in value of convertible debentures		3,768	(3,030)
Increase (decrease) in value of exchangeable interest liability		10,644	(14,496)
Interest expense on exchangeable interest liability		2,590	2,748
Interest expense, net of interest income	8	737	749
Loss (gain) on foreign currency	9	(782)	3,641
		<b>16,957</b>	<b>(10,388)</b>
<b>Income (loss) before income taxes</b>		<b>(2,133)</b>	<b>26,570</b>
Income tax expense (recovery)	10	(2,863)	8,723
<b>Income for the period from continuing operations</b>		<b>730</b>	<b>17,847</b>
<b>Discontinued operation</b>			
Income for the period from discontinued operation, net of tax	5	29	942
<b>Net income for the period</b>		<b>759</b>	<b>18,789</b>
<b>Attributable to:</b>			
Owners of the Corporation		(5,786)	11,257
Non-controlling interest		6,545	7,532
		<b>759</b>	<b>18,789</b>
<b>Earnings (loss) per share</b>			
From continuing and discontinued operations			
Basic	11	\$ (0.19)	\$ 0.36
Fully diluted	11	\$ (0.19)	\$ 0.05
From continuing operations			
Basic	11	\$ (0.19)	\$ 0.34
Fully diluted	11	\$ (0.19)	\$ 0.04

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Interim Consolidated Statements of Cash Flows  
(In thousands of U.S. dollars)  
(Unaudited)

	Note	Three Months Ended March 31,	
		2016 \$	2015 \$
<b>Cash flows from operating activities</b>			
Net income for the period		759	18,789
Adjustments for:			
Depreciation of property and equipment		2,150	2,434
Amortization of other intangibles		2,922	3,900
Share of equity income in an associate		(35)	(127)
Change in value of convertible debentures		3,768	(3,030)
Change in value of exchangeable interest liability		10,644	(14,496)
Loss (gain) on foreign currency		(782)	3,641
Income tax expense (recovery)		(2,853)	8,811
Interest expense, net of interest income		3,327	3,533
		19,900	23,455
Changes in non-cash operating working capital	7	3,893	(498)
		23,793	22,957
Interest paid		(2,906)	(3,040)
Income and withholding taxes paid		(742)	(1,665)
<b>Net cash provided by operating activities</b>		<b>20,145</b>	<b>18,252</b>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment		(2,250)	(1,275)
Investment in Integrated Medical Delivery, L.L.C.	4	(1,738)	-
Redemption of short-term bank deposits		4,960	3,644
Redemption of long-term bank deposits		-	282
Collateral posted on foreign exchange forward contracts classified as restricted cash		-	(2,061)
<b>Net cash generated by investing activities</b>		<b>972</b>	<b>590</b>
<b>Cash flows from financing activities</b>			
Net proceeds from revolving credit facilities at the Centers		3,058	1,243
Repayments of notes payable at the Centers		(932)	(907)
Distributions, return of capital and loan receivable from an associate		27	117
Distributions to non-controlling interest		(9,242)	(10,434)
Dividends paid		(6,338)	(7,192)
Purchase of common shares under the terms of normal course issuer bids	6	(644)	(160)
<b>Net cash used in financing activities</b>		<b>(14,071)</b>	<b>(17,333)</b>
<b>Increase in cash and cash equivalents</b>		<b>7,046</b>	<b>1,509</b>
Effect of exchange rate fluctuations on cash balances held	9	782	(2,655)
Cash and cash equivalents, beginning of the period		57,969	41,309
<b>Cash and cash equivalents, end of the period</b>		<b>65,797</b>	<b>40,163</b>

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
For the three month ended March 31, 2016  
(Unaudited)

## 1. REPORTING ENTITY

Medical Facilities Corporation (the "Corporation") is a British Columbia corporation. The address of the Corporation's head office is 45 St. Clair Avenue West, Suite 200, Toronto, Ontario, Canada. The common shares of the Corporation are listed on the Toronto Stock Exchange under the ticker symbol "DR".

The Corporation's operations are based in the United States. Through its wholly-owned subsidiaries, the Corporation owns controlling interests in six limited liability entities, five of which own a specialty hospital or an ambulatory surgery center (the "Centers"). On June 30, 2015, Dakota Plains Surgical Center, LLP, the Corporation's 65% owned subsidiary, sold assets related to the operation of its specialty hospital (note 5). During the quarter the Corporation acquired a 51% controlling interest in Integrated Medical Delivery, L.L.C., a diversified healthcare service company that provides third-party business solutions to healthcare entities (note 4).

