

2015 Annual Report



**Business. Needs. People.**



## Chair's message to shareholders

2015 was a good year for Morneau Shepell. The Company continued on its steady path of solid business results and resilient operating performance. It also witnessed a number of changes at the Board level — changes that we are confident will lead us to further success within the evolving human resources industry.

In October 2015, I was honoured to be appointed Chair of the Board of Morneau Shepell, after serving as a Director of the Company for seven years. Succeeding Executive Chair Bill Morneau, who made significant and lasting contributions to the Company, is a formidable undertaking, but it is one that I am excited to take on.

The Board also recently welcomed three new members. Kevin Pennington, who joined in early 2015, is the Chief Human Resources Officer of Fiserv, Inc., and has held senior executive and human resources positions in both Canada and the United States. Dale R. Ponder, who joined in early 2016, is the National Managing Partner and Chief Executive of Osler, Hoskin & Harcourt LLP, and has extensive experience leading transactions relating to public and private merger and acquisition matters and advising boards of public companies. Ron Lalonde, who also joined in early 2016, currently serves as a director of several companies, and prior to his retirement in 2010, held the roles of Senior Executive Vice President, Technology and Operations and Chief Administrative Officer of CIBC.

On behalf of the Board, I would like to thank Robert Chisholm for his 10 years of service on the Board. His contribution to Morneau Shepell during a period of change and growth was invaluable, and we'll miss his guidance.

I am pleased to be given the opportunity to work with our President and CEO, Alan Torrie. I am also confident in the commitment, expertise and experience of the Company's executive team and 4,000 employees, who ensure that Morneau Shepell is able to deliver on its objective of profitable growth.

In 2016 Morneau Shepell celebrates its 50th year of business. Frank Morneau started W.F. Morneau and Associates in 1966 with a vision — that small- and medium-sized businesses could pool their resources to create purchasing power for their employees' health and benefits programs. At the time, these programs were largely only affordable by the largest organizations. Since then, Morneau Shepell has evolved into a company that helps all types of organizations build programs that increase the financial security, health and productivity of their employees. Much has changed in how we do this — technology is now fundamental to how we help our clients manage their programs — but we're proud that we've maintained this same vision of helping organizations and their employees for the past 50 years, and we're committed to expanding this vision further in the future.

In closing, on behalf of the Board of Directors, I'd like to thank our shareholders, clients, employees and partners for their support in 2015. We are excited about the future of Morneau Shepell, and we are confident that under the leadership of the executive team we will chart the course for the next 50 years.



**Jill Denham**

Chair of the Board

# President and CEO's message to shareholders

## Building on our success; laying the foundation for the future

2015 demonstrated the continued ability of Morneau Shepell to deliver consistent, profitable growth while moving forward with strategies that will sustain our long track record of success. With the objective of building on the exceptional revenue growth of 2014, the Company was able to successfully navigate the challenging economic conditions and make continued progress against our financial goals.

- Revenue for the year reached \$567.3 million, increasing by \$31.4 million, or 5.9 per cent compared to the previous year.
- Organic revenue increased by 6.0 per cent compared to 2014 as a result of delivering growth across each of the four core lines of business.
- We delivered another year of record adjusted EBITDA, increasing in 2015 by \$6.9 million to \$105.8 million.
- We continued to achieve exceptionally high recurring revenues of 98 per cent.

We attribute this success in 2015 to a number of factors, but primarily to an unwavering commitment to our corporate strategic plan. We developed this plan to ensure that while reaching our short- and mid-term targets, we also lay the foundation to reach our longer-term goals.

The plan focuses on the business through three complementary lenses — lenses that each sharpen our vision of the business from different perspectives.

### Lens 1: Current performance and laying the foundation

This lens focuses on performance in the current and upcoming year, and emphasizes the key attributes that will continue to be critical in future years. These attributes are:

- **Continued positive client satisfaction levels.** Our annual survey found that nine out of 10 clients were very satisfied with us overall. We believe these satisfaction levels are at the root of our ability to maintain such high recurring revenues.
- **Strong brand recognition.** Our 2015 survey found that our brand recognition in Canada is healthy and improving. This is an ongoing priority for the Company, but we also recognize an opportunity to ensure that all of our clients better understand the full scope of our capabilities, which will provide new opportunities for deeper relationships across a broader suite of our services.
- **Robust pipeline.** Development of a strong sales pipeline in each of our lines of business has positioned us well to meet our 2016 targets (and beyond). Implementing a cross line of business development strategy to take advantage of our broad client base has also bolstered our sales pipeline.

- **Successful acquisition strategy.** We completed the purchase of Ceridian's U.S. health and welfare administration business, and we also acquired Bensinger, DuPont & Associates, a well-regarded provider of employee and family assistance services in the U.S. These acquisitions support our continuing U.S. expansion strategy and also position us for success in international markets.
- **Positive community involvement.** Morneau Shepell entered into a partnership with the Canadian Olympic Committee as its official Mental Health Partner and a Founding Partner of Game Plan, a program that supports athletes in their transition to the workplace. We've launched a number of programs designed to support the mental health of Canadian athletes and their support teams. It's an exciting opportunity and reinforces our leadership in providing mental health support services in the workplace.

## Lens 2: Stimulating progress for tomorrow

While executing against our 2015 targets and solidifying our sales pipeline for 2016, the Company also made significant progress in positioning Morneau Shepell for future growth. As our clients' needs evolve, we are expanding our capabilities in a number of areas through strategic investment:

- **Geographic expansion.** Morneau Shepell continues to view the U.S. market as a significant opportunity in the longer term, notably building on our existing presence in the pension and health plan technology and administration spaces. We are also focused on expanding globally, leveraging our international EFAP presence.
- **Adjacent services.** We are continually evaluating ways to better serve our clients through new services to meet their evolving needs. We are investing in innovative services and technologies that give our clients more powerful tools to evaluate, manage and improve the health and productivity of their people.
- **Client expansion.** Government and other public sector organizations represent a significant growth opportunity across all our markets for the long term. We are also exploring the relatively untapped potential in small- and mid-sized businesses.

## Lens 3: Seeding growth for the long term

The dynamic, increasingly globalized human resources services sector that Morneau Shepell operates within is being transformed by a number of complex factors.

Planning beyond the immediate horizon and identifying the key trends with the potential to transform client needs and our business is an important part of our long-term industry leadership.

Through our strategic planning process, we have identified the trends that have the potential to significantly reshape our business, and where we believe investment and innovation will yield positive results.

Trends such as the evolution of big data and predictive analytics, growth in the use of mobile technology to monitor and manage health, changes in the makeup, shape and relationship between employee and employer in the workplace, and the potential of the transfer of accountability and risk by employers to employees, all continue to be a part of our Lens 3 look into the future.

## Maintaining a consistent focus on our priorities

As we evaluate opportunities and take action across each of the three lenses of our strategy, we remain focused on the following priorities that have consistently guided who we are as a company.

- **Growth and performance.** Sustaining or exceeding our historical organic growth of 6 to 8 per cent, supplemented by tuck-in acquisitions, while achieving strong margins.
- **Clients.** Building a strong brand presence with our target audience, and being their provider of choice by delivering a unique and integrative client experience.
- **People.** Being an employer of choice and developing the leadership capacity within our talent pool to deliver our long-term strategies.
- **Shareholder value.** Aligning our capital structure and investments to keep the business strong while sustaining our dividend strategy.

These priorities continue to be those by which we measure our success as an organization. By balancing the needs of all our stakeholders — our clients who entrust us with their business, our shareholders who invest in us, our people who dedicate themselves to their work, and our communities where we live and work — we will continue to succeed in the future.

In closing, I would like to extend my appreciation and gratitude to everyone involved in making our business a success year after year: our employees, clients, business partners, Board of Directors and shareholders.

We thank you for your continued support and guidance and look forward to continuing our relationship with you in future.



**Alan Torrie**

President and CEO

# Management's Discussion and Analysis

# MORNEAU SHEPELL MANAGEMENT'S DISCUSSION AND ANALYSIS

*FOR THE YEAR ENDED DECEMBER 31, 2015*

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

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Morneau Shepell Inc. ("Morneau Shepell" or the "Company") was incorporated pursuant to the laws of the Province of Ontario on October 19, 2010, and as of January 1, 2011, is the successor to Morneau Sobeco Income Fund (the "Fund").

This Management's Discussion and Analysis ("MD&A") covers the year ended December 31, 2015 and should be read in conjunction with the consolidated financial statements of Morneau Shepell and notes thereto for the years ended December 31, 2015 and 2014. Unless otherwise noted, all financial information presented has been rounded to the nearest thousand.

All financial information is presented in Canadian dollars and in accordance with International Financial Reporting Standards ("IFRS"), unless otherwise noted. Certain totals, subtotals and percentages may not reconcile due to rounding.

This MD&A contains "forward-looking statements" within the meaning of applicable securities laws, such as statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts. They are based on certain factors and assumptions, including expected growth, results of operations, business prospects and opportunities. Use of words such as "may", "will", "expect", "believe", or other words of similar effect may indicate a "forward-looking" statement. These statements are not guarantees of future performance and are subject to numerous risks and uncertainties, including those described in our publicly filed documents (available on SEDAR at [www.sedar.com](http://www.sedar.com)) and in this MD&A under the heading "Risks and Uncertainties". Those risks and uncertainties include the ability to maintain profitability and manage growth, ability to pay dividends, reliance on information systems and technology, reputational risk, dependence on key clients, reliance on key professionals and general economic conditions. Many of these risks and uncertainties can affect our actual results and could cause our actual results to differ materially from those expressed or implied in any forward-looking statement made by us or on our behalf. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. All forward-looking statements in this MD&A are qualified by these cautionary statements. These statements are made as of the date of this MD&A and, except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. Additionally, we undertake no obligation to comment on analyses, expectations or statements made by third parties in respect of us, our financial or operating results or our securities.

To assist investors in assessing our financial performance, this discussion also makes reference to certain non-IFRS measures such as EBITDA, adjusted EBITDA, EBITDA margin, adjusted EBITDA margin, Free Cash Flow, Normalized Free Cash Flow, twelve-month rolling Normalized Payout Ratio, and twelve-month rolling Normalized Payout Ratio including changes in adjusted non-cash operating working capital. EBITDA and adjusted EBITDA are intended to represent an indication of Morneau Shepell's capacity to generate profit from operations before taking into account management's financing decisions and costs of consuming tangible capital assets and intangible assets, which vary according to their vintage, technological currency, and management's estimate of their useful life. Accordingly, EBITDA comprises profit before finance costs, income tax expenses, depreciation and amortization, while Adjusted EBITDA represents EBITDA before taking into account certain unusual expenditures. EBITDA margin represents EBITDA as a percentage of revenue, and Adjusted EBITDA margin represents Adjusted EBITDA as a percentage of revenue. We believe both EBITDA and Adjusted EBITDA are useful measures in evaluating our performance. We utilize them to monitor compliance with debt covenants and to make decisions related to dividends to shareholders rather than profit due to the significant amount of amortization expense related to our intangible assets acquired from acquisitions. We also believe that Free Cash Flow, Normalized Free Cash Flow, Normalized Payout Ratio, the twelve-month rolling Normalized Payout Ratio, and the twelve-month rolling Normalized Payout Ratio

including changes in adjusted non-cash operating working capital, are useful supplemental measures of Morneau Shepell's ability to generate cash after deducting capital expenditures required to maintain or expand the business. We also utilize them to make decisions related to dividends to shareholders. These ratios, however, are non-IFRS measures and therefore, should not be seen as a substitute for cash flow from operating activities. Free Cash Flow is defined as cash provided by operating activities adjusted for capital expenditures. Normalized Free Cash Flow is defined as cash provided by operating activities, adjusted for changes in non-cash operating working capital, capital expenditures, current income taxes (net of income taxes paid) and certain unusual expenditures.

Non-IFRS measures do not have any standard meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. Non-IFRS measures are reconciled to IFRS measures elsewhere in this MD&A.

## **OUTSTANDING SHARE DATA**

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The Company is authorized to issue an unlimited number of common shares and 10 million preferred shares. Each common share entitles the holder to one vote at all meetings of shareholders and represents an interest in dividends declared by the Company and an undivided interest in the net assets of the Company. As at March 2, 2016, Morneau Shepell had 48,272,449 common shares, nil preferred shares and \$74,904 aggregate principal amount of 5.75% convertible debentures outstanding. In the event all of the outstanding 5.75% convertible debentures are converted into common shares of the Company by the holders prior to their maturity date, the total number of common shares issuable will be approximately 5,000,000. The number of long-term incentive plan ("LTIP") units, including those that remain unvested, that are outstanding and may be converted to common shares is approximately 2,390,000.

## **BUSINESS OVERVIEW**

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Morneau Shepell is the largest Canadian firm providing health and productivity, administrative and retirement solutions. We deliver solutions to assist employers in managing the financial security, health and productivity of their employees. With almost 4,000 employees in offices across North America, we offer services to approximately 20,000 organizations in Canada, the United States and around the globe directly and through our distribution channel partners.

We derive our revenue primarily from fees charged to clients for consulting engagements, outsourcing engagements, employee and family assistance programs, and absence management solution services.

Fees from consulting engagements are charged based on billable hours or on a fee-for-service basis. In some cases, consulting engagements may be billed on a fixed-fee basis, although these engagements are typically much smaller and the services are delivered over a shorter period of time. For some benefits consulting assignments which involve the purchase of an insurance policy underwritten by an insurance company, we may be paid commissions (in lieu of fees) by the client's insurance company, which is a common practice in the industry. These commissions are based on a percentage of the premiums paid by the client to the insurance company and our policy is to disclose them to our client. We assume no underwriting risk as the insurance policy is underwritten by the insurance company.

Our Administrative Solutions practice is characterized by fixed contracts, which typically have three-year to five-year terms. Most outsourcing contracts contain an upfront implementation fee and an ongoing monthly service fee. Implementations usually take three to twelve months and involve transferring the administration of a client's pension and/or benefits plans onto our systems, tailoring our systems and training our employees. Additional services provided that are outside the scope of the outsourcing contract are usually paid on a fee-for-service basis. A small number of contracts contain a large up front

customization and implementation fee, with lower ongoing maintenance fees.

In the billing for Employee Support Solutions (“ESS”) services, a portion of the ESS client agreements require payment of a minimum retainer and incremental usage-based fees. The remainder of the ESS agreements are billed based on an actual usage or fixed fees. Most ESS agreements may be terminated by the client upon 30 to 60 days’ notice to us, however, it is typical for ESS agreements to continue for multiple years and many automatically renew on an annual basis.

Fees from Absence Management Solutions (“AMS”) services, such as attendance support and disability management are generally based on negotiated fees or a formula tied to the nature of the service being provided. Like most ESS agreements, most workplace health and productivity agreements may be terminated by the client upon 30 to 60 days’ notice to us; however, it is typical for these agreements to continue for multiple years and many automatically renew on an annual basis.

Our largest operating expense is compensation and related costs. This includes salaries, annual performance-based bonuses, benefits, payroll taxes, independent service providers and temporary staffing services.

The remaining operating expenses include rent and occupancy costs, technology costs (including equipment leases, telecommunications, and software licenses and maintenance), non-recoverable client service costs (such as printing and travel), training, marketing, office costs, professional services and insurance.