The Centers' and Integrated Medical Delivery, L.L.C.'s locations and the Corporation's ownership interest in each are as follows:

Centers	Location	Ownership Interest March 31,	
		2016	2015
Black Hills Surgical Hospital, LLP ("BHSB")	Rapid City, South Dakota	54.2%	54.2%
Sioux Falls Specialty Hospital, LLP ("SFSB")	Sioux Falls, South Dakota	51.0%	51.0%
Oklahoma Spine Hospital, LLC ("OSH")	Oklahoma City, Oklahoma	60.3%	58.8%
Arkansas Surgical Hospital, L.L.C. ("ASH")	North Little Rock, Arkansas	51.0%	51.0%
The Surgery Center of Newport Coast, LLC ("SCNC")	Newport Beach, California	51.0%	51.0%
<b>Other</b>			
Integrated Medical Delivery, L.L.C. ("IMD")	Oklahoma City, Oklahoma	51.0%	-

## 2. STATEMENT OF COMPLIANCE

These unaudited interim condensed consolidated financial statements ("consolidated financial statements") have been prepared in accordance with International Accounting Standard IAS 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB") using the accounting policies as described in the annual financial statements as at December 31, 2015 and presented in note 15 to these consolidated financial statements.

These consolidated financial statements were approved for issue by the Corporation's Board of Directors on May 11, 2016.

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
For the three months ended March 31, 2016  
(Unaudited)

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### 3. BASIS OF PREPARATION

These consolidated financial statements do not contain all of the disclosures that are required in annual financial statements prepared under International Financial Reporting Standards (“IFRS”) and should be read in conjunction with the Corporation’s audited consolidated financial statements for the year ended December 31, 2015, which include information necessary or useful to understand the Corporation’s business and financial statement presentation.

These consolidated financial statements are presented in United States dollars.

### 4. ACQUISITION OF INTEGRATED MEDICAL DELIVERY, L.L.C.

On January 14, 2016, the Corporation acquired a 51% controlling interest in Integrated Medical Delivery, L.L.C. (“IMD”) for a cash purchase price of \$1,750. IMD is a diversified healthcare service company located in Oklahoma City, Oklahoma that provides third-party business solutions to healthcare entities such as physician practices, facilities, and insurance companies. The transaction has been accounted for as a business combination with the Corporation consolidating 100% of the operations as at the acquisition date. The assets and liabilities of IMD are included in the consolidated financial statements.

The purchase price allocation as at March 31, 2016 is as follows:

	\$
Current assets, less current liabilities (including cash of \$12)	411
Property and equipment	337
Goodwill	4,082
Long-term debt	(1,398)
Non-controlling interest	(1,682)
<b>Fair value of net assets acquired</b>	<b>1,750</b>

The goodwill attributable to this acquisition includes the value of the workforce acquired, the benefit of future revenue growth and opportunities to expand within the marketplace.



# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
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## 5. DISCONTINUED OPERATION

On June 4, 2015, Dakota Plains Surgical Center, LLP (“DPSC”), the Corporation’s 65% owned subsidiary, entered into an asset purchase agreement to sell its assets related to the operation of its specialty hospital in Aberdeen, South Dakota, and to discharge any encumbrances related to the assets sold. The transaction was completed on June 30, 2015.

### 5.1 Results of discontinued operation

The comparative statement of comprehensive income has been re-presented to show the discontinued operation separately from continuing operations.

	Three Months Ended March 31,	
	2016 \$	2015 \$
Facility service revenue	65	3,334
Operating expenses	26	2,268
<b>Income from operations</b>	<b>39</b>	<b>1,066</b>
Finance costs	-	36
<b>Income before income taxes</b>	<b>39</b>	<b>1030</b>
Income tax expense	10	88
<b>Net income for the period from discontinued operation</b>	<b>29</b>	<b>942</b>

### 5.2 Cash flows from discontinued operation

	Three Months Ended March 31,	
	2016 \$	2015 \$
Net cash provided by (used in) operating activities	(57)	1,899
Net cash generated by investing activities	-	-
Net cash used in financing activities	(29)	(2,026)
<b>Net cash flow for the period</b>	<b>(86)</b>	<b>(127)</b>

## 6. NORMAL COURSE ISSUER BIDS FOR COMMON SHARES

The Corporation’s current normal course issuer bid for its common shares is in effect from May 15, 2015 to May 14, 2016. During the three-month period ended March 31, 2016, the Corporation purchased 67,500 of its common shares for a total consideration of \$644 from the open market. During the three-month period ended March 31, 2015, the Corporation purchased 12,100 of its common shares for a total consideration of \$160 under the previous normal course issuer bid.

The purchases under the bids are recorded in share capital. All common shares acquired under these bids were cancelled.