## 2015 SUMMARY AND OUTLOOK

<i>In thousands of dollars</i>	<b>Three months ended December 31, 2015</b>	<b>Three months ended December 31, 2014</b>	<b>Year ended December 31, 2015</b>	<b>Year ended December 31, 2014</b>
Revenue	\$145,696	\$131,195	\$567,286	\$535,866
Organic Revenue <sup>(1)</sup>	\$139,302	\$130,896	\$553,123	\$521,653
Adjusted EBITDA	\$25,211	\$22,581	\$105,801	\$98,927
Adjusted EBITDA margin	17.3%	17.2%	18.7%	18.5%
Normalized Free Cash Flow	\$18,178	\$13,446	\$61,584	\$50,530
Profit	\$2,422	\$461	\$16,418	\$25,140

(1) Organic revenue is defined as revenue excluding acquisitions not in the comparative period and divestitures, and is calculated as follows:

<i>(In thousands of dollars)</i>	<b>Three months ended December 31, 2015</b>	<b>Three months ended December 31, 2014</b>	<b>Year ended December 31, 2015</b>	<b>Year ended December 31, 2014</b>
<b>Revenue</b>	<b>\$145,696</b>	<b>\$131,195</b>	<b>\$567,286</b>	<b>\$535,866</b>
Acquisitions	(6,394)	–	(14,163)	–
Divestitures	–	(299)	–	(14,213)
<b>Organic Revenue</b>	<b>\$139,302</b>	<b>\$130,896</b>	<b>\$553,123</b>	<b>\$521,653</b>

### Fourth quarter:

- Fourth quarter Revenue increased by 11.1% versus the comparative quarter in 2014, while Organic Revenue grew by 6.4%. Adjusted EBITDA increased by \$2.6 million to \$25.2 million versus the comparative period.

- On November 30, 2015, the Company completed the acquisition of 100% of the outstanding shares of Bensigner Du Pont & Associates, Inc. (“BDA”), a U.S. based company providing problem gambling services, drug testing management, and employee and family assistance programs. This acquisition complements the Company’s existing employee support solutions line of business, and expands the Company’s operations and service offerings in the U.S.

#### **Highlights of 2015:**

- Revenue and Organic Revenue grew by 5.9% and 6.0%, respectively versus the comparative period from new business wins and continued growth with existing clients from all four lines of our business.
- Adjusted EBITDA increased by \$6.9 million to \$105.8 million.
- As a result of the wind down of business directive issued by the New York State Department of Financial Services, the Centers for Medicare and Medicaid Services, and the New York State of Health to Health Republic Insurance of New York (HRINY), we wrote-off deferred implementation costs of \$12.2 million and recognized impairment charges of \$2.9 million on internally developed software related to the US Health Exchange outsourcing services business in the third quarter of 2015.

HRINY represented approximately 3.5% of our revenue, with an insignificant contribution to profit. We remain confident in our overall U.S growth strategy and our core benefits administration business and technology offering remain a strategic focus, as evidenced by our acquisition of Ceridian’s health and welfare administration business in the third quarter of 2015.

We are confident that our continued investment in our business and our established and prospective client base will continue to yield positive results for the Company.

## 2015 OPERATING RESULTS SUMMARY

Results of Operations	Three Months Ended		Year Ended	
	December 31		December 31	
Selected Consolidated Financial Information (In thousands of dollars except per share amounts)	2015	2014	2015	2014
<b>Revenue</b>	\$145,696	\$131,195	\$567,286	\$535,866
Deduct (add):				
Salary, benefits and contractor expenses	105,438	93,183	392,121	368,727
Other operating expenses	23,510	21,843	88,027	83,289
Finance costs	4,178	3,731	15,002	14,582
Depreciation and amortization	8,610	9,512	32,867	33,947
Write-down of deferred implementation costs and impairment	–	–	15,100	–
(Gain)/loss on business divestitures	–	350	–	(1,763)
Income tax expenses	1,538	2,115	7,751	11,944
<b>Profit for the period</b>	<b>2,422</b>	<b>461</b>	<b>16,418</b>	<b>25,140</b>
Add:				
Finance costs	4,178	3,731	15,002	14,582
Depreciation and amortization	8,610	9,512	32,867	33,947
Income tax expenses	1,538	2,115	7,751	11,944
<b>EBITDA<sup>(1)</sup></b>	<b>\$16,748</b>	<b>\$15,819</b>	<b>\$72,038</b>	<b>\$85,613</b>
Adjustments:				
Reorganization and operational effectiveness initiatives	4,440	3,928	4,440	5,382
Sublease loss provision	–	–	700	–
Write-down of deferred implementation costs and impairment	–	–	15,100	–
(Gain)/loss on business divestitures	–	350	–	(1,763)
Mercer Canada Outsourcing conversion costs	4,023	2,484	13,523	9,695
<b>Adjusted EBITDA</b>	<b>\$ 25,211</b>	<b>\$ 22,581</b>	<b>\$105,801</b>	<b>\$98,927</b>
<b>EBITDA margin<sup>(2)</sup></b>	11.5%	12.1%	12.7%	16.0%
<b>Adjusted EBITDA margin<sup>(2)</sup></b>	17.3%	17.2%	18.7%	18.5%
<b>Cash provided by operating activities</b>	\$38,899	\$19,528	\$63,898	\$48,916
Deduct: Capital expenditures <sup>(3)</sup>	(5,788)	(7,636)	(25,913)	(33,550)
<b>Free Cash Flow<sup>(4)</sup></b>	<b>33,111</b>	<b>11,892</b>	<b>37,985</b>	<b>15,366</b>
Add (deduct):				
Changes in non-cash operating working capital	(24,805)	(7,251)	(4,988)	14,598
Mercer Canada Outsourcing conversion – capital	270	230	658	723
Current income taxes, net of income taxes paid	1,614	2,163	(1,769)	4,766
Adjustments to EBITDA <sup>(5)</sup>	7,988	6,412	29,698	15,077
<b>Normalized Free Cash Flow<sup>(6)</sup></b>	<b>\$18,178</b>	<b>\$13,446</b>	<b>\$61,584</b>	<b>\$50,530</b>
Earnings per Share (basic)	\$ 0.05	\$ 0.01	\$ 0.33	\$ 0.51
Earnings per Share (diluted)	\$ 0.05	\$ 0.01	\$ 0.33	\$ 0.51
EBITDA per Share (basic)	\$ 0.34	\$ 0.32	\$ 1.46	\$ 1.74
Adjusted EBITDA per Share (basic)	\$ 0.51	\$ 0.46	\$ 2.14	\$ 2.01
Dividends declared	9,379	9,358	37,467	37,422

	Three Months Ended December 31		Year Ended December 31	
	2015	2014	2015	2014
Twelve-month rolling Normalized Payout Ratio <sup>(7)</sup>	60.8%	74.1%	60.8%	74.1%
Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital <sup>(8)</sup>	66.5%	98.1%	66.5%	98.1%

Footnotes:

- (1) "EBITDA" is defined as profit before finance costs, income tax expenses, depreciation and amortization.
- (2) "EBITDA margin" represents EBITDA as a percentage of revenue, and "Adjusted EBITDA margin" represents Adjusted EBITDA as a percentage of revenue.
- (3) "Capital Expenditures" includes additions to capital assets and intangible assets but excludes additions to capital assets and intangible assets acquired through business acquisitions, and is presented net of disposals.
- (4) "Free Cash Flow" is defined as cash provided by operating activities adjusted for capital expenditures.
- (5) Adjustments to EBITDA do not include the sublease loss provision of \$700, the impairment charges for internally developed software of \$2,890, and \$475 of non-cash reorganization costs as these amounts have already been added back in cash from operating activities before the change in non-cash operating working capital.
- (6) "Normalized Free Cash Flow" is defined as cash provided by operating activities, adjusted for changes in non-cash operating working capital, capital expenditures, current income taxes (net of income taxes paid) and certain unusual expenditures.
- (7) "Twelve-month rolling Normalized Payout Ratio" is defined as dividends declared divided by Normalized Free Cash Flow for the rolling twelve-month period.
- (8) "Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital" is defined as dividends declared divided by the Twelve-month rolling Normalized Free Cash Flow, including changes in non-cash operating working capital adjusted for unusual fluctuations. For the three-months ended December 31, 2015 and December 31, 2014 the non-cash working capital was adjusted for by \$(690), and for the year ended December 31, 2014 the non-cash operating working capital was adjusted for by \$2,196, which represents changes in leasehold inducements receivable related to capital expenditures. For the year ended December 31, 2015 the non-cash operating working capital was adjusted for by (\$10,262), which represents 2014 leasehold inducements receivable related to capital expenditures collected in 2015 and the year over year change in non-cash operating working capital resulting from the HRINY deferred implementation costs write-off..

## ANALYSIS OF FOURTH QUARTER 2015 OPERATING RESULTS

### Revenue

Revenue for the three months ended December 31, 2015 increased by \$14.5 million, or 11.1%, to \$145.7 million compared to \$131.2 million for the same period in 2014. Revenue from acquisitions contributed to an increase of 4.7% or \$6.1 million from the comparative quarter in 2014. The remaining increase of 6.4% represents organic revenue growth primarily from our Administrative Solutions and ESS lines of business as a result of increased activity with existing clients and new client wins.

### Salary, Benefits and Contractor Expenses

Salary, benefits and contractor expenses for the three months ended December 31, 2015 increased by \$12.3 million, or 13.2%, to \$105.4 million compared to \$93.2 million for the same period in 2014. Excluding the \$3.5 million increase in compensation expense resulting from acquisitions, net of the divestiture of the clinic based occupational health business not in the comparative period, compensation expense increased by \$8.8 million. The increase was mainly attributable to incremental compensation expense for Mercer Canada Outsourcing conversion of \$1.4 million, higher reorganization costs of \$0.5 million, and \$6.9 million from general increases to support the Company's continued growth.

### Other Operating Expenses

Other operating expenses for the three months ended December 31, 2015 increased by \$1.7 million, or 7.6%, to \$23.5 million compared to \$21.8 million for the same period in 2014. Excluding the increase in other operating expenses of \$1.4 million resulting from acquisitions not in the comparative period, net of the

divestiture of the clinic based occupational health business, other operating expenses grew by \$0.3 million due to general increases required to support business growth.

### ***Finance Costs***

Finance costs for the three months ended December 31, 2015 increased by \$0.4 million, or 12.0%, to \$4.2 million compared to \$3.7 million for the same period in 2014. The increase is primarily due to accretion interest related to discounted liabilities recorded in the current quarter.

### ***Depreciation and Amortization***

Depreciation and amortization for the three months ended December 31, 2015 decreased by \$0.9 million, or 9.5%, to \$8.6 million compared to \$9.5 million for the same period in 2014. This decrease is mainly attributable to lower amortization on Groupe AST acquired customer contracts which were fully amortized by December 31, 2014, partially offset by higher depreciation from capital expenditures required to support business growth.

### ***Income Tax Expenses***

Income tax expenses decreased by \$0.6 million, or 27.3% to \$1.5 million compared to \$2.1 million for the same period in 2014. The decrease was primarily due to higher deferred taxes expenses in the comparative period as a result of a rate adjustment to the deferred tax liabilities previously recognized.

### ***Profit for the Period***

As a result of the changes noted above, the profit for the three months ended December 31, 2015 was \$2.4 million compared to a \$0.5 million profit for the same period in 2014.

### ***Key Financial Measures: EBITDA, Adjusted EBITDA, Free Cash Flow and Normalized Free Cash Flow***

#### ***Adjusted EBITDA and EBITDA***

Adjusted EBITDA increased by \$2.6 million, or 11.6%, to \$25.2 million compared to \$22.6 million for the same period in 2014. The increase is primarily due to growth in revenue of \$14.5 million, partially offset by an increase in salaries and other operating expenses of \$11.8 million after EBITDA adjustments. These adjusted EBITDA items do not constitute a part of the Company's on-going operating expenses. Below is a description of the fourth quarter ended December 31, 2015 adjustments:

- Mercer Canada Outsourcing conversion costs represent systems and service improvements required to support the clients acquired in November, 2012. The process commenced immediately after the acquisition. At year end we have substantially completed the original planned conversion and we expect to finish the remainder during the first half of 2016.
- Reorganization and operational effectiveness initiatives represents severance and professional fees incurred as a result of the loss of HRINY, and corporate reorganizations and employee terminations to achieve post-acquisition planned synergies. We anticipate additional severance costs in the first quarter of 2016 related to these activities.

EBITDA increased by \$0.9 million to \$16.7 million compared to \$15.8 million for the same period in 2014.

### ***Free Cash Flow***

Free Cash Flow for the three months ended December 31, 2015 increased by \$21.2 million to \$33.1 million compared to \$11.9 million for the same period in 2014. The increase is due to higher cash provided by operating activities of \$19.4 million due to favorable changes in non-cash operating working capital and an increase in profit as well as lower capital expenditures of \$1.8 million (see liquidity and capital resources section below).

### ***Normalized Free Cash Flow***

Normalized Free Cash Flow for the three months ended December 31, 2015 increased by \$4.7 million to \$18.2 million compared to \$13.4 million for the same period in 2014. The increase was mainly due to lower capital expenditures of \$1.8 million and higher cash generated from operating activities, before non-cash operating working capital and EBITDA adjustments of \$2.6 million.

## **ANALYSIS OF YEAR ENDED DECEMBER 31, 2015 OPERATING RESULTS**

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### ***Revenue***

Revenue for the year ended December 31, 2015 increased by \$31.4 million, or 5.9%, to \$567.3 million compared to \$535.9 million in 2014. Excluding acquisitions and the divestiture of the clinic based occupational health business in 2014, organic revenue grew by \$31.5 million, or 6.0%. Our Administrative Solutions line of business contributed 4.4% of the organic revenue growth, with the remainder of the increase coming from our other lines of business.

### ***Salary, Benefits and Contractor Expenses***

Salary, benefits and contractor expenses for the year ended December 31, 2015 increased by \$23.4 million, or 6.3%, to \$392.1 million compared to \$368.7 million in 2014. Excluding the \$2.3 million decrease in compensation expense resulting from the divestiture of the clinic based occupational health business, net of acquisitions not in the comparative period, compensation expense increased by \$25.7 million of which \$4.1 million was attributable to incremental compensation expense for Mercer Canada Outsourcing conversion and \$22.5 million from general increases to support the Company's continued growth. This was partially offset by lower reorganization and operational effectiveness initiatives expenses of \$0.9 million.

### ***Other Operating Expenses***

Other operating expenses for the year ended December 31, 2015 increased by \$4.7 million, or 5.7%, to \$88.0 million compared to \$83.3 million in 2014. Excluding the increase in other operating expenses of \$1.6 million resulting from acquisitions not in the comparative period, net of the divestiture of the clinic based occupational health business, other operating expenses grew by \$3.1 million of which \$0.7 million was due to a sublease loss provision and \$2.4 million due to general increases required to support business growth.

### ***Finance Costs***

Finance costs for the year ended December 31, 2015 increased by \$0.4 million, or 2.9%, to \$15.0 million compared to \$14.6 million in 2014. The increase was due to incremental borrowings required to support business growth and acquisitions, which was partially offset by a lower applicable margin charged on borrowings under the Company's amended credit facility agreement, and higher accretion interest related to discounted liabilities.

### ***Depreciation and Amortization***

Depreciation and amortization for the year ended December 31, 2015 decreased by \$1.1 million, or 3.2%, to \$32.9 million compared to \$33.9 million in 2014. The decrease is due to lower amortization on Groupe AST customer contracts which were fully amortized by December 31, 2014, partially offset by higher depreciation on capital assets and amortization of internally developed software.

### ***Income Tax Expenses***

Income tax expenses decreased by \$4.2 million, or 35.1%, to \$7.7 million, compared to \$11.9 million in 2014. The decrease is mainly due to the deferred income tax recovery related to the write-down of the deferred implementation costs and impairment loss on internally developed software.