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

For the three months ended March 31, 2016

(Unaudited)

## 7. NET CHANGES IN NON-CASH WORKING CAPITAL

The net changes in non-cash working capital included in the statement of cash flows consist of the following:

	Three Months Ended March 31,	
	2016 \$	2015 \$
Accounts receivable	9,489	7,389
Supply inventory	326	(897)
Prepaid expenses and other	227	(149)
Accounts payable	(5,373)	(4,903)
Accrued liabilities	(776)	(1,938)
<b>Net changes in non-cash working capital</b>	<b>3,893</b>	<b>(498)</b>

## 8. INTEREST EXPENSE, NET OF INTEREST INCOME

Interest expense, net of interest income, from continuing operations included in the statement of comprehensive income consists of the following:

	Three Months Ended March 31,	
	2016 \$	2015 \$
Interest expense at Centers' level	287	296
Interest expense on convertible debentures	419	490
Amortization of available line of credit stand-by fees	59	77
Interest income at Centers' level	(4)	(62)
Interest income at corporate level	(24)	(52)
<b>Interest expense, net of interest income</b>	<b>737</b>	<b>749</b>

## 9. LOSS (GAIN) ON FOREIGN CURRENCY

Loss (gain) on foreign currency included in the statement of comprehensive income consists of the following:

	Three Months Ended March 31,	
	2016 \$	2015 \$
Unrealized loss on foreign exchange forward contracts	-	986
Realized loss on foreign exchange forward contracts which matured in the current period	-	1,567
Translation loss (gain) on cash balances denominated in Cdn\$	(782)	1,088
<b>Loss (gain) on foreign currency</b>	<b>(782)</b>	<b>3,641</b>

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

For the three months ended March 31, 2016

(Unaudited)

## 10. INCOME TAXES

Income taxes from continuing operations reported in these consolidated financial statements are as follows:

	Three Months Ended March 31,	
	2016 \$	2015 \$
<b>Provision for Income Taxes</b>		
Current	36	(21)
Deferred	(2,899)	8,744
<b>Income tax expense (recovery)</b>	<b>(2,863)</b>	<b>8,723</b>

## 11. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share attributable to owners of the Corporation are calculated as follows:

	Three Months Ended March 31,			Three Months Ended March 31,		
	2016			2015		
	Continuing Operations	Discontinued Operation	Total	Continuing Operations	Discontinued Operation	Total
Net income (loss) for the period attributable to owners of the Corporation	\$ (5,805)	19	(5,786)	10,729	528	11,257
Divided by weighted average number of common shares outstanding for the period	31,062,593	31,062,593	31,062,593	31,328,519	31,328,519	31,328,519
<b>Basic earnings (loss) per share attributable to owners of the Corporation</b>	<b>\$ (0.19)</b>	<b>0.00</b>	<b>(0.19)</b>	<b>0.34</b>	<b>0.02</b>	<b>0.36</b>

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
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(Unaudited)

## 11. EARNINGS (LOSS) PER SHARE (Continued)

Fully diluted earnings (loss) per share attributable to owners of the Corporation are calculated as follows:

	Three Months Ended March 31,			Three Months Ended March 31,		
	2016			2015		
	Continuing Operations	Discontinued Operation	Total	Continuing Operations	Discontinued Operation	Total
Net income (loss) for the period attributable to owners of the Corporation	\$ (5,805)	19	(5,786)	10,729	528	11,257
Change in value of convertible debentures	-	-	-	(3,030)	-	(3,030)
Interest saved by converting debentures (tax effected)	-	-	-	360	-	360
Change in value of exchangeable interest liability (tax effected)	-	-	-	(9,278)	-	(9,278)
Interest expense on exchangeable interest liability	-	-	-	2,748	-	2,748
Modified net income (loss) for the period attributable to owners of the Corporation	\$ (5,805)	19	(5,786)	1,529	528	2,057
Divided by weighted average number of common shares:						
Outstanding for the period	31,062,593	31,062,593	31,062,593	31,328,519	31,328,219	31,328,519
Deemed to be issued on the conversion of the outstanding convertible debentures	-	-	-	2,186,603	2,186,603	2,186,603
Deemed to be issued on the exchange of the outstanding exchangeable interest liability	-	-	-	5,828,252	5,828,252	5,828,252
Weighted average number of common shares	31,062,593	31,062,593	31,062,593	39,343,374	39,343,374	39,343,374
<b>Fully diluted earnings (loss) per share</b>	<b>\$ (0.19)</b>	<b>(0.00)</b>	<b>(0.19)</b>	<b>0.04</b>	<b>0.01</b>	<b>0.05</b>

## 12. FINANCIAL INSTRUMENTS

### 12.1 Fair values and classification of financial instruments

The fair values of the convertible debentures and exchangeable interest liability are determined based on the closing trading price of the securities at each reporting period. The fair values of notes payable and revolving credit facilities at the Centers' level approximate their book values as the interest rates are similar to prevailing market rates. The fair values of all other financial instruments of the Corporation, due to the short-term nature of these instruments, approximate their book values.