### ***Profit for the Year***

As a result of the changes noted above, and the write-down of the HRINY deferred implementation costs and impairment charges on internally developed software, profit for the year ended December 31, 2015 was \$16.4 million compared to \$25.1 million in 2014.

### ***Key Financial Measures: EBITDA, Adjusted EBITDA, Free Cash Flow and Normalized Free Cash Flow***

#### ***Adjusted EBITDA and EBITDA***

Adjusted EBITDA increased by \$6.9 million, or 7.0%, to \$105.8 million, compared to \$98.9 million in 2014. The increase is primarily due to growth in revenue of \$31.4 million, partially offset by an increase in salaries and other operating expenses of \$24.6 million after EBITDA adjustments. These adjusted EBITDA items do not constitute a part of the Company's on-going operating expenses. Below is a description of the year end December 31, 2015 adjustments not previously described:

- The sublease loss provision arose as a result of actual subtenant income being lower than originally forecasted in the fourth quarter of 2013 when the provision was recorded for the Vancouver office consolidation. The sublease agreements for all the vacated Vancouver offices are now complete.
- The write-down of the deferred implementation costs and impairment loss on internally developed software was triggered by the sudden wind-down of HRINY following a business directive issued by certain regulatory authorities in the United States, two years after the commencement of the first outsourcing contract term.

EBITDA decreased by \$13.6 million to \$72.0 million compared to \$85.6 million for the same period in 2014.

#### ***Free Cash Flow***

Free Cash Flow for the year ended December 31, 2015 increased by \$22.6 million to \$38.0 million compared to \$15.4 million for the same period in 2014. The increase is due to higher cash provided by operating activities of \$15.0 million due to favorable changes in non-cash operating working capital, and lower capital expenditures of \$7.6 million (see liquidity and capital resources section below).

#### ***Normalized Free Cash Flow***

Normalized Free Cash Flow for the year ended December 31, 2015 increased by \$11.1 million to \$61.6 million compared to \$50.4 million for the same period in 2014. The increase was mainly due to lower capital

expenditures of \$7.6 million and higher cash generated from operating activities, before non-cash operating working capital and EBITDA adjustments of \$3.9 million.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Flows

The following table provides an overview of the Company's cash flows for the years indicated:

#### Cash Flow Information

Selected Consolidated Financial Information:

Cash provided by (used in): (In thousands of dollars)	Year ended December 31, 2015	Year ended December 31, 2014
Operating activities	\$ 63,898	\$ 48,916
Financing activities	(20,859)	9,091
Investing activities	(35,968)	(57,983)
Increase in cash	\$ 7,071	\$ 24

Cash provided by operating activities for the year ended December 31, 2015 increased by \$15.0 million to \$63.9 million compared to \$48.9 million in 2014. The increase is primarily due to higher cash generated from operating activities of \$8.8 million as a result of an improvement in the change in non-cash operating working capital, and lower taxes paid of \$6.7 million due to lower tax installments required in 2015 compared to 2014.

Cash used in financing activities for the year ended December 31, 2015 was \$20.9 million compared to cash provided by financing activities of \$9.1 million for the same period in 2014. This decrease was due to higher incremental borrowings required in 2014 to finance the Groupe AST acquisition, and higher cash generated from operating activities for the year ended December 31, 2015 which was used to limit incremental borrowings required to support in-year acquisitions and continued business growth.

Cash used in investing activities for the year ended December 31, 2015 decreased by \$22.0 million to \$36.0 million compared to \$58.0 million in 2014. This decrease was primarily due to lower acquisitions related payments of \$19.7 million, and a decrease in additions to intangible and capital assets of \$7.6 million (see capital expenditures section below) offset by proceeds received from the divestiture of the clinic based occupational health business in 2014 of \$5.3 million. In the comparative 2014 period the Company paid \$26.9 million (net of \$0.1 million cash received) as initial cash consideration for the acquisition of Groupe AST.

#### Dividends to Shareholders

Monthly dividends were declared for shareholders of record on the last business day of each month and were paid approximately on the 15th day of the following month. Monthly dividends were \$0.065 per share for the quarter. The Company continued to declare the same monthly dividend amount in January and February 2016.

We consider the amount of cash generated by the business in determining the amount of dividends to pay to shareholders. In general, we do not take into account quarterly working capital fluctuations as these tend to be temporary in nature. We do not generally consider profit or loss in setting the level of dividends as this is a non-cash metric and is not reflective of the level of cash flow that we generate.

The twelve-month rolling Normalized Payout Ratio at December 31, 2015 was 60.8% compared to 74.1% for

2014. The decrease in the Normalized Payout Ratio is primarily due to higher Normalized Free Cash Flow during the past twelve months.

### **Capital Expenditures**

Our capital expenditures typically include information technology hardware and software (external and internally developed), leasehold improvements, and office furniture. Such amounts are expected to be funded from our operating cash flow. Additional capital expenditure requirements may result from significant business expansion. Capital expenditures for the three months ended December 31, 2015 decreased by \$1.8 million to \$5.8 million compared to \$7.6 million for the same period in 2014 and the decrease for the year ended December 31, 2015 was \$7.6 million to \$25.9 million from \$33.6 million in 2014. The decrease in capital expenditures for the three months and year ended December 31, 2015 is primarily due to reduced leasehold improvements and office furniture capital expenditures after the completion of the office consolidations in various regions and to integrate Groupe AST.

### **Contractual Obligations**

#### **Commitments**

We lease office space and selected equipment under operating lease agreements with terms ranging from one to fifteen years. We also have revolving loans under the amended credit facility arrangement and convertible debentures described under the section “Capital Resources”.

A summary of contractual obligations, which outlines the year the payments are due is as follows:

<i>(In thousands of dollars)</i>	<b>Total</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020 and thereafter</b>
Long-term debt	\$ 242,456	\$ -	\$ 242,456	\$ -	\$ -	\$ -
Convertible debenture	74,904	-	74,904	-	-	-
Promissory notes <sup>(1)</sup>	2,500	2,500	-	-	-	-
Operating leases, net	104,434	15,498	13,836	12,917	12,138	50,045
<b>Total</b>	<b>\$ 424,294</b>	<b>\$ 17,998</b>	<b>\$ 331,196</b>	<b>\$ 12,917</b>	<b>\$ 12,138</b>	<b>\$ 50,045</b>

Footnote:

- (1) The promissory notes were issued as partial consideration for the acquisition of Groupe AST, and are unsecured and non-interest bearing with \$2,500 due on February 28, 2016.

We are party to various subleases to which we would be liable for the rental payment in the case of a default by the subtenants. The minimum payments and the aggregate sublease income related to these premises have been netted against the operating leases amounts reported above. We consider the risk of default by the subtenants to be low therefore no accrual has been set up.

### **Contingent Consideration**

The purchase price for Dion Durrell Workers’ Compensation, BDA, and the U.S. health and welfare benefits administration business of Ceridian are contingent on future business results and the estimated remaining installments of \$0.6 million, \$2.8 million (\$2.0 million U.S.), and \$1.2 million (\$0.9 million U.S.), respectively, are due in 2016 and 2017. These contingent future installments have been recognized as an acquisition liability on the statement of financial position at their discounted amounts as at December 31, 2015.

In addition there is \$0.2 million of contingent consideration due from 2016 through 2018 for other smaller acquisitions.

We have no material contractual obligations other than those described in this MD&A and have no off-balance sheet financing arrangements.

### **Capital Resources**

The following table provides an overview of our capital resources:

<i>(In thousands of dollars)</i>	<b>As at December 31, 2015</b>	<b>As at December 31, 2014</b>
Cash	\$ 1,900	\$ –
Bank indebtedness	–	5,171
Long-term debt, net of debt issuance costs	241,846	222,435
Convertible debenture, net of issuance costs	73,760	72,875
Shareholders' equity	301,114	318,020

As at December 31, 2015, our working capital increased by \$2.7 million from \$75.9 million as at December 31, 2014 to \$78.6 million as at December 31, 2015. The increase is primarily due to a cash balance of \$1.9 million compared to bank indebtedness of \$5.2 million as at December 31, 2014, partially offset by a \$4.8 million decrease in trade receivables and unbilled fees because of improved collections.

#### *Long-term debt*

Long-term debt, net of debt issuance costs, increased by \$19.4 million from \$222.4 million as at December 31, 2014 to \$241.8 million as at December 31, 2015. This increase is the result of an increase in borrowing under the Company's amended credit facility agreement to finance business growth and acquisition related payments.

The Company had a credit facility agreement maturing on November 29, 2017 which provided for a revolving facility of \$250.0 million (including a swing line of \$7.0 million). The credit facility agreement was amended during the second quarter of 2015 to form the amended credit facility agreement (the "Amended Credit Facility Agreement"). The Amended Credit Facility Agreement provides for a revolving facility of \$300.0 million (including a swing line of \$7.0 million).

The interest rates for the Amended Credit Facility Agreement are floating, based on a margin over certain referenced rates of interest. The applicable margin may vary up and down depending on the ratio of our consolidated debt to Adjusted EBITDA as defined in the Amended Credit Facility agreement. EBITDA is defined in the Amended Credit Facility Agreement as profit before finance costs, taxes, depreciation, amortization, non-controlling interest, non-recurring gains, and limited non-recurring losses. Adjusted EBITDA is defined in the Amended Credit Facility Agreement as EBITDA plus the pro-forma EBITDA from permitted acquisitions' entities.

The Amended Credit Facility is secured by a general assignment of all our assets. The Amended Credit Facility Agreement also requires us to maintain the following financial covenants on a consolidated basis:

- (i) Ratio of debt to Adjusted EBITDA not greater than 3.0:1.0 or for the twelve month period immediately following the completion of a permitted acquisition as defined in the Amended Credit Facility Agreement with a purchase price of \$25.0 million or more, not more than 3.5:1.0
- (ii) Ratio of EBITDA to interest expense of not less than 3.0:1.0

We are in compliance with all of the required financial covenants.

#### *Interest-rate Swap*

In February 2014, the Company entered into a forward starting interest-rate swap agreement to hedge against the variable interest rate component on \$160.0 million notional amount borrowed under the credit facility agreement for the period from January 5, 2015 up to and ending November 29, 2017. The notional amount of this swap is \$160.0 million and is used to fix the variable component of the interest rate at 1.98%, before the applicable margin, for the duration of this period and has been designated as a cash flow hedge.

#### *Convertible debenture*

On March 27, 2012, the Company issued \$75.0 million principal amount of 5.75% Convertible Unsecured Subordinated Debentures (“Debentures”) for net proceeds of \$71.4 million allocated between debt and equity. The Debentures pay interest semi-annually on March 31 and September 30, and have a maturity date of March 31, 2017.

The debentures are convertible at the option of the holder to common shares at a conversion price of \$15.00 per common share. The Company has the option to redeem the debentures on and after March 31, 2015 and at any time prior to March 31, 2016 at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest provided that the weighted average trading price for the 20 consecutive trading days ending five days preceding the date on which the notice of redemption is given is at least 125% of the conversion price of \$15.00. On and after March 31, 2016, but prior to the maturity date, the debentures will be redeemable at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest. On redemption or maturity the Company may elect to repay the principal and satisfy its interest obligations by issuing the Company’s common shares. During the year ended December 31, 2015, 1,666 shares were issued upon conversion of debentures.

### **SELECTED STATEMENT OF FINANCIAL POSITION DATA**

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The following table provides an overview of our selected statement of financial position data:

<i>(in thousands of dollars)</i>	<b>As at December 31, 2015</b>	<b>As at December 31, 2014</b>
Current assets	\$ 156,410	\$ 160,280
Non-current assets	599,238	596,375
Current liabilities	77,761	84,380
Non-current liabilities	376,773	354,255

#### **Current Assets**

Current assets as at December 31, 2015 decreased by \$3.9 million to \$156.4 million from \$160.3 million as at December 31, 2014. The decrease is primarily due to a \$4.9 million decrease in trade and other receivables, net of the change in unbilled fees, because of improved collections, a decrease in income taxes receivable of \$1.0 million, and a decrease in deferred implementation costs of \$0.9 million. This was partially offset by an increase in prepaid expenses of \$1.6 million due to growth in the business and cash of \$1.9 million compared to a bank indebtedness balance as at December 31, 2014.

## **Non-current Assets**

Non-current assets as at December 31, 2015 increased by \$2.9 million to \$599.2 million from \$596.4 million at December 31, 2014. The increase was primarily related to intangible assets and goodwill acquired as part of the BDA acquisition of \$10.0 million, capital expenditures of \$25.9 million, and a deferred tax asset of \$2.6 million in the U.S. This was partially offset by a decrease in the non-current portion of deferred implementation costs of \$3.4 million due to the HRINY write-off, and depreciation and amortization on capital and intangible assets of \$32.9 million.

## **Current Liabilities**

Current liabilities as at December 31, 2015 decreased by \$6.6 million to \$77.8 million from \$84.4 million as at December 31, 2014. The decrease is mainly due to a decrease in trade and other payables of \$2.7 million from timing of vendor payments, and bank indebtedness of \$5.2 million as at December 31, 2014, partially offset by an increase in the current portion of the liability for interest rate swaps of \$1.7 million.

## **Non-current Liabilities**

Non-current liabilities as at December 31, 2015 increased by \$22.5 million to \$376.8 million from \$354.3 million at December 31, 2014. The increase is due to an increase in long-term debt of \$19.4 million to support overall business growth and in-year acquisitions, an increase in the convertible debenture payable of \$0.9 million due to accretion and amortization of issuance costs, an increase in the non-current portion of future consideration related to acquisition of \$3.0 million, and an increase in the deferred tax liability of \$1.3 million. This was partially offset by the promissory note (non-current) with an amortized cost of \$2.4 million as at December 31, 2014 becoming a current liability as at December 31, 2015.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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The preparation of financial statements requires us to make estimates and assumptions that affect the reported values of assets and liabilities as well as disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

These estimates are reviewed periodically and, as adjustments become necessary, they are reported in profit or loss in the periods in which they become known. Accordingly, actual results could differ from these estimates. The Company's significant accounting policies are presented in Note 3 of the audited consolidated financial statements and notes thereto for the years ended December 31, 2015 and 2014. The accounting policies and estimates that are critical to our business relate to the following items:

### ***Revenue Recognition***

Revenue includes fees generated from consulting engagements, outsourcing engagements, ESS and AMS services.

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

- The amount of revenue can be reliably measured;
- The stage of completion can be reliably measured;
- The receipt of economic benefits is probable; and
- Costs incurred and to be incurred can be reliably measured.

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

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

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

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

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

- The delivered item has value to the customer on a stand-alone basis; and
- The fair value of the undelivered item can be reliably measured.

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

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

Other sources of operating revenue include the following:

- (i) Investment income earned in the course of normal business operations, and is recorded on the accrual basis.
- (ii) Commissions income are recognized when earned, which is at the later of the billing or the effective date of the policy, net of a provision for return commissions due to policy cancellations or change of brokers.

### ***Intangible Assets***

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

Internally-developed software is recognized at the cost of all eligible development costs, when all the

following criteria are met:

- It is technically feasible to complete the software so that it will be available for use;
- Management intends to complete the software and use or sell it;
- Morneau Shepell is able to use or sell the software;
- Future benefits associated with the software can be demonstrated;
- Adequate technical, financial, and other resources to complete the development and to use or sell the software are available; and
- The expenditures attributable to the software during its development can be reliably measured.