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
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## 12. FINANCIAL INSTRUMENTS (Continued)

The following table presents the carrying values and classification of the Corporation's financial instruments as at March 31, 2016 and December 31, 2015:

	March 31, 2016 \$	December 31, 2015 \$
<b>Financial assets</b>		
Fair value through profit or loss		
Cash and cash equivalents	65,797	57,969
Short-term investments	-	3,496
Held-to-maturity (carried at amortized cost)		
Short-term investments	8,015	9,479
Loans and receivable (carried at amortized cost)		
Accounts receivable	40,059	48,754
Other assets	847	839
<b>Financial liabilities</b>		
Fair value through profit or loss		
Convertible debentures	34,382	30,614
Exchangeable interest liability	72,325	61,681
Other liabilities (carried at amortized cost)		
Dividends payable	2,241	2,107
Accounts payable	13,886	19,035
Accrued liabilities	13,856	14,307
Long-term debt	38,954	35,428

The financial instruments of the Corporation that are recorded at fair value have been classified into levels using a fair value hierarchy (note 15.17). The following tables represent the fair value hierarchy of the Corporation's financial instruments that were recognized at fair value as of March 31, 2016 and December 31, 2015. It does not include fair value information for financial instruments not measured at fair value if the carrying amount is a reasonable approximation of fair value.

	March 31, 2016			
	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
<b>Financial assets</b>				
Cash and cash equivalents	65,797	-	-	65,797
<b>Financial liabilities</b>				
Convertible debentures	34,382	-	-	34,382
Exchangeable interest liability	-	72,325	-	72,325
<b>Total</b>	<b>65,831</b>	<b>72,325</b>	<b>-</b>	<b>138,156</b>

	December 31, 2015			
	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
<b>Financial assets</b>				
Cash and cash equivalents	57,969	-	-	57,969
Short-term investments	3,496	-	-	3,496
<b>Financial liabilities</b>				
Convertible debentures	30,614	-	-	30,614
Exchangeable interest liability	-	61,681	-	61,681
<b>Total</b>	<b>92,079</b>	<b>61,681</b>	<b>-</b>	<b>153,760</b>

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
For the three months ended March 31, 2016  
(Unaudited)

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## 12. FINANCIAL INSTRUMENTS (Continued)

### 12.2 Measurement of fair values

The following is the valuation technique used in measuring Level 2 fair values (the Corporation does not have any Level 3 fair values).

<b>Financial Instrument</b>	<b>Valuation Technique</b>
Exchangeable interest liability	<i>Market comparison technique:</i> The number of the Corporation's common shares to issue is based on the contractual agreements with the holders of non-controlling interest that have exchange agreements with the Corporation and take into account the distributions to the non-controlling interest over the prior twelve months. The liability is valued based on the market price of the Corporation's common shares converted to the reporting currency as of the reporting date.

## 13. RELATED PARTY TRANSACTIONS AND BALANCES

The Centers routinely enter into transactions with certain related parties. These parties are considered related through common ownership by the holders of the non-controlling interest in the respective Centers. Such transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed by the related parties.

The expenses (primarily general and administrative) resulting from the Centers' transactions with related parties were \$2,435 for the three months ended March 31, 2016, and \$4,892 for the three months ended March 31, 2015.

The amounts payable to related parties, included in the Centers' accounts payable, as of March 31, 2016 were \$636 and as of December 31, 2015 were \$875.

Certain of the physicians, who indirectly own the non-controlling interest in each of the Centers, routinely provide professional services directly to patients utilizing the facilities of the Centers and reimburse the Centers for the space and staff utilized. Also, certain of the physicians serve on the boards of management of the Centers and two such individuals perform the duties of Medical Director at the respective Centers and are compensated in recognition of their contribution to the Centers. Also, a physician with a non-controlling interest in SFSH is its Chief Executive Officer.

### 13.1 Other transactions

The Corporation owns a 34.2% equity interest in an associate. The Corporation has significant influence over the associate because of its equity position and it has representation on the board of the associate. The investment in and loan receivable from the associate as of March 31, 2016 were \$405 and \$101, respectively (December 31, 2015: \$391 and \$107, respectively). The Corporation also has a 0.35% ownership interest in an entity that holds indirect interest in BSHS for a total investment of \$341 (December 31, 2015: \$341), for which the investment is accounted for at cost in the consolidated financial statements. Together, the two investments comprise the 'Other assets' on the consolidated balance sheet.

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## 14. COMMITMENTS AND CONTINGENCIES

### 14.1 Commitments

In the normal course of operations, the Centers lease certain equipment under non-cancellable long-term leases and enter into various commitments with third parties. In addition, certain of the Centers lease their facility space from related and non-related parties.

### 14.2 Contingencies

In the normal course of business, the Centers are, from time to time, subject to allegations that may result in litigation. Certain allegations may not be covered by the Centers' commercial and liability insurance. The Centers evaluate such allegations by conducting investigations to determine the validity of each potential claim. Based on the advice of the legal counsel, management records an estimate of the amount of the ultimate expected loss for each of these matters. Events could occur that would cause the estimate of the ultimate loss to differ materially from the amounts recorded.

In 2012, ASH recorded an accrued liability of approximately \$780 for the estimated cost of surgeries to replace a recalled hip implant product ("revision surgeries"). ASH has received denials from third-party payors for the revision surgeries performed and anticipates having to perform additional revision surgeries that will result in no reimbursement. As at March 31, 2016, this accrued liability had decreased to \$505 (December 31, 2015: \$533).

## 15. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by the Centers.

### 15.1 Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair value (note 15.15).

### 15.2 Functional and presentation currency

The Corporation's consolidated financial statements are reported in U.S. dollars which is its functional and presentation currency. All financial information presented in U.S. dollars has been rounded to the nearest thousand, unless otherwise indicated.

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Corporation translates monetary assets and liabilities denominated in Canadian dollars, principally its convertible debentures, exchangeable interest liability and certain of its cash balances, which are all denominated in Canadian dollars, at exchange rates in effect at the reporting date. Non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations were incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses, including translation adjustments, are included in the determination of net income.

### 15.3 Basis of consolidation

Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation (a) has the power over the entity, (b) is exposed, or has rights, to variable returns from its involvement with the entity, and (c) has the ability to use its power to affect its returns. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Non-controlling interest represents the portion of a subsidiary's net earnings and net assets that are attributable to shares of such subsidiary not held by the Corporation. The non-controlling interest in the equity of the Corporation's subsidiaries is included as a separate component of equity.

All intra-company balances and transactions have been eliminated in preparing these consolidated financial statements. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Corporation.

### 15.4 Business combinations

Business combinations are accounted for using the acquisition method as of the date when control is transferred to the Corporation. The Corporation measures goodwill as the excess of the sum of the fair value of the consideration transferred over the net identifiable assets acquired and liabilities assumed, all measured as at the acquisition date. Transaction costs that the Corporation incurs in connection with a business combination, other than those associated with the issue of debt or equity securities, are expensed as incurred.

Any contingent consideration is measured at fair value at the date of acquisition. If an obligation to pay contingent consideration that meets the definition of a financial instrument is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognized in net income.

At the date of the acquisition, the non-controlling interest is measured at the non-controlling interest's proportionate share of the fair value of identifiable assets of the acquiree. Contingent consideration in respect of those acquisitions, accounted for as exchangeable interest liability, is recorded on the balance sheet with periodic changes in fair value of that liability reflected in net income.



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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 15.5 Segment information

The operations and productive capacity of the Centers revolve around the provision of surgical procedures. Each Center is organized as an individual entity and separate financial statements are prepared for each entity. The chief operating decision makers of the Corporation, being the Chief Executive Officer and the Chief Financial Officer, regularly review performance of each individual Center to make decisions about resources to be allocated to each Center and assess their performance. Therefore, each Center represents an operating segment as defined by IFRS 8 *Operating Segments*.

Management of the Corporation has concluded that the operating segments of the Corporation meet the criteria for aggregation pursuant to IFRS 8, paragraph 12 and, therefore, discloses a single reportable segment. In forming its conclusion about the aggregation of the Centers, management of the Corporation evaluated the long-term economic characteristics of each Center, the comparative nature of the Centers' operations, and the level of regulation of each Center.

The service delivered by each Center and the patients who use those services are similar. The vast majority of patients are insured through private insurance or government insurance programs (i.e., Medicaid or Medicare), which allows for a wide group of patients electing to have their procedures performed at one of the Centers. The Centers principally provide surgical facilities, support staff and pre- and post-surgical care related to surgeries. Finally, the Centers have similar economic characteristics, which management defines as comparable long-term operating margins, recognizing differences between the Centers in payor mix, surgical specialties and local healthcare markets.