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

Intangible assets with a finite life are amortized on a straight-line basis over their estimated useful lives. Intangible assets with an indefinite life are not amortized, but are tested for impairment annually or whenever impairment indicators are identified. Trade names have been determined to have an indefinite life based on their strength, history, and expected future use.

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

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

### ***Goodwill***

Goodwill represents the excess of the cost of business acquisitions over the fair value of our share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is carried at cost less accumulated impairment charges and is subject to impairment test annually or whenever impairment indicators are identified.

### ***Deferred implementation costs and deferred outsourcing revenues:***

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

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

### ***Deferred income tax assets and liabilities (utilization of tax losses)***

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

### ***Future consideration related to acquisitions***

The Company may pay future consideration related to acquisitions based upon performance measures contractually agreed at the time of purchase. Management estimates the future consideration payable based on underlying contract terms, and best estimates of the future performance of the acquiree. Depending on the future performance of the acquiree, management estimates of the amounts payable for future consideration related to acquisitions may materially differ from the consideration ultimately paid.

### ***Impairment of Non-financial Assets***

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

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

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

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

Goodwill and intangible assets impairment review involves significant estimates and assumptions regarding cash flow projections, growth projections, economic risk, and weighted cost of capital. If future events or results differ adversely from these estimates and assumptions, the Company could incur impairment charges in future periods.

### ***Allowance for Doubtful Accounts***

We are required to assess whether accounts receivables are collectible from customers. Accordingly, management establishes an allowance for estimated losses arising from non-payment and delinquent accounts, taking into consideration customer creditworthiness, current economic trends, and past experience. If future collections differ from estimates, future earnings could be adversely affected.

### ***Litigation and Claims***

We are involved in litigation and other claims arising in the normal course of business. We must use judgment to determine whether or not a claim has any merit, the amount of the claim and whether to record a provision, which is dependent upon the potential success of the claim. We believe that none of the current claims will have a material adverse impact on our financial position.

### **Changes in Accounting Policies**

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2015.

#### *IFRS 8, Operating Segments (“IFRS 8”)*

IFRS 8 has been amended to explicitly require disclosure of judgments made in applying the aggregation criteria to aggregate operating segments. The amendments to IFRS 8 also clarify that a reconciliation of total reportable segments’ assets to the entity’s total assets is only required if this information is regularly provided to the entity’s chief operating decision maker. The Company adopted these amendments to IFRS 8 effective January 1, 2015. The adoption of these amendments resulted in the Company enhancing its disclosure of the criteria that it uses to identify its reportable segment for the purposes of its disclosure for the consolidated financial statements for the year ended December 31, 2015.

### **Future Accounting Changes**

#### *IFRS 15, Revenue from Contracts with Customers (“IFRS 15”)*

On May 28, 2014 the IASB issued IFRS 15. The new standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company intends to adopt IFRS 15 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.

#### *IFRS 9, Financial Instruments (“IFRS 9”)*

In July 2014 the IASB finalized IFRS 9. The standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The new standard includes revised guidance on the classification and measurement of financial assets, a new ‘expected loss’ impairment model and introduces a substantially-reformed approach to hedge accounting. The Company intends to adopt IFRS 9 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.

#### *IFRS 16, Leases (“IFRS 16”)*

In January 2016, the IASB issued IFRS 16. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted for those entities that have also adopted IFRS 15. The new standard provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements. IFRS 16 supersedes IAS 17, Leases, and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, differentiating between leases and service contracts on the basis of whether there is an identified asset controlled by the customer. Among other significant changes, the distinction between operating and finance leases is removed and assets and liabilities are recognized in respect of all leases. Furthermore, IFRS 16 requires a front-loaded pattern for the recognition of lease expense over the life of the lease. The Company intends to adopt IFRS 16 in its 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.

## **RISKS AND UNCERTAINTIES**

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The results of operations, business prospects and financial considerations of Morneau Shepell remains subject to a number of risks and uncertainties and are affected by a number of factors outside of our control.

### **Ability to Maintain Profitability and Manage Growth**

There can be no assurance that Morneau Shepell will be able to sustain profitability in future periods. Morneau Shepell's future operating results will depend on a number of factors, including its ability to continue to successfully execute its strategic initiatives.

There can be no assurance that Morneau Shepell will be successful in achieving its strategic plan or that its strategic plan will enable the firm to maintain its historical revenue growth rates or to sustain profitability. Failure to successfully execute any material part of Morneau Shepell's strategic plan could have a material adverse effect on its business, financial condition and operating results, and the ability of Morneau Shepell to pay dividends.

There can be no assurance that Morneau Shepell will be able to effectively manage its growth, and any failure to do so could have a material adverse effect on the firm's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Cash Dividends Are Not Guaranteed and Will Fluctuate With the Business Performance**

As a corporation, Morneau Shepell's dividend policy is at the discretion of its Board of Directors. The ability of Morneau Shepell to make dividend payments, and the actual amount paid is entirely dependent on the operations and assets of its subsidiaries and is subject to various factors applicable to Morneau Shepell and its subsidiaries including financial performance, obligations under credit facilities, fluctuations in working capital, the sustainability of margin and capital expenditure requirements and applicable laws and regulations.

### **Reliance on Information Systems and Technology**

Information systems are an integral part of Morneau Shepell's business and the products and services

offered to its clients. Morneau Shepell relies on systems to maintain accurate, accessible and secure records and to carry on its business and deliver services to its clients. In order to maintain the level of security, service and reliability that clients require, Morneau Shepell may be required to make significant investments in the online means of delivering services. Morneau Shepell maintains a robust information technology development and management program that includes disaster recovery, business continuity and security defenses.

Any disruptions in Morneau Shepell's systems or internet access, or the failure of the systems to operate as expected, including as a result of security breaches, cyber attacks, fraud or other criminal activity could, depending on the magnitude of the problem, result in a loss of current or future business and/or potential claims against Morneau Shepell, all of which could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Reputational Risk**

Morneau Shepell depends to a large extent upon its relationships with its clients and its reputation for high-quality services. As a result, the impact of client dissatisfaction with Morneau Shepell's services or products may be more damaging in Morneau Shepell's business than in other businesses. Moreover, if the firm fails to meet its contractual or regulatory obligations, Morneau Shepell could be subject to legal liability and a loss of client relationships.

### **Confidentiality of Client Information**

Morneau Shepell depends to a large extent on its relationships with its customers and its ability to properly maintain confidential client information. Morneau Shepell maintains rigorous controls to protect confidential information from unauthorized use or disclosure, however the failure of Morneau Shepell to maintain client confidentiality could, depending on the magnitude of the problem, result in a loss of future business and/or potential claims against Morneau Shepell. This could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Dependence on Key Clients**

As clients may terminate engagements with minimum notice, there can be no assurance that Morneau Shepell will be able to retain relationships with its largest clients. Moreover, there can be no assurance that such clients will continue to use Morneau Shepell's services in the future. Any negative change involving any of Morneau Shepell's largest clients, including but not limited to a client's financial condition or desire to continue using the firm's services, could result in a significant reduction in revenue which could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends. No one Morneau Shepell client makes up more than 10% of Morneau Shepell's total revenue for the years ended December 31, 2015 and 2014.

### **Reliance on Key Professionals**

Morneau Shepell's operations are dependent upon the abilities, experience and efforts of its professionals, many of whom have excellent reputations and a significant number of contacts in the industries in which Morneau Shepell operates. Morneau Shepell's business depends, in part, on its professionals' abilities to develop and maintain client relationships and alliances with businesses such as financial services companies, healthcare organizations, insurance companies, business process outsourcing organizations and other companies, in order to develop, market and deliver its services. Profitability could be negatively impacted if

Morneau Shepell's client relationships or business alliances are discontinued due to the loss of professional staff or if the firm has difficulty developing new alliances.

Should any member of its professional staff be unable or unwilling to continue his or her relationship with Morneau Shepell, this change could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Risk of Future Legal Proceedings**

Morneau Shepell may be threatened with, or may be named as a defendant in, or may become subject to, various legal proceedings in the ordinary course of conducting its business, including lawsuits based upon professional errors and omissions.

Consulting services involves assumptions and estimates concerning future events, the actual outcome of which cannot be known with certainty in advance. In addition, computational, software programming or data management errors could occur. For example, possible legal proceedings could result from a client's assertion that actuarial assumptions used in a pension plan were unreasonable, leading to plan underfunding; a claim that inaccurate data was used, which could lead to an underestimation of plan liabilities; or a claim that employee benefits plan documents were misinterpreted or plan amendments were misstated in plan documents, which could lead to overpayments to beneficiaries. The employee health and productivity services involve confidential counseling, occupational health activities and disability case management. Each of these activities could potentially put Morneau Shepell in conflict with its customers, their employees, or both. Possible legal proceedings could also result from matters such as an employee claiming for breach of confidence, failure to provide adequate counsel, or denial of benefits or employment as a result of Morneau Shepell's actions.

Defending lawsuits of this nature could require much management attention, which could divert its focus from operations. Such claims could produce negative publicity that could harm Morneau Shepell's reputation and business. A significant judgment against Morneau Shepell, or the imposition of a significant fine or penalty as a result of a finding that Morneau Shepell failed to comply with laws or regulations, could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Economic Conditions**

An economic slowdown could cause a decline in demand for Morneau Shepell's services. Growth in its clients' businesses may be affected by economic slowdowns and could therefore potentially have an impact on Morneau Shepell's operating results. During an economic downturn, Morneau Shepell clients and potential clients may reduce or delay services or projects, or defer contracts currently underway. This situation could also lead to greater delays and defaults in payments or debt collection, resulting in lower operating results. Because of lower revenue during an economic slowdown, competition may increase and prices may be reduced by certain competitors to maintain or expand their market share. Pricing and profitability could be adversely affected as a result.

### **Competition**

Morneau Shepell operates in a highly competitive North American market. As a result, Morneau Shepell competes with many domestic and international firms. Some of its competitors have achieved substantially more market penetration in certain of the areas in which Morneau Shepell competes. In addition, some of Morneau Shepell's competitors have substantially more financial resources and/or financial flexibility than Morneau Shepell. Further, Morneau Shepell's business relies, in part, upon its ability to develop and

implement technology solutions, in a cost effective manner that anticipate and keep pace with rapid and continuing changes in technology, industry standards and client preferences.

Morneau Shepell's competitors may offer new technologies more efficiently or cost effectively than Morneau Shepell. Competitive forces could result in reduced market share and thus have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Satisfactory Performance of Obligations**

In its contracts with clients, Morneau Shepell is sometimes committed to meeting identified service levels and/or timelines. If the service levels/timelines are not met, Morneau Shepell may experience reduced revenues, incur significant additional costs or be held responsible for the costs incurred by the client for failure to meet the service level/timeline. Morneau Shepell's success depends in large part upon whether it fulfills these and other contractual obligations with clients and maintains client satisfaction. If Morneau Shepell fails to satisfactorily perform its contractual obligations, its clients could terminate contracts and/or take legal action against Morneau Shepell. Such occurrences could result in a loss of its professional reputation and in extra costs needed to defend or rectify the situation and thus have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Protection of Intellectual Property**

Morneau Shepell continually develops and improves its proprietary technology solutions for the delivery of its services. No assurance can be given that Morneau Shepell's competitors will not develop substantially similar technology.

Morneau Shepell relies on one or more of the following to protect its proprietary rights: trademarks, copyrights, trade secrets, confidentiality procedures and contractual provisions. Despite Morneau Shepell's efforts to protect its proprietary rights, unauthorized parties may attempt to obtain and use information that Morneau Shepell regards as proprietary. Stopping unauthorized use of Morneau Shepell's intellectual property may be difficult, time-consuming and costly. There can be no assurance that Morneau Shepell will be successful in protecting its proprietary rights and, if it is not, this could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Relationship with Channel Partners**

Morneau Shepell markets its services directly to end-user employers as well as through certain channel partners, primarily insurance companies (many of which compete amongst themselves directly). There can be no assurance that Morneau Shepell will be able to maintain its existing relationships with all these channel partners, which could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Implications of Fixed-Price Contracts**

A portion of Morneau Shepell's revenue comes from fixed-price contracts. A fixed-price contract requires Morneau Shepell to perform either all or a specified portion of work under the contract for a fixed price.

Fixed-price contracts expose Morneau Shepell to a number of risks, including underestimation of costs,

ambiguities in specifications, unforeseen costs or difficulties, problems with new technologies, delays beyond the control of Morneau Shepell, failures of subcontractors to perform, and economic or other changes that may occur during the contract period. Losses under fixed-price contracts could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Potential Undisclosed Liabilities Associated with Acquisition/Limited Indemnification**

In connection with acquisitions completed by Morneau Shepell, there may be liabilities and contingencies that Morneau Shepell failed to discover or were unable to quantify in its due diligence which it conducted prior to the execution of an acquisition, and Morneau Shepell may not be indemnified for some or all of these liabilities and contingencies. The existence of any material liabilities or contingencies could have a material adverse effect on Morneau Shepell's business, financial condition, liquidity and results of operations.

### **Insurance**

Morneau Shepell believes that its professional errors and omissions insurance, cyber liability insurance, crime insurance, director and officer liability insurance, and commercial general liability insurance coverage address all material insurable risks, provides coverage that is similar to that which would be maintained by a prudent operator of a similar business and is subject to deductibles, limits and exclusions which are customary or reasonable given the cost of procuring insurance and current operating conditions.

However, there can be no assurance that such insurance will continue to be offered on economically feasible terms, that all events that could give rise to a loss or liability are insurable, or that the amounts of insurance will at all times be sufficient to cover each and every loss or claim that may occur involving Morneau Shepell's assets or operations.

### **Foreign Exchange Risk**

A portion of Morneau Shepell's sales are in U.S. dollars and thus Morneau Shepell is exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar.

The net revenue exposure denominated in U.S. dollars was \$7.9 million for the year ended December 31, 2015. An increase in foreign revenues would expose Morneau Shepell to fluctuations in exchange rates which may have a material adverse effect on Morneau Shepell's business, financial condition, and operating results, and on the ability of Morneau Shepell to pay dividends.

### **Indebtedness and Interest Rates**

The ability of Morneau Shepell to pay dividends or make other payments or advances will be subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness of Morneau Shepell.

The degree to which Morneau Shepell is leveraged could have important consequences including: Morneau Shepell's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited; a significant portion of Morneau Shepell's cash flow from operations may be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future operations; certain borrowings will be at variable rates of interest, which exposes

Morneau Shepell to the risk of increased interest rates; and Morneau Shepell may be more vulnerable to economic downturns and be limited in its ability to withstand competitive pressures.

These factors may increase the sensitivity of free cash flow to interest rate variations. Interest rate swap agreements are used as part of Morneau Shepell's program to manage the fixed and floating interest rate of Morneau Shepell's credit facility related overall cost of borrowing.

The credit facility contains numerous restrictive covenants that limit the discretion of management with respect to certain business matters. These covenants place significant restrictions on, among other things, the ability of Morneau Shepell to create liens or other encumbrances, to pay dividends or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity.

In addition, the credit facility contains financial covenants that require Morneau Shepell to meet certain financial ratios and financial condition tests. A failure to comply with the obligations in the credit facility could result in a default which, if not cured or waived, could result in a reduction or termination of dividends by Morneau Shepell and permit acceleration of the relevant indebtedness. If the indebtedness under the credit facility was to be accelerated, there can be no assurance that the assets of Morneau Shepell would be sufficient to repay in full that indebtedness. In addition, the credit facility matures on November 29, 2017. There can be no assurance that future borrowings or equity financing will be available to Morneau Shepell or available on acceptable terms, in an amount sufficient to fund Morneau Shepell's needs.

The convertible debentures are convertible into the Company's common shares at the option of the holder of the debenture. If the debentures are converted this may have a dilutive impact on the Company's earnings per share.

### **Market Price of Common Shares**

The market price of the Common Shares may be subject to wide fluctuations in response to many factors, including variations in operating results of Morneau Shepell, divergence in financial results from expectations, changes in business prospects for Morneau Shepell, general economic conditions, legislative changes, and other events and factors outside Morneau Shepell's control.

Sales of a substantial number of Common Shares by a significant shareholder in the public market or otherwise could adversely affect the prevailing market prices of the Common Shares and could impair the Corporation's ability to raise additional capital through an offering of Common Shares. The possible perception among the public that these sales will occur could also produce the same effect.

### **Dilution of Common Shares**

Pursuant to its articles of incorporation, Morneau Shepell is authorized to issue an unlimited number of Common Shares and 10 million preferred shares for the consideration and on such terms as are established by the Board of Directors without the approval of any shareholders. Any further issuance of Common shares may dilute the interests of existing shareholders. Furthermore, Morneau Shepell may make future acquisitions or enter into financings or other transactions involving the issuance of securities of Morneau Shepell which may be dilutive.

## SELECTED ANNUAL INFORMATION

(In thousands of dollars except per share amounts)

	Year ended December 31, 2015	Year ended December 31, 2014	Year ended December 31, 2013
Revenue	\$567,286	\$535,866	\$471,154
Profit <sup>(1)</sup>	16,418	25,140	10,445
Earnings per share (basic)	0.33	0.51	0.21
Earnings per share (diluted)	0.33	0.51	0.21
Dividends declared per share	0.78	0.78	0.78
Total assets	755,648	756,655	700,116
Total long-term debt <sup>(2)</sup>	315,606	295,310	247,668

Footnotes:

- (1) The profit for the year ended December 31, 2013 included impairment charges of \$16,700 primarily related to the Health Clinics sub-service line within the former OHS line of business, and the profit for the year ended December 31, 2015 includes the write-down of deferred implementation costs and impairment charges totaling \$15,100 related to HRINY.
- (2) Includes convertible debentures issued on March 27, 2012.

## SUPPLEMENTARY SUMMARY OF QUARTERLY RESULTS

Selected Unaudited Consolidated Financial information (in thousands of dollars except per share amounts)

Quarter ended	December 31, 2015	September 30, 2015	June 30, 2015	March 31, 2015	December 31, 2014	September 30, 2014	June 30, 2014	March 31, 2014
Revenue	145,696	140,778	142,420	138,392	131,195	132,703	140,877	131,091
Profit (loss) <sup>(1,3)</sup>	2,422	(3,487)	9,272	8,211	461	7,235	9,246	8,198
EBITDA	16,748	7,391	24,653	23,246	15,819	22,321	25,026	22,447
Adjusted EBITDA	25,211	25,886	28,060	26,644	22,581	24,429	27,240	24,677
EBITDA margin	11.5%	5.3%	17.3%	16.8%	12.1%	16.8%	17.8%	17.1%
Adjusted EBITDA margin	17.3%	18.4%	19.7%	19.3%	17.2%	18.4%	19.3%	18.8%
Earnings (loss) per share (basic) <sup>(1)</sup>	0.05	(0.07)	0.19	0.17	0.01	0.15	0.19	0.17
Earnings (loss) per share (diluted) <sup>(1)</sup>	0.05	(0.07)	0.19	0.16	0.01	0.15	0.19	0.17
Normalized Free Cash Flow	18,178	13,177	16,054	14,175	13,446	9,357	13,039	14,688
Dividends declared	9,379	9,365	9,363	9,360	9,358	9,359	9,352	9,353
Twelve-month rolling normalized payout ratio	60.8%	65.9%	70.6%	74.8%	74.1%	70.6%	68.4%	65.5%
Twelve-month rolling normalized payout ratio, including changes in adjusted non-cash operating working capital	66.5%	89.0%	114.5%	107.5%	98.1%	108.0%	117.9%	94.9%
Total assets	755,648	762,021	775,921	772,449	756,655	759,968	767,980	751,754
Total long-term debt <sup>(2)</sup>	315,606	325,686	323,923	303,904	295,310	300,590	300,452	282,112

Footnotes:

- (1) The profit, basic and diluted earnings per share, and total assets for the quarters ended June 30, 2014 and March 31, 2014 were revised to reflect the retrospective adjustment due to the finalization of the intangible assets valuation for Groupe AST in the third quarter of 2014. This resulted from a change to the purchase price allocation and faster amortization of acquired customer contract intangible assets. The amounts previously reported for these figures for the quarters ended June 30, 2014 and March 31, 2014 were as follows:

	June 30, 2014	March 31, 2014
Profit	10,105	8,484
Earnings per share (basic)	0.21	0.17
Earnings per share (diluted)	0.20	0.17
Total assets	769,583	752,165

(2) Includes convertible debentures issued on March 27, 2012.

(3) The profit for the quarter ended September 30, 2015 included the write-down of deferred implementation costs and impairment charges totaling \$15,100 related to HRINY

## Disclosure Controls and Procedures

Our disclosure controls and procedures have been designed to provide reasonable assurance that all relevant information is identified to our Disclosure Committee to ensure appropriate and timely decisions are made regarding public disclosure.

The Chief Executive Officer and the Chief Financial Officer have concluded that the disclosure controls and procedures are appropriately designed and operating effectively as at December 31, 2015.

## Internal Control over Financial Reporting

Management is responsible for designing internal controls over financial reporting, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. In designing these controls, Management used the *Internal Control – Integrated Framework* (COSO 2013 Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission.

The Chief Executive Officer and the Chief Financial Officer have concluded that the internal controls over financial reporting are appropriately designed and operating effectively to provide this assurance based on the evaluation of these controls conducted as at December 31, 2015. No changes were made in our internal controls over financial reporting during the fourth quarter ended December 31, 2015, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## Additional Information

Morneau Shepell's shares currently trade on the Toronto Stock Exchange under the symbol MSI. Additional information relating to us, including all public filings and our Annual Information Form, is available on the SEDAR website ([sedar.com](http://sedar.com)) and on our own website at [morneaushepell.com](http://morneaushepell.com).

The content of this MD&A reflects information known as of March 2, 2016.

# **Consolidated Financial Statements**

(In Canadian dollars)

Years ended December 31, 2015 and 2014



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## INDEPENDENT AUDITORS' REPORT

To the Shareholders of Morneau Shepell Inc.

We have audited the accompanying consolidated financial statements of Morneau Shepell Inc., which comprise the consolidated statements of financial position as at December 31, 2015 and 2014, the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### ***Management's Responsibility for the Consolidated Financial Statements***

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

### ***Auditors' Responsibility***

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

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

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

### ***Opinion***

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Morneau Shepell Inc. as at December 31, 2015 and 2014, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Chartered Professional Accountants, Licensed Public Accountants  
March 2, 2016  
Toronto, Canada

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# MORNEAU SHEPELL INC.

Consolidated Statements of Financial Position

(In thousands of Canadian dollars)

December 31, 2015 and December 31, 2014

	2015	2014
<b>Assets</b>		
<b>Current assets:</b>		
Cash	\$ 1,900	\$ –
Trade and other receivables (note 6)	65,579	74,372
Unbilled fees	64,229	60,271
Income taxes receivable	721	1,677
Prepaid expenses and other	6,092	4,451
Cash and investments held in trust	12,449	13,121
Deferred implementation costs (note 7)	5,440	6,388
<b>Total current assets</b>	<b>156,410</b>	<b>160,280</b>
<b>Non-current assets:</b>		
Unbilled fees	20	400
Deferred implementation costs (note 7)	10,831	14,232
Capital assets (note 8)	35,658	34,459
Intangible assets (note 9)	233,305	235,625
Goodwill (note 10)	316,834	311,659
Deferred tax asset (note 17)	2,590	–
<b>Total non-current assets</b>	<b>599,238</b>	<b>596,375</b>
<b>Total assets</b>	<b>\$ 755,648</b>	<b>\$ 756,655</b>

# MORNEAU SHEPELL INC.

Consolidated Statements of Financial Position

(In thousands of Canadian dollars)

December 31, 2015 and December 31, 2014

	2015	2014
<b>Liabilities and Equity</b>		
<b>Current liabilities:</b>		
Bank indebtedness (note 14)	\$ –	\$ 5,171
Trade and other payables (note 11)	54,241	56,935
Deferred revenue	2,521	2,597
Insurance premium liabilities	12,449	13,121
Future consideration related to acquisitions (note 28)	1,043	810
Promissory notes (note 4)	2,481	2,481
Dividends payable	3,120	3,120
Interest rate swaps (note 14)	1,906	145
<b>Total current liabilities</b>	<b>77,761</b>	<b>84,380</b>
<b>Non-current liabilities:</b>		
Long-term debt (note 14)	241,846	222,435
Convertible debenture payable (note 15)	73,760	72,875
Interest rate swaps (note 14)	1,769	1,968
Future consideration related to acquisitions (note 28)	3,538	537
Promissory notes (note 4)	–	2,369
Other liabilities (note 12)	13,552	13,483
Provisions (note 13)	2,367	2,029
Deferred tax liability (note 17)	39,941	38,559
<b>Total non-current liabilities</b>	<b>376,773</b>	<b>354,255</b>
<b>Equity:</b>		
Share capital (note 20)	477,500	474,490
Contributed surplus (note 20)	23,312	20,812
Equity component of convertible debenture (note 15)	757	757
Accumulated other comprehensive loss (note 20)	(2,850)	(1,484)
Deficit	(197,605)	(176,555)
<b>Total equity</b>	<b>301,114</b>	<b>318,020</b>
<b>Total liabilities and equity</b>	<b>\$755,648</b>	<b>\$756,655</b>

Commitments and contingencies (notes 4, 26 and 28)

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

"Robert Chisholm"  
Audit Committee Chair

"Alan Torrie"  
President & CEO

# MORNEAU SHEPELL INC.

Consolidated Statements of Income and Comprehensive Income

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

Years ended December 31, 2015 and 2014

	2015	2014
Operating revenue	\$567,286	\$535,866
Operating expenses:		
Salary, benefits and contractors (note 25)	392,121	368,727
Office and administration	61,099	58,388
Rent and occupancy	26,928	24,901
Depreciation and amortization	32,867	33,947
Write-down of deferred implementation costs and impairment (notes 7 and 27)	15,100	–
Total operating expenses	528,115	485,963
Finance costs (note 14)	15,002	14,582
Gain on business divestitures (note 5)	–	(1,763)
Profit before income taxes	24,169	37,084
Income taxes (recovery) (note 17):		
Current	9,493	9,611
Deferred	(1,742)	2,333
Total income taxes	7,751	11,944
Profit for the year	16,418	25,140
Other comprehensive income (loss):		
Items that may be reclassified subsequently to profit:		
Effective portion of change in interest rate cash flow hedges	(1,562)	(324)
Foreign currency translation differences for foreign operations	(229)	3
Reclassification of foreign currency translation differences on divestiture of foreign operations (note 5)	–	289
Income taxes on the above items	424	87
	(1,367)	55
Items that will not be reclassified to profit:		
Actuarial gain on post-employment benefit plans	1	405
Income taxes on the above item	–	(105)
	1	300
Other comprehensive income (loss), net of tax effect	(1,366)	355
Comprehensive income for the year	\$ 15,052	\$ 25,495
Earnings per share (note 21):		
Basic	\$ 0.33	\$ 0.51
Diluted	\$ 0.33	\$ 0.51

See accompanying notes to the consolidated financial statements.

## MORNEAU SHEPELL INC.

Consolidated Statements of Changes in Equity

(In thousands of Canadian dollars)

Years ended December 31, 2015 and 2014

2015	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Equity component of convertible debenture	Total equity
Balance, January 1, 2015	\$ 474,490	\$ 20,812	\$ (176,555)	\$ (1,484)	\$ 757	\$ 318,020
Long-term incentive plan – issuance (notes 19 and 20)	–	5,486	–	–	–	5,486
Long-term incentive plan – redemption	2,986	(2,986)	–	–	–	–
Shares issued upon conversion of convertible debentures	24	–	–	–	–	24
Profit for the year	–	–	16,418	–	–	16,418
Dividends	–	–	(37,468)	–	–	(37,468)
Other comprehensive income (note 20)	–	–	–	(1,366)	–	(1,366)
<b>Balance, December 31, 2015</b>	<b>\$ 477,500</b>	<b>\$ 23,312</b>	<b>\$ (197,605)</b>	<b>\$ (2,850)</b>	<b>\$ 757</b>	<b>\$ 301,114</b>

2014	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Equity component of convertible debenture	Total equity
Balance, January 1, 2014	\$ 474,088	\$ 16,514	\$ (164,273)	\$ (1,839)	\$ 757	\$ 325,247
Long-term incentive plan – issuance (notes 19 and 20)	–	4,630	–	–	–	4,630
Long-term incentive plan – redemption	332	(332)	–	–	–	–
Shares issued upon conversion of convertible debentures	70	–	–	–	–	70
Profit for the year	–	–	25,140	–	–	25,140
Dividends	–	–	(37,422)	–	–	(37,422)
Other comprehensive income (note 20)	–	–	–	355	–	355
<b>Balance, December 31, 2014</b>	<b>\$ 474,490</b>	<b>\$ 20,812</b>	<b>\$ (176,555)</b>	<b>\$ (1,484)</b>	<b>\$ 757</b>	<b>\$ 318,020</b>

See accompanying notes to the consolidated financial statements.

# MORNEAU SHEPELL INC.

## Consolidated Statements of Cash Flows

(In thousands of Canadian dollars)

Years ended December 31, 2015 and 2014

	2015	2014
Operating activities:		
Profit for the year	\$ 16,418	\$ 25,140
Items not involving cash:		
Depreciation and amortization	32,867	33,947
Impairment (notes 9 and 27)	2,890	–
Finance costs (note 14)	15,002	14,582
Long-term incentive plan expense (note 19)	5,194	4,515
Income taxes (note 17)	7,751	11,944
Change in provisions	338	(1,297)
Gain on business divestitures (note 5)	–	(1,763)
Other	(330)	3,805
	80,130	90,873
Change in non-cash operating working capital (note 23)	4,988	(14,598)
Cash generated from operating activities	85,118	76,275
Finance costs paid	(13,496)	(12,982)
Income taxes paid	(7,724)	(14,377)
Cash provided by operating activities	63,898	48,916
Financing activities:		
Change in revolving loan (net)	19,216	46,513
Credit facility agreement amendment fees (note 14)	(107)	–
Dividends paid	(37,468)	(37,422)
Repayment of promissory note	(2,500)	–
Cash provided by (used in) financing activities	(20,859)	9,091
Investing activities:		
Business acquisitions (note 4)	(10,055)	(29,757)
Business divestitures (note 5)	–	5,324
Additions to intangible assets	(15,215)	(13,879)
Additions to capital assets	(10,698)	(19,671)
Cash used in investing activities	(35,968)	(57,983)
Increase in cash for the year	7,071	24
Bank indebtedness, beginning of year	(5,171)	(5,195)
Cash (bank indebtedness), end of year	\$ 1,900	\$ (5,171)

See accompanying notes to the consolidated financial statements.

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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## 1. Organization and nature of the business:

Morneau Shepell Inc. was incorporated pursuant to the laws of the Province of Ontario on October 19, 2010 and is a continuation of Morneau Sobeco Income Fund, which was converted from an income trust structure into Morneau Shepell Inc., effective January 1, 2011.