### 15.6 Discontinued operations

A discontinued operation is a component of the Corporation's business which can be clearly distinguished from the rest of the Corporation, both operationally and for financial reporting purposes. Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held for sale. When an operation is classified as a discontinued operation, the comparative statements of comprehensive income are re-presented as if the operation has been discontinued from the start of the comparative year. Discontinued operations are excluded from the results of continuing operations and are presented as a single amount net of tax as net income from discontinued operations in the statement of comprehensive income.

### 15.7 Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and all liquid investments purchased with a maturity of three months or less from the purchase date and which can be redeemed by the Corporation.

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 15.8 Short-term and long-term investments

Investments represent liquid investments purchased with a maturity of three months or more. Investments with maturities of more than three months but less than twelve months are classified as short-term and investments with maturities of twelve months or more are classified as long-term. The Corporation limits its exposure to credit risk through application of its investment policy. The policy permits investment of its cash and cash equivalents and short-term and long-term investments in (i) liquid securities issued or guaranteed by the Governments of Canada and the United States of America, or political subdivisions thereof and with (ii) certain Canadian chartered banks or banks regulated by the United States of America as listed in the policy. The carrying amount of investments represents the Corporation's maximum exposure to credit risk for such investments.

### 15.9 Accounts receivable

Accounts receivable are recorded at the time services are rendered at the amounts estimated to be recoverable from third-party payors and patients, by applying the following policies:

- (i) Amounts billed are reduced by an allowance for third-party payor adjustments which are maintained at a level management believes reflects the estimated adjustments that will be applied upon collection of the amounts billed. The allowance is established using the third-party payor contracts effective at period end and/or based on historical payment rates.
- (ii) An allowance for non-collectible receivable balances is recognized at a level management believes is adequate to absorb probable losses. Management determines the adequacy of the allowance based on historical data, current economic conditions, and other pertinent factors for the respective Center. Patient receivables are written off as non-collectible when all reasonable collection efforts have been exhausted.

Payments from third-party payors are generally received within 60 days of the billing date. However, accounts involving non-contracted payment sources, such as auto and general liability insurance, are subject to recovery efforts, including rebilling and insurance litigation, until they are collected or considered not collectible. Residual amounts due from patients, such as co-payments and deductibles, are considered past due 30 days after receiving payment from third-party payors.

### 15.10 Supply inventory

Supply inventory consists of medical supplies, including implants and pharmaceuticals. It is stated at the lower of cost or net realizable value, using the first-in, first-out valuation method.

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 15.11 Property and equipment

Property and equipment are stated at cost less accumulated depreciation. Cost includes expenditures that are directly attributable to the acquisition of the asset.

Depreciation of property and equipment is computed using the straight-line and declining balance methods over the estimated useful lives of the assets. Assets under finance leases are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Centers will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of property and equipment are as follows:

Building and improvements	3-40 years
Equipment and furniture	3-20 years

Leases that substantially transfer the risk and benefits of ownership are capitalized with the cost included in property and equipment and the related liability recorded in long-term debt.

Depreciation methods, useful lives and residual values are reviewed on an annual basis.

### 15.12 Goodwill

Goodwill arises on the acquisition of subsidiaries and represents the excess of cost over the fair value of identifiable net assets acquired. For business acquisitions occurring after the date of transition to IFRS (January 1, 2010), goodwill is also recognized on non-controlling interest. Goodwill is stated at cost less accumulated impairment losses. Goodwill is not amortized but is reviewed at least annually for impairment and when events or changes in circumstances indicate that the carrying amount may not be recoverable.

### 15.13 Other intangibles

Other intangibles are recognized only when it is probable that the expected future economic benefits attributable to the assets will be realized by the Corporation and the cost can be reliably measured. Other intangibles represent the value of the hospital operating licenses, medical charts and records, referral sources and trade names. Other intangibles are stated at cost less accumulated amortization and accumulated impairment losses, when applicable.

Upon recognition of an intangible asset, the Corporation determines if the asset has a definite or indefinite life. In making the determination, the Corporation considers the expected use, expiry of agreements, nature of assets, and whether the value of the assets decreases over time.

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Amortization is recognized on a straight-line basis over the estimated useful lives of other intangibles, other than trade names, from the date they are available for use. The estimated useful lives of other intangibles are as follows:

Hospital operating licenses	5 years
Medical charts and records	5-10 years
Referral sources	10-15 years

Trade names represent the value assigned to the reputation of the hospitals and their standing in the business and local community which allow them to earn higher than average returns. Trade names are not amortized as there is no foreseeable limit to the period over which trade names are expected to generate cash inflows for the Corporation.