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

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

These consolidated financial statements were approved by the Company's Board of Directors on March 2, 2016.

## 2. Basis of preparation:

### (a) Statement of compliance:

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

### (b) Basis of measurement:

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

- (i) interest rate swap is measured at fair value;
- (ii) future consideration related to acquisitions is measured at fair value; and
- (iii) net pension benefit liability is measured in accordance with employee benefit policy

### (c) Functional currency:

These consolidated financial statements are presented in Canadian dollars, which is the Company's presentation currency and functional currency of Morneau Shepell Inc. Items included in the financial statements of each of Morneau Shepell Inc.'s subsidiaries are measured using their functional currency, which

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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is the currency of the primary economic environment in which they operate in. Unless otherwise noted, all financial information presented herein is in thousands of Canadian dollars.

(d) Use of estimates and judgments:

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

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

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

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

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

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

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

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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(ii) Unbilled fees:

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

(iii) Intangible assets (note 9):

(a) Internally-developed software:

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

(b) Other intangible assets:

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

(iv) Goodwill (note 10):

Goodwill impairment review involves significant estimates and assumptions regarding cash flow projections, growth projections, economic risk, and cost of capital. If future events or results differ adversely from these estimates and assumptions, the Company could incur impairment charges in future periods. Additional discussion on impairment of long-lived assets can be found in notes 9 and 10.

(v) Trade receivables (allowance for doubtful accounts) (note 6):

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

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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(vi) Deferred income tax assets and liabilities (utilization of tax losses) (note 17):

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

(vii) Provisions (note 13):

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

(viii) Future consideration related to acquisitions (note 28):

The Company may pay future consideration related to acquisitions based upon performance measures contractually agreed at the time of purchase. Management estimates the future consideration payable based on underlying contract terms, and best estimates of the future performance of the acquiree. Depending on the future performance of the acquiree, management estimates of the amounts payable for future consideration related to acquisitions may materially differ from the consideration ultimately paid.

### 3. Significant accounting policies:

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

(a) Basis of consolidation:

(i) Business combinations:

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

Goodwill arising on acquisition is initially measured at cost, being the difference between the fair value of the consideration transferred including the recognized amount of any non-controlling interest in the acquiree and the net recognized amount (generally fair value) of the identifiable assets and liabilities assumed at the

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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

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

## (ii) Subsidiaries:

These consolidated financial statements include the assets, liabilities, revenue and expenses of all the Company's subsidiaries. Subsidiaries are entities that the Company controls either when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated from the date control is transferred to the Company, and de-consolidated from the date control ceases.

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

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	<b>% Ownership</b>
Morneau Shepell Ltd.	100.0
Morneau Shepell Limited	100.0
Morneau Shepell Asset & Risk Management Ltd.	100.0
Morneau Shepell (Bahamas) Ltd.	100.0
Groupe AST (1993) Inc.	100.0
Morneau Shepell BDA Limited	100.0

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

## (b) Foreign currency translation:

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

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

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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(c) Revenue recognition and unbilled fees:

Revenues include fees generated from outsourcing, consulting services, Employee Support Solutions (“ESS”), and absence management solutions contracts.

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

- (i) the amount of revenue can be reliably measured;
- (ii) the stage of completion can be reliably measured;
- (iii) the receipt of economic benefits is probable; and
- (iv) costs incurred and to be incurred can be reliably measured.

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

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

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

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

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

- (i) the delivered item has value to the customer on a stand-alone basis; and
- (ii) the fair value of the undelivered item can be reliably measured.

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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

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

Other sources of operating revenue include the following:

- (i) Investment income earned in the course of normal business operations, and is recorded on the accrual basis.
- (ii) Commissions income are recognized when earned, which is at the later of the billing or the effective date of the policy, net of a provision for return commissions due to policy cancellations or change of brokers.

(d) Deferred implementation costs and deferred outsourcing revenues:

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

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

(e) Cash and bank indebtedness:

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

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

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(f) Trade and other receivables:

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

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

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

(g) Capital assets:

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

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

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

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

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

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# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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

(h) Intangible assets:

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

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

- (i) it is technically feasible to complete the software so that it will be available for use;
- (ii) management intends to complete the software and use or sell it;
- (iii) the Company is able to use or sell the software;
- (iv) future benefits associated with the software can be demonstrated;
- (v) adequate technical, financial, and other resources to complete the development and to use or sell the software are available; and
- (vi) the expenditures attributable to the software during its development can be reliably measured.

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

Purchased software is recognized at initial cost.

Other intangible assets acquired as part of business acquisitions are measured initially at fair value.

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

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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

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

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

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

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

(i) Goodwill:

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

(j) Impairment of non-financial assets:

The Company's identifiable tangible and intangible assets with finite useful lives are reviewed for indications of impairment at each statement of financial position date and when events or changes in circumstances indicate that they may be impaired. Impairments are recorded when the recoverable amount of assets are less than their carrying amounts. The recoverable amount is the higher of an asset's fair value less cost of disposal or its value in use.

Similarly, intangible assets with indefinite useful lives and goodwill are tested annually and whenever impairment indicators are identified, by estimating their recoverable amounts and comparing it to their carrying amounts. Where individual assets cannot be tested individually, they are grouped together into cash-generating units ("CGUs"), which represent the smallest group of assets that are capable of generating cash inflows from continuing use largely independent of other groups of assets, and tested on this basis. Goodwill

# MORNEAU SHEPELL INC.

## Notes to Consolidated Financial Statements

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acquired through a business combination is allocated to each CGU, or groups of CGUs but not larger than an operating segment, that are expected to benefit from the synergies of the combination.

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

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

(k) Provisions:

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

(l) Deferred revenue:

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

(m) Convertible debentures:

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

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

# MORNEAU SHEPELL INC.

## Notes to Consolidated Financial Statements

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

Years ended December 31, 2015 and 2014

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

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

(n) Share capital:

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

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

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

(p) Employee benefits:

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

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

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

(i) Defined benefit plan:

The liability recognized in the consolidated statements of financial position in respect of the defined benefit option is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated using the projected benefit method pro-rated on service. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension obligation. Past service costs are recognized immediately in profit or loss. Interest is recognized on the net defined benefit liability using market yields on high quality bonds.

# MORNEAU SHEPELL INC.

Notes to Consolidated Financial Statements

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(ii) Defined contribution plan:

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

For other members who had completed at least 10 years of service on December 31, 2010, their contributions follow the grandfathered provisions. Each member is required to contribute a specific dollar amount based on the member's job level classification. Each member may elect to make an optional contribution up to 300% of the member's required contribution. The Company matches required contributions and contributes 75% of optional contributions for grandfathered members and 50% for all other members.

The Company has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due.

(q) Share-based compensation plan:

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

Expense related to LTIP Units is measured based on the fair value of the awards at the grant date. The expense is recognized as salary, benefit and contractor expense over the vesting period, which is the period over which all of the specified vesting conditions are satisfied. As LTIP Units vest, they are issued to the participant and are recorded as share capital. At the option of the Company holders of LTIP Units are entitled to either additional LTIP Units as determined based on the fair market value of those LTIP Units on the date credited or cash bonuses equivalent to the dividends payable had those Units been common shares. LTIP Units credited under the dividend reinvestment policy ("DRIP") vest at the same rate as the LTIP Units to which they are determined. Cash bonuses are recorded as salary, benefit, and contractor expense.

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

(r) Income taxes:

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

# MORNEAU SHEPELL INC.

## Notes to Consolidated Financial Statements

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

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

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

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

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

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

(s) Financial instruments:

Financial assets and liabilities are recognized initially at fair value, defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In certain circumstances, however, the initial fair value may be based on other observable current market transactions in the same instrument, without modification or on a valuation technique using market based inputs. Subsequent measurement of the Company's financial assets and liabilities is dependent on their classification as held for trading, loans and receivables, other financial liabilities or derivative instruments.

# MORNEAU SHEPELL INC.

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

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

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

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

(i) Non-derivative financial assets:

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

Financial assets at fair value through profit and loss are comprised of cash and investments held in trust. A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if it is a part of an identified portfolio of financial instruments that the Company manages and has an actual pattern of short-term profit-taking. Upon initial recognition attributable transaction costs are recognized in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value at each reporting date, and any unrealized gains or losses from market fluctuations are recognized in profit or loss.

(b) Loans and receivables:

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

# MORNEAU SHEPELL INC.

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## (ii) Non-derivative financial liabilities:

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

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

Non-derivative financial liabilities of the Company include long-term debt, convertible debenture payable, bank indebtedness, trade and other payables, promissory notes and insurance premium liabilities.

## (iii) Derivative financial instruments:

Derivative financial instruments are used by the Company in the management of its interest rate risk exposure on debt financing. Derivatives that have been designated and function effectively as hedges are accounted for using hedge accounting principles (see note 3(t) below). Derivative financial instruments that are not accounted for as a hedging instrument are measured at fair value through profit or loss.

## (iv) Fair value of financial instruments:

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

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

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

# MORNEAU SHEPELL INC.

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(t) Cash flow hedge - derivative instruments:

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

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

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

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

(u) Changes in accounting policies:

These changes were made in accordance with the applicable transitional provisions.

(i) IFRS 8, Operating Segments ("IFRS 8"):

IFRS 8 has been amended to explicitly require disclosure of judgments made in applying the aggregation criteria to aggregate operating segments. The amendments to IFRS 8 also clarify that a reconciliation of total reportable segments' assets to the entity's total assets is only required if this information is regularly provided to the entity's chief operating decision maker. The Company adopted these amendments to IFRS 8 effective January 1, 2015. The adoption of these amendments resulted in the Company enhancing its disclosure of the criteria that it uses to identify its reportable segment for the purposes of disclosure in its consolidated financial statements (see note 22).

# MORNEAU SHEPELL INC.

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

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(v) Future accounting changes:

(i) IFRS 15, Revenue from Contracts with Customers (“IFRS 15”)

On May 28, 2014 the IASB issued IFRS 15. The new standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company intends to adopt IFRS 15 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.

(ii) IFRS 9, Financial Instruments (“IFRS 9”)

In July 2014 the IASB finalized IFRS 9. The standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The new standard includes revised guidance on the classification and measurement of financial assets, a new ‘expected loss’ impairment model and introduces a substantially-reformed approach to hedge accounting. The Company intends to adopt IFRS 9 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.

(iii) IFRS 16, Leases (“IFRS 16”)

In January 2016, the IASB issued IFRS 16. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted for those entities that have also adopted IFRS 15. The new standard provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements. IFRS 16 supersedes IAS 17, Leases, and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, differentiating between leases and service contracts on the basis of whether there is an identified asset controlled by the customer. Among other significant changes, the distinction between operating and finance leases is removed and assets and liabilities are recognized in respect of all leases. Furthermore, IFRS 16 requires a front-loaded pattern for the recognition of lease expense over the life of the lease. The Company intends to adopt IFRS 16 in its 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.

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## 4. Business acquisitions:

### (a) Bensigner Du Pont & Associates, Inc.

On November 30, 2015, the Company completed the acquisition of 100% of the outstanding shares of Bensigner Du Pont & Associates, Inc. ("BDA"), a U.S. based company providing problem gambling services, drug testing management and employee and family assistance programs. This acquisition complements the Company's existing employee support solutions line of business, and expands the Company's operations and service offerings in the U.S.

The consideration for this acquisition included an initial payment of \$9,217 (\$7,000 U.S.) that was settled on closing, an additional \$236 (\$170 U.S.) in cash consideration for working capital and other adjustments which is expected to be settled in the first quarter of 2016, and estimated future cash consideration of \$2,671 (\$2,000 U.S.) which is dependent on achieving certain revenue targets and is due within 120 days of 2017. At the date of acquisition, \$2,229 was recognized as an acquisition liability representing the estimated future cash payments discounted.

This acquisition has been accounted for using the acquisition method of accounting. The allocation of the \$11,446 purchase consideration for this acquisition is preliminary, and is as follows:

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Working capital	\$ 1,432
Intangible assets	5,613
Goodwill	4,401
	<hr/>
	\$ 11,446

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The goodwill is attributable primarily to the network of providers acquired and from the ability to expand the Company's existing employee support solutions practice in the U.S. The goodwill is deductible for tax purposes.

From the date of acquisition up to and including December 31, 2015, BDA has contributed revenues of \$1,147 and profit of \$100. Had this acquisition occurred on January 1, 2015, the Company estimates that the consolidated revenues of the Company would have been higher by \$10,700 and the profit would remain unchanged. In determining these amounts, the Company has assumed that the fair value adjustments that arose on the acquisition date of BDA would have been the same had the acquisition occurred on January 1, 2015.

# MORNEAU SHEPELL INC.

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(b) Other Acquisitions during year ended December 31, 2015

In 2015, the Company completed two other smaller strategic acquisitions. On March 13, 2015, the Company completed the acquisition of PAE Consultants Inc. ("PAE"). This acquisition complements the Company's existing Employee Support Solutions line of business, and expands the Company's market presence. On August 1, 2015, the Company acquired the U.S. health and welfare benefits administration business of Ceridian. This acquisition expands the Company's U.S. presence and complements the Company's existing Administrative Solutions line of business. The total consideration for the above acquisitions was as follows:

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Amounts paid on closing	\$288
Future consideration, discounted	\$1,598

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Of the future consideration, \$1,191 is dependent on achieving certain revenue targets. At December 31, 2015, \$1,684 has been recognized as an acquisition liability on the statement of financial position, representing the fair value of future cash consideration discounted.

These acquisitions have been accounted for using the acquisition method of accounting. The allocation of the \$1,886 purchase consideration for these acquisitions is final, and is as follows:

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Intangible assets	\$ 1,868
Capital assets	72
Deferred tax liability	(54)
	<hr/> \$ 1,886

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(c) Groupe AST (1993) Inc.:

On March 3, 2014, the Company completed the acquisition of 100% of the outstanding shares of Groupe AST (1993) Inc. ("Groupe AST") from ADP Canada Co. This acquisition complements the Company's existing workers' compensation practice in the Absence Management Solutions line of business. Acquiring Groupe AST will expand the Company's client base and market share in Quebec and nationally.

The consideration for this acquisition included an initial payment of \$27,000 that was settled on closing, an additional \$686 in cash consideration for working capital adjustments, of which \$553 was settled in the second quarter of 2014 and the remainder was settled in the first quarter of 2015, and the issuance of promissory notes in the principal amount of \$5,000. The promissory notes are unsecured, non-interest

# MORNEAU SHEPELL INC.

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bearing and had a fair value of \$4,664 upon issuance, with \$2,500 due and paid on February 28, 2015, and \$2,500 due on February 28, 2016. The fair value of the promissory notes due on February 28, 2015 and 2016 on initial recognition was determined using market rates of interest of 4.70% and 4.80%, respectively, that would be charged on similar promissory notes issued by a company with a similar risk profile (Level 2 inputs on the fair value hierarchy). The promissory notes are accreted to their principal amount due on maturity as finance costs through profit or loss. At December 31, 2015, \$2,481 has been recognized on the statement of financial position, representing the amortized cost of the promissory note due to be paid on February 28, 2016.

The final purchase price allocation was as follows:

Cash	\$	107
Trade and other receivables		1,518
Prepaid expenses and other		65
Income taxes receivable		496
Capital assets		671
Intangible assets		23,520
Goodwill		15,703
Trade and other payables		(1,254)
Deferred revenue		(2,287)
Deferred tax liability		(6,188)
	\$	32,351

The goodwill acquired is attributable primarily to the synergies expected to be achieved from integrating Groupe AST's workers' compensation practice into the Company's existing Absence Management Solutions line of business. The goodwill recognized is not deductible for tax purposes.

From the date of acquisition up to and including December 31, 2014, Groupe AST has contributed revenues of \$18,908 and profit of \$4,434. Had this acquisition occurred on January 1, 2014, the Company estimates that the consolidated revenues of the Company would have been higher by \$3,505 and consolidated profit would have remained unchanged. In determining these amounts, the Company has assumed that the fair value adjustments that arose on the acquisition date of Groupe AST would have been the same had the acquisition occurred on January 1, 2014.

#### (d) Other Acquisitions during year ended December 31, 2014

In 2014, the Company completed three other smaller strategic acquisitions. On March 31, 2014, the Company completed the acquisition of Pacific Risk Management Corp. ("PRM"), a workers' compensation provider in British Columbia. On July 4, 2014, the Company completed the acquisition of Blue Balloon Health Services

# MORNEAU SHEPELL INC.

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("Blue Balloon"), a privately-held group of professionals providing pediatric health-centered care in the Greater Toronto Area. Finally, on December 31, 2014 the Company completed the acquisition of D.A. Krieger Insurance Agency Ltd. ("Krieger"), a Health and Benefits consulting provider in Ontario. These acquisitions complement our Absence Management Solutions, Employee Support Solutions and Consulting lines of business. The estimated consideration for the above acquisitions at the date of acquisition was as follows:

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Amounts paid on closing and settlement of working capital adjustments	\$1,439
Future consideration, discounted	359
	<hr/>
	\$1,798

The future consideration is dependent on achieving certain revenue and/or earnings before interest, taxes, depreciation and amortization ("EBITDA") targets. No amounts have been paid for future consideration related to these acquisitions. The fair value of the future consideration related to these acquisitions as at December 31, 2015 is nil.

These acquisitions have been accounted for using the acquisition method of accounting. The allocation of the \$1,798 purchase consideration for these acquisitions was as follows:

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Working capital	\$56
Intangible assets	1,131
Capital assets	60
Goodwill	622
Deferred tax liability	(71)
	<hr/>
	\$1,798

Goodwill arose on the Blue Balloon acquisition and is attributable primarily to the workforce and the synergies expected to be achieved from the ability to expand the Company's existing Children's Support Solutions portfolio. For the purpose of impairment testing, the goodwill amount has been included under the Employee Support Solutions CGU.

## 5. Business divestitures:

During 2014, the Company completed a strategic review of its clinic-based occupational health operations and made the decision to exit the business. The Company closed some locations and sold the remainder of the business and health clinic locations, including its 48% and 70% interest held in Innu-Med Inc. and FGI World New Caledonia, respectively. The assets and liabilities disposed of were comprised of the following:

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Cash	\$	376
Trade and other receivables		5,774
Unbilled fees		356
Prepaid expenses and other		40
Capital assets		78
Intangible assets		176
Trade and other payables		(900)
Income taxes payable		(15)
	\$	5,885

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The sales price included cash consideration of \$5,700 that was received during the third quarter of 2014, future cash consideration including adjustments for working capital and customer contracts of \$568 which were settled in the first quarter of 2015, and a \$2,000 holdback receivable that was received in the third quarter of 2015. The holdback receivable is included in Trade and other receivables on the December 31, 2014 statement of financial position. Its fair value on initial recognition of \$1,860 was determined using a market rate of interest of 7.5% that would be received on a similar holdback receivable due from a company with a similar risk profile as the purchaser (Level 2 inputs on the fair value hierarchy). The holdback receivable was accreted to its gross amount receivable on maturity as a reduction of finance costs through profit or loss.

Total selling costs for the divestiture of the Health Clinics sub-service line were \$191. The gain recognized through profit or loss for the divestiture, including reclassification of foreign currency translation differences on the divestiture of FGI World New Caledonia from accumulated other comprehensive income, was \$1,763.

### 6. Trade and other receivables:

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

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	December 31, 2015	December 31, 2014
Trade receivables	\$ 65,357	\$ 71,847
Less allowance for doubtful accounts	(802)	(803)
Net trade receivables	64,555	71,044
Other receivables	1,024	3,328
	\$ 65,579	\$ 74,372

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# MORNEAU SHEPELL INC.

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

	December 31, 2015	December 31, 2014
Current	\$ 21,304	\$ 24,693
Past due 1 - 30 days	20,350	19,049
Past due 31 - 90 days	12,937	11,883
Past due > 90 days	10,766	16,222
	\$ 65,357	\$ 71,847

The change in allowance for doubtful accounts was as follows:

Balance, January 1, 2014	\$ 728
Additions	482
Amounts written off as uncollectible	(407)
Balance, December 31, 2014	803
Additions	2,966
Amounts written off as uncollectible	(2,967)
Balance, December 31, 2015	\$ 802

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## 7. Deferred implementation costs:

The Company's deferred implementation costs comprise the following:

	Cost	Accumulated amortization	Net book value
Balance, January 1, 2014	\$ 22,164	\$ (7,337)	\$ 14,827
Deferred implementation costs for the year, net of revenue	10,877	–	10,877
Amortization for the year	–	(5,084)	(5,084)
Balance, December 31, 2014	33,041	(12,421)	20,620
Deferred implementation costs for the year, net of revenue	13,282	–	13,282
Write-down of HRI deferred implementation costs (note 29)	–	(12,210)	(12,210)
Amortization for the year	–	(7,316)	(7,316)
Effect of movement in exchange rates	3,727	(1,832)	1,895
Balance, December 31, 2015	\$ 50,050	\$ (33,779)	\$ 16,271
Less current portion			5,440
Non-current portion			\$ 10,831

## 8. Capital assets:

The Company's capital assets comprise the following:

	Computer hardware	Furniture and fixtures	Leasehold improvements	Total
<b>Cost</b>				
Balance, January 1, 2014	\$ 22,965	\$ 8,052	\$ 22,551	\$ 53,568
Additions	6,632	2,473	10,566	19,671
Acquired through business acquisitions (note 4)	38	632	61	731
Disposals	(347)	(21)	(618)	(986)
Effect of movement in exchange rates	195	152	223	570
Balance, December 31, 2014	29,483	11,288	32,783	73,554
Additions	6,218	1,250	3,230	10,698
Acquired through business acquisitions (note 4)	72	–	–	72
Disposals of fully depreciated assets	(14,169)	(4,309)	(8,618)	(27,096)
Effect of movements in exchange rates	382	238	597	1,217
Balance, December 31, 2015	\$ 21,986	\$ 8,467	\$ 27,992	\$ 58,445

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	Computer hardware	Furniture and fixtures	Leasehold improvements	Total
<b>Accumulated depreciation</b>				
Balance, January 1, 2014	\$ 13,558	\$ 4,894	\$ 12,258	\$ 30,710
Depreciation	5,134	1,303	2,756	9,193
Impairment charges	(289)	(21)	(618)	(928)
Disposals	63	21	36	120
Balance, December 31, 2014	18,466	6,197	14,432	39,095
Depreciation	5,982	1,308	3,007	10,297
Disposals of fully depreciated assets	(14,169)	(4,309)	(8,618)	(27,096)
Effect of movements in exchange rates	257	74	160	491
Balance, December 31, 2015	\$ 10,536	\$ 3,270	\$ 8,981	\$ 22,787
<b>Carrying amount</b>				
December 31, 2014	\$ 11,017	\$ 5,091	\$ 18,351	\$ 34,459
December 31, 2015	\$ 11,450	\$ 5,197	\$ 19,011	\$ 35,658

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### 9. Intangible assets:

The Company's intangible assets comprise the following:

Cost	Indefinite useful life		Finite useful life				Total	
	Trade names	Customer relationships	Customer contracts	Proprietary software	Internally-developed software	Purchased software		
Balance, January 1, 2014	\$ 70,000	\$ 208,126	\$ -	\$ 2,497	\$ 26,817	\$ 10,598	\$ 155	\$ 318,193
Internally Developed	-	-	-	-	9,336	-	-	9,336
Purchased	-	-	-	1,500	-	3,043	-	4,543
Acquired through business acquisitions	-	19,931	4,720	-	-	-	-	24,651
Disposals	-	(1,992)	-	-	(516)	-	-	(2,508)
Effects of movements in exchange rates	-	-	-	95	-	17	-	112
Balance, December 31, 2014	70,000	226,065	4,720	4,092	35,637	13,658	155	354,327
Internally Developed	-	-	-	-	13,338	-	-	13,338
Purchased	-	-	-	-	-	1,877	-	1,877
Acquired through business acquisitions	-	7,481	-	-	-	-	-	7,481
Disposals of fully depreciated assets	-	-	-	-	-	(7,861)	-	(7,861)
Effects of movements in exchange rates	-	226	-	87	-	141	-	454
Balance, December 31, 2015	\$ 70,000	\$ 233,772	\$ 4,720	\$ 4,179	\$ 48,975	\$ 7,815	\$ 155	\$ 369,616

# MORNEAU SHEPELL INC.

## Notes to Consolidated Financial Statements

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	Indefinite useful life		Finite useful life					Total
	Trade names	Customer relationships	Customer contracts	Proprietary software	Internally-developed software	Purchased software	Other	
<b>Accumulated amortization</b>								
Balance, January 1, 2014	\$ -	\$ 84,800	\$ -	\$ 480	\$ 5,226	\$ 5,722	\$ 8	\$ 96,236
Amortization	-	12,992	4,259	250	4,214	3,024	15	24,754
Disposals	-	(1,816)	-	-	(516)	-	-	(2,332)
Effects of movements in exchange rates	-	-	-	19	-	25	-	44
Balance, December 31, 2014	-	95,976	4,259	749	8,924	8,771	23	118,702
Amortization	-	13,379	395	400	5,211	3,170	15	22,570
Impairment charges (note 27)	-	-	-	-	2,890	-	-	2,890
Disposals of fully depreciated assets	-	-	-	-	-	(7,861)	-	(7,861)
Effects of movements in exchange rates	-	-	-	-	-	10	-	10
Balance, December 31, 2015	\$ -	\$ 109,355	\$ 4,654	\$ 1,149	\$ 17,025	\$ 4,090	\$ 38	\$ 136,311
<b>Carrying amount</b>								
Balance, December 31, 2014	\$ 70,000	\$ 130,089	\$ 461	\$ 3,343	\$ 26,713	\$ 4,887	\$ 132	\$ 235,625
Balance, December 31, 2015	\$ 70,000	\$ 124,417	\$ 66	\$ 3,030	\$ 31,950	\$ 3,725	\$ 117	\$ 233,305

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As at December 31, 2015, \$6,360 (2014 - \$5,281) of internally-developed software remained under development and had not been put into use.

Impairment test of indefinite-lived intangible assets:

For the purposes of impairment testing, the cash flows associated with the Company's trade name have been allocated to the ESS CGU. In accordance with our policy described in note 2, an impairment test for the trade name was performed for the year ended December 31, 2015 as part of the impairment testing of goodwill included in the ESS CGU (see note 10). The estimated fair value less cost of disposal exceeded its carrying value, and as a result, no impairment charge was recorded. The valuation techniques, significant assumptions and sensitivities applied in the trade name impairment test are similar to Goodwill and are described in note 10.

## 10. Goodwill:

(i) The change in goodwill was as follows:

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Balance, January 1, 2014	\$ 295,067
Acquired through business combination – Groupe AST	15,703
Acquired through business combination – Blue Balloon	622
Effect of movement in exchange rates	267
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Balance, December 31, 2014	311,659
Acquired through business combination – BDA	4,401
Effect of movement in exchange rates	774
Balance, December 31, 2015	\$ 316,834

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(ii) Impairment test of goodwill

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

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	December 31, 2015	December 31, 2014
Consulting	\$ 113,536	\$ 113,536
Administrative Solutions	65,136	64,514
Employee Support Solutions	122,459	117,906
Absence Management Solutions	15,703	15,703
	<u>\$ 316,834</u>	<u>\$ 311,659</u>

Goodwill impairment is assessed on an annual basis and whenever there is an indication that the asset may be impaired. The valuation techniques, significant assumptions and sensitivities applied in the goodwill impairment test as at December 31, 2015 and December 31, 2014 are described below.

(a) Valuation technique:

The recoverable amount of each CGU was calculated based on its fair value less costs of disposal, using an income approach to estimate its fair value. The recoverable amount of each CGU was as follows:

	December 31, 2015	December 31, 2014
Consulting	\$ 370,400	\$ 395,400
Administrative Solutions	336,000	310,500
Employee Support Solutions	343,900	372,900
Absence Management Solutions	72,900	72,500
	<u>\$ 1,123,200</u>	<u>\$ 1,151,300</u>

The income approach is predicated upon the value of the future cash flows that the business is expected to generate going forward. The discounted cash flow ("DCF") method was used which involved projecting cash flows and converting them into a present value equivalent through discounting. The discounting process uses a rate of return that will commensurate with the risks associated with the business and the time value of money. This approach requires assumptions about revenue growth rates, operating margins, prevailing tax rates, and discount rates, which are Level 3 inputs based on the fair value hierarchy.

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

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## (b) Growth and EBITDA margins

The assumptions used were based on the Company's internal forecasts. The Company projected revenue, EBITDA margins, working capital, and capital expenditures for a period of five years, and applied a perpetual long-term growth rate thereafter. Customer retention rates, past experience, economic trends (i.e. GDP, CPI, interest rate, and unemployment rate projections), and human resource industry and market trends were also considered in deriving these forecasts. A perpetuity growth rate of 2.5% (2014: 3.0%) was applied in determining the recoverable amount of the CGUs.

## (c) Discount rate:

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

The following discount rates were applied in determining the recoverable amount of the CGU:

	December 31, 2015	December 31, 2014
Consulting	10.8%	9.9%
Administrative Solutions	11.0%	11.0%
Employee Support Solutions	9.9%	9.6%
Absence Management Solutions	11.9%	11.4%

The recoverable amounts of the Consulting, Administrative Solutions, Employee Support Solutions, and Absence Management Solutions CGUs assessed as at December 31, 2015 and 2014, were all in excess of their respective carrying amounts.

The Company has also performed a sensitivity analysis on the perpetuity growth rate and discount rate in assessing the recoverable amounts of each of the CGUs. Sensitivity analysis indicates reasonable changes to key assumptions will not result in an impairment loss for the CGUs.

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## 11. Trade and other payables:

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

	December 31, 2015	December 31, 2014
Trade payables and accrued liabilities	\$ 24,524	\$ 25,133
Accrued salaries and compensation	26,926	28,996
Other current liabilities	2,791	2,806
	\$ 54,241	\$ 56,935

## 12. Other liabilities:

The Company's other liabilities were as follows:

	December 31, 2015	December 31, 2014
Acquired above-market leases	\$ 1,486	\$ 2,304
Deferred lease obligations	11,909	10,821
Net pension benefit liability (note 18)	157	358
	\$ 13,552	\$ 13,483

## 13. Provisions:

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

	December 31, 2015	December 31, 2014
Contingency reserve	\$ 596	\$ 561
Sublease loss provisions	1,771	1,468
	\$ 2,367	\$ 2,029

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The following tables present the movement in provisions for the years ended December 31, 2015 and 2014:

	Sublease loss provisions	Contingency reserve	Total provisions
Balance, January 1, 2014	\$ 2,877	\$ 449	\$ 3,326
Accrual	–	202	202
Utilization and amortization	(1,409)	(90)	(1,499)
Balance, December 31, 2014	\$ 1,468	\$ 561	\$ 2,029
Accrual and accretion	1,000	90	1,090
Utilization and amortization	(697)	(55)	(752)
Balance, December 31, 2015	\$ 1,771	\$ 596	\$ 2,367

## 14. Long-term debt:

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

	December 31, 2015	December 31, 2014
Revolving loans	\$ 242,456	\$ 223,240
Less: debt issuance costs, net of accumulated amortization	(610)	(805)
	\$ 241,846	\$ 222,435

The Company had a credit facility agreement (the "Credit Facility Agreement") maturing on November 29, 2017 which provided for a revolving facility of \$250,000 (including a swing line of \$7,000). The credit facility agreement was amended during the second quarter of 2015 to form the amended credit facility agreement (the "Amended Credit Facility Agreement"). The Amended Credit Facility Agreement's maturity date remains unchanged, but now provides for a revolving facility of \$300,000 (including a swing line of \$7,000).