### 15.14 Impairment of non-financial assets

Non-financial assets that have an indefinite useful life, such as goodwill and trade names, are tested at least annually for impairment and when events or changes in circumstances indicate that the carrying amount may not be recoverable. Non-financial assets that have a definite useful life which are subject to amortization are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

For the purposes of assessing impairment, assets are grouped at the cash generating unit ("CGU") level, which is the lowest level for which there are separately identifiable cash flows. Management considers each Center as a CGU.

An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to dispose and value in use. Value in use is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognized in net income. It is allocated first to reduce the carrying amount of any goodwill allocated to the respective Center and, then, to reduce the carrying amount of the other assets of the respective Center on a pro rata basis.

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 15.15 Financial assets and liabilities

The Corporation initially recognizes financial assets on the date that they originate or on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument. The Corporation derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. The Corporation assesses financial assets for impairment at each reporting date.

The Corporation initially recognizes financial liabilities on the date that they originate or on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument. The Corporation derecognizes a financial liability when its contractual obligations are discharged, cancelled, or expire.

All financial assets and liabilities are initially recorded at fair value and designated into one of the following categories:

(i) Fair value through profit or loss ("FVTPL")

Cash and cash equivalents, certain short-term investments, foreign exchange forward contracts, convertible debentures and exchangeable interest liability are designated as FVTPL and are carried at fair value with unrealized gains or losses recognized through net income.

(ii) Held-to-maturity

Certain short-term and long-term investments are designated as held-to-maturity and are carried at amortized cost using the effective interest rate method.

(iii) Loans and receivables

Accounts receivable and other assets are designated as loans and receivables and are carried at amortized cost using the effective interest rate method.

(iv) Other liabilities

Interest payable, dividends payable, accounts payable, accrued liabilities and long-term debt are designated as other liabilities and are carried at amortized cost using the effective interest rate method.

### 15.16 Impairment of non-derivative financial assets

Financial assets not designated as FVTPL, including interest in an equity-accounted investee, are assessed at each reporting date to determine whether there is objective evidence of impairment.

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 15.16.1 Financial assets measured at amortized cost

The Corporation considers evidence of impairment for financial assets measured at amortized cost on both an individual and collective basis. In assessing impairment, the Corporation uses historical information on the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that actual losses are likely to be greater or lesser than suggested by historical trends.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in net income and reflected in an allowance account. If the amount of an impairment loss subsequently decreases, then the amount is reversed through net income.

### 15.16.2 Equity-accounted investee

An impairment loss in respect of an equity-accounted investee is measured by comparing the recoverable amount of the investment with its carrying amount. An impairment loss is recognized in net income and is reversed if there has been a favourable change in the estimates used to calculate that recoverable amount.

## 15.17 Measurements of fair value

A number of the Corporation's accounting policies and disclosures require the measurement of fair value for both financial and non-financial assets and liabilities.

The Corporation has an established control framework with respect to the measurement of fair values. The valuation of all fair value measurements is overseen directly by the Chief Financial Officer. Management of the Corporation regularly reviews significant unobservable inputs and valuation adjustments. If third-party information, such as broker quotes or pricing services, is used to measure fair values, then management assesses the evidence obtained from these sources to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

When measuring the fair value of an asset or a liability, the Corporation uses observable market data to the extent possible. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation technique as follows:

Level 1 – unadjusted quoted prices available in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or liability fall into different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. The Corporation recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

### 15.18 Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured at the estimated expenditures required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation. Provisions are discounted to their present values where the time value of money is material. All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

### 15.19 Convertible debentures

The Corporation's convertible debentures are convertible into a fixed number of common shares at the option of the holder. The number of common shares to be issued does not vary with changes in the market value of the convertible debentures.

The convertible debentures are denominated in Canadian dollars while the Corporation's functional currency is U.S. dollars, which requires the Corporation to deliver a variable amount of cash to settle the obligation. Because the conversion option requires the Corporation to deliver a fixed number of common shares to settle a variable liability, the convertible debentures are considered hybrid financial instruments. The Corporation elected to account for the convertible debentures as financial liability measured at FVTPL. The changes in the recorded amounts of the liability, resulting from the changes in the fair value of the convertible debentures and fluctuations in foreign exchange rates between the periods, are reflected in net income.

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 15.20 Exchangeable interest liability

Exchangeable interest liability represents an estimated liability for the remaining portion of the interest in the Centers held by the non-controlling interest which can be exchanged, subject to certain restrictions, for common shares of the Corporation. The exchangeable interest liability has been designated as FVTPL and accordingly is re-measured at the end of each reporting period taking into account (i) the calculated amount of common shares potentially issuable for the remaining portion of the exchangeable interest in the Centers held by the non-controlling interest, (ii) the market value of common shares, and (iii) the exchange rate between Canadian and U.S. dollars at the end of the reporting period. The change in value of the exchangeable interest liability is included in net income for the respective periods.

### 15.21 Facility service revenue

Facility service revenue consists of the actual amounts received and the estimated net realizable amounts receivable from patients and third-party payors. Facility service revenue is derived from the provision of the facilities and ancillary services for the performance of scheduled (as opposed to emergency) surgical, imaging, and diagnostic procedures. The Centers bill either their patients or the patients' third-party payors as of the date of service upon completion of the procedure. Facilities service revenue is recognized as of the date of the service when the recovery of consideration is probable and the Corporation is satisfied with the performance objectives.

A small amount of facility service revenue is received directly from self-paying patients while the majority of facility service revenue is received from third-party payors that provide insurance and coverage to patients. Each Center has agreements with third-party payors that provide for payments at amounts different from the Center's established rates. Payment arrangements include pre-determined rates per diagnosis, reimbursed costs, discounted charges, and per diem payments. As a result of established agreements with third-party payors, settlements under reimbursement arrangements are determined with a high degree of accuracy and are accrued on an estimated basis in the period the services are rendered, and are adjusted in future periods, as final settlements are determined. Differences between the estimated amounts accrued and interim and final settlements are reported in operations in the period of settlement. Revenues relating to IMD's third party business solution service are included in facility service revenue, and consist of fees for business services provided to healthcare entities, recorded as services are provided and collection is reasonably assured.

### 15.22 Income taxes

Income tax expense (recovery) consists of current and deferred taxes. Income tax expense (recovery) is recognized in the statement of comprehensive income except to the extent that it relates to a business combination or items recognized directly in equity, in which case it is recognized in equity or in other comprehensive income.



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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

The Corporation calculates deferred income taxes using the asset and liability method on temporary differences between the carrying amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are calculated, without discounting, at tax rates that are expected to apply to their respective period of realization, provided they are enacted or substantively enacted at the end of the reporting period. The effect on tax assets and liabilities of a change in tax rates is recognized in net income in the period that includes the date of enactment or substantive enactment.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. Deferred tax liabilities are always recognized in full. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Corporation intends to settle its current tax assets and liabilities on a net basis. Deferred tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of temporary differences is controlled by the Corporation and it is probable that the temporary differences will not reverse in the foreseeable future.

### 15.23 New and revised IFRS not yet adopted

The Corporation has not applied the following new and revised IFRS that have been issued but are not yet effective:

#### 15.23.1 IAS 7 *Statement of Cash Flows*

As part of their disclosure initiative, the IASB has issued amendments to IAS 7 *Statement of Cash Flows* requiring a reconciliation of liabilities arising from financing activities to enable users of the financial statements to evaluate both cash flow and non-cash changes in the net debt of a company. The Corporation intends to adopt the amendments to IAS 7 in its consolidated financial statements for the annual period beginning January 1, 2017. The extent of the impact of adoption of the amendments has not yet been determined.

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## 15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 15.23.2 IAS 12 *Income Taxes*

In January 2016, the IASB has issued amendments to IAS 12 *Income Taxes* to provide clarification on the requirements relating to the recognition of deferred tax assets for unrealized losses on debt instruments measured at fair value. The Corporation intends to adopt the amendments to IAS 12 in its consolidated financial statements for the annual period beginning January 1, 2017. The extent of the impact of adoption of the amendments has not yet been determined.

### 15.23.3 IFRS 9 *Financial Instruments*

In July 2014, the IASB issued the complete IFRS 9 *Financial Instruments* ("IFRS 9 (2014)"). The mandatory effective date of IFRS 9 (2014) is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The Corporation intends to adopt IFRS 9 (2014) in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

### 15.23.4 IFRS 15 *Revenue from Contracts with Customers*

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers* which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 11 *Construction Contracts*, IAS 18 *Revenue*, and the related Interpretations when it becomes effective. The new standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Corporation intends to adopt IFRS 15 in its consolidated financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

### 15.23.5 IFRS 16 *Leases*

In January 2016, the IASB issued IFRS 16 *Leases*, which provides guidance for leases whereby lessees will recognize a liability for the present value of future lease liabilities and record a corresponding right of use asset on the balance sheet. There are minimal changes to lessor accounting. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted, provided IFRS 15 *Revenue from Contracts with Customers* has been adopted. The Corporation intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.