Under IAS 39, the amendments to the Original Credit Facility Arrangement were not substantive and therefore, amounts owing under the Credit Facility Agreement at the date of amendment were not deemed to be extinguished.

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The interest rates for the Amended Credit Facility Agreement are floating, based on a margin over certain referenced rates of interest. The applicable margin may vary up or down depending on the ratio of the Company's consolidated Debt to Adjusted EBITDA as defined in the Amended Credit Facility Agreement.

The Amended Credit Facility is secured by a general assignment of all the assets of the Company and requires the Company to maintain, on a consolidated basis, a Debt to Adjusted EBITDA financial covenant of not more than 3.0:1.0 or for the twelve month period immediately following the completion of a permitted acquisition as defined in the Amended Credit Facility Agreement with a purchase price of \$25,000 or more, not more than 3.5:1.0, and an EBITDA to interest expense ratio of not less than 3.0:1.0.

In the calculation of the consolidated Debt to Adjusted EBITDA financial covenant under the Amended Credit Facility Agreement, Debt excludes the Convertible Debenture payable.

EBITDA in the Credit Facility Agreement is defined as profit before finance costs, income taxes, depreciation, amortization, non-controlling interest, non-recurring gains, and limited non-recurring losses. Adjusted EBITDA is defined as EBITDA plus the pro-forma EBITDA from permitted acquisitions' entities.

At December 31, 2015, the Company had utilized the following amounts under the Amended Credit Facility:

- \$230,000 of BA loans under the revolving loan. The BA loans are renewed on a monthly basis, bearing interest at the one-month BA rate plus an applicable margin of 1.70%.
- \$9,688 (U.S. \$7,000) of US Libor loans under the revolving loan. The US Libor loans are renewed on a monthly basis, bearing interest at the one-month Libor rate plus an applicable margin of 1.70%.
- \$2,768 (U.S. \$2,000) of US Base Rate loans under the revolving loan. The US Base Rate loans are renewed on a monthly basis, bearing interest at the one-month US Base Rate plus an applicable margin of 0.70%.
- \$nil of the swing line available. The swing line carries interest at prime plus an applicable margin of 0.70%.

As at December 31, 2015, the Company complied with all the required financial covenants.

(a) Interest rate swaps:

The Company entered into a forward starting interest-rate swap agreement in February 2014 to hedge against the variable interest rate component on \$160,000 notional amount borrowed under the Amended Credit Facility Agreement for the period from January 5, 2015 up to and ending November 29, 2017. The notional amount of this swap is \$160,000 and is used to fix the variable component of the interest rate at 1.98%, before the applicable margin, for the duration of this period and has been designated as a cash flow hedge. As detailed above, the amendments to the Credit Facility Agreement were not considered substantive and therefore the variable interest payments on this revolving facility, the hedged item under the designated cash

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flow hedge, were not deemed to be extinguished under IAS 39. Therefore, the designated cash flow hedge was not required to be discontinued upon the amendment of the credit facility arrangement.

The fair value of the interest rate swap at December 31, 2015 was a liability of \$3,675 (December 31, 2014 - \$2,113).

## (b) Finance costs:

The Company's finance costs comprise the following:

	2015	2014
Interest on term loan, revolving loan, bank indebtedness and other charges	\$ 8,874	\$ 8,696
Interest on convertible debenture	4,521	4,529
Amortization of debt issuance costs	998	986
Other	609	371
	\$ 15,002	\$ 14,582

## 15. Convertible debentures:

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

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

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The following table indicates the changes in the convertible debentures during the years ended December 31, 2015 and 2014:

	Debt component	Equity component
Balance January 1, 2014	\$ 72,021	\$ 757
Accretion and amortization on convertible debentures	924	–
Conversion of convertible debentures	(70)	–
Balance, December 31, 2014	72,875	757
Accretion and amortization on convertible debentures	909	–
Conversion of convertible debentures	(24)	–
Balance, December 31, 2015	\$ 73,760	\$ 757

## 16. Financial instruments:

### (a) Financial risk management:

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

#### (i) Interest rate risk:

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

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

Interest rate sensitivity analysis:

A sensitivity analysis that assumes interest rates increased or decreased by 50 basis points with all other variables held constant would result in an increase or decrease of the Company's interest expense, excluding the interest subjected to interest rate swap agreements, by \$381 (2014 - \$448).

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## (ii) Credit risk:

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

No allowance for credit losses on financial assets was required as of December 31, 2015, other than the allowance for doubtful accounts (note 6). The Company determines its allowance for doubtful accounts based on its best estimate of the net recoverable amount by customer account. Accounts that are considered uncollectible are written off. The Company's bad debt expense for the year ended December 31, 2015 was \$2,966 (2014 - \$482).

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

- (a) Risk associated with concentration of credit risk with respect to accounts receivable is limited due to the credit rating of the Company's top 10 clients.
- (b) Management regularly reviews and assesses customer accounts and credit risk. Historically, bad debt as a percentage of revenue has been minimal.

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

## (iii) Currency risk:

The Company realizes a portion of sales in U.S. dollars and has operations in the United States and thus is exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. Morneau Shepell Inc.'s U.S. operation's functional currency is the U.S. dollar. Any fluctuations in the value of the U.S. dollar relative to the Canadian dollar on the Company's U.S. operation's net assets will result in a change in other comprehensive income for the year. The net revenue exposure after accounting for related expenses denominated in U.S. dollars for the year ended December 31, 2015 was \$7,855 (2014 - \$13,073).

Foreign exchange sensitivity analysis:

As at December 31, 2015, the Company's net exposure to currency risk through its current assets and liabilities denominated in U.S. dollars was U.S. \$12,302. An appreciation (depreciation) of the Canadian dollar against the U.S. dollar would have resulted in an increase (decrease) of \$850 in the Company's profit and other comprehensive income as a result of the Company's net exposure to currency risk through its current assets and liabilities denominated in U.S. dollars. This analysis is based on a foreign currency exchange rate variance of 5% which the Company considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

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## (iv) Liquidity risk:

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

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

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

2015	<1 year	1 - 2 years	3 - 5 years
Non-derivative financial liabilities:			
Trade and other payables	\$ 54,241	\$ –	\$ –
Dividends payable	3,120	–	–
Insurance premium liabilities	12,449	–	–
Future consideration related to acquisitions	1,043	3,346	192
Long-term debt	–	242,456	–
Convertible debentures	–	74,904	–
Promissory note	2,500	–	–
Derivative financial liabilities:			
Cash flow hedges - interest rate swaps	1,906	1,769	–
	\$ 75,259	\$ 322,475	\$ 192

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2014	<1 year	1 - 2 years	3 -5 years
Non-derivative financial liabilities:			
Bank indebtedness	\$ 5,171	\$ –	\$ –
Trade and other payables	56,935	–	–
Dividends payable	3,120	–	–
Insurance premium liabilities	13,120	–	–
Future consideration related to acquisitions	810	537	–
Long-term debt	–	–	223,240
Convertible debentures	–	–	74,929
Promissory notes	2,481	2,369	–
Derivative financial liabilities:			
Cash flow hedges - interest rate swaps	145	1,968	–
	\$ 81,782	\$ 4,874	\$ 298,169

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

(b) Fair values:

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

The following table summarizes information regarding the carrying value, fair value and level used to determine the fair value measurement of the Company's financial assets and liabilities carried at fair value:

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	Carrying Value and Fair Value		Level
	December 31, 2015	December 31, 2014	
Assets carried at fair value:			
Cash and investments held in trust	\$ 12,449	\$ 13,121	2
	\$ 12,449	\$ 13,121	
Liabilities carried at fair value:			
Bank indebtedness	–	5,171	1
Interest rate swaps	3,675	2,113	2
Future consideration related to acquisitions	4,581	1,347	3
	\$ 8,256	\$ 8,631	

## Fair value hierarchy:

Below is a discussion of the Company's determination of fair value for financial instruments carried at fair value. The three levels of fair value hierarchy are defined as follows:

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

During the year ended December 31, 2015, there were no transfers between any levels.

The interest rate swaps are financial instruments carried at fair value through other comprehensive income.

The future consideration related to acquisitions is a financial instrument carried at fair value through profit or loss. Contingent consideration arose on the acquisitions of Dion Durrell Workers' Compensation, PAE, BDA and the U.S. health and welfare benefits administration business of Ceridian. In these acquisitions, there is a clause that entitles the seller to an amount based on exceeding revenue targets. The fair value of the future consideration related to these acquisitions is determined considering the estimated payment, discounted to present value. The contingent consideration remaining to be paid for these acquisitions ranges from a contractual amount of \$nil to a contractual maximum as follows:

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	December 31, 2015	December 31, 2014
BDA	\$ 4,150	\$ –
Dion Durrell Workers' Compensation	838	1,636
U.S. health and welfare benefits administration business of Ceridian	1,290	–
Other acquisitions	216	600
	<u>\$ 6,494</u>	<u>\$ 2,236</u>

The estimated payment is calculated considering different scenarios of projected revenue and EBITDA, and the amount to be paid under each scenario, weighted by the probability of each scenario. The key unobservable inputs include anticipated revenue and EBITDA, and the discount rate. The estimated fair value increases the higher the annual revenue and EBITDA, and the lower the discount rate, with estimated payments being limited to a contractual maximum for each of the acquisitions.

Management considers that changing the above mentioned unobservable inputs to reflect other reasonably possible alternative assumptions would not result in a significant change in the estimated fair value.

The following tables indicate the changes in the future consideration related to acquisitions during the year ended December 31, 2015 and December 31, 2014:

2015	Future consideration related to acquisitions
Balance at January 1, 2015	\$ 1,347
Fair value of future consideration for acquisitions	3,827
Second instalment contingent consideration for Dion Durrell Workers' Compensation	(550)
Accretion on future consideration related to acquisitions	256
Foreign exchange on future consideration related to acquisitions	98
Re-measurement of future consideration related to acquisitions	(397)
	<u>\$ 4,581</u>

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2014	Future consideration related to acquisitions
Balance at January 1, 2014	\$ 1,680
Fair value of future consideration for acquisitions	492
Settlement of final contingent consideration for SBC Systems Company	(552)
First instalment contingent consideration for Dion Durrell Workers' Compensation	(320)
Accretion on future consideration related to acquisitions	209
Foreign exchange on future consideration related to acquisitions	22
Re-measurement of future consideration related to acquisitions	(184)
	<hr/>
	\$ 1,347

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Financial instruments carried at amortized cost:

The carrying values of trade and other receivables, trade and other payables, insurance premium liabilities, and dividends payable are amortized cost and approximate their fair value because of their short-term nature.

The promissory notes are financial instruments carried at amortized cost whose carrying value approximates their fair value. The fair value is determined based on the market rate of interest that would be charged on similar promissory notes issued by a company with a similar risk profile (Level 2).

The convertible debenture payable and long-term debt are financial instruments carried at amortized cost whose carrying values do not equal their fair market values. The convertible debenture payable has a carrying value of \$73,760 (December 31, 2014 - \$72,875) and a fair value of \$77,900 (December 31, 2014 - \$88,416). The fair value is determined using quoted market values (Level 1) for the convertible debentures at the end of the period. The long-term debt has a carrying value of \$241,846 (December 31, 2014 - \$222,435) and a fair value of \$242,456 (December 31, 2014 - \$223,240). The fair value is determined based on the cost of borrowing for a company with a similar risk profile (Level 2).

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## 17. Income taxes:

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

	2015	2014
Current tax expense:	\$ 9,493	\$ 9,611
Deferred tax expense (benefit):		
Origination and reversal of temporary differences	(2,008)	2,329
Effect of changes in tax rates	266	4
	(1,742)	2,333
Total income tax expense	\$ 7,751	\$ 11,944

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

	2015	2014
Income taxes at statutory rates:		
Federal	15.00%	15.00%
Provincial	11.71%	11.65%

	2015	2014
Income tax provision applied to profit before income taxes:		
Combined basic federal and provincial income taxes at statutory rates	\$ 6,456	\$ 9,883
Non-deductible expenses	1,916	1,767
Adjustment to deferred income taxes and liabilities for change in income tax rate	266	4
Other	(887)	290
	\$ 7,751	\$ 11,944

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

	Before taxes	Tax expense (benefits)	2015 Net of taxes
Change in fair value of interest rates swaps	\$ 1,562	\$ (424)	\$ 1,138
Actuarial gain on post-employment benefit plans	1	–	1
	\$ 1,563	\$ (424)	\$ 1,139

	Before taxes	Tax expense (benefits)	2014 Net of taxes
Change in fair value of interest rates swaps	\$ 324	\$ (87)	\$ 237
Actuarial gain on post-employment benefit plans	(405)	105	(300)
	\$ (81)	\$ 18	\$ (63)

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

	December 31, 2015	December 31, 2014
Loss carry forwards	\$ 4,171	\$ 3,889
Interest rate swaps	987	563
Post-employment benefit plans	174	164
Other assets	3,962	1,820
Deferred implementation costs	(5,236)	(5,229)
Capital assets	(1,799)	(1,140)
Intangible assets	(38,747)	(37,606)
Other liabilities	(863)	(1,020)
Net deferred income tax (liabilities) assets	\$ (37,351)	\$ (38,559)

Recorded on the consolidated statements of financial position as follows:

Deferred income tax assets	\$ 2,590	\$ –
Deferred income tax liabilities	39,941	38,559
Net deferred income tax (liabilities) assets	\$ (37,351)	\$ (38,559)

The Company has losses available to offset future taxable income of \$13,794 that expire commencing from 2034.

Movement in temporary differences during the year 2015:

	Balance at January 1, 2015	Recognized in profit or loss	Recognized in other comprehensive income	Acquisition & other	Balance at December 31, 2015
Capital assets	\$ (1,140)	\$ (659)	\$ –	\$ –	\$ (1,799)
Intangible assets	(37,606)	(1,088)	–	(53)	(38,747)
Tax value – losses carried forward	3,889	282	–	–	4,171
Interest rate swaps	563	–	424	–	987
Post-employment benefit plans	174	–	–	–	174
Deferred implementation	(5,229)	1,664	–	(1,671)	(5,236)
Other	790	1,544	–	765	3,099
	\$ (38,559)	\$ 1,743	\$ 424	\$ (959)	\$ (37,351)

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Movement in temporary differences during the year 2014:

	Balance at January 1, 2014	Recognized in profit or loss	Recognized in other comprehensive income	Acquisition & other	Balance at December 31, 2014
Capital assets	\$ 386	\$ (1,526)	\$ -	\$ -	\$ (1,140)
Intangible assets	(29,725)	(1,723)	-	(6,158)	(37,606)
Tax value – losses carried forward	315	3,574	-	-	3,889
Interest rate swaps	476	-	87	-	563
Post-employment benefit plans	279	-	(105)	-	174
Deferred implementation	(1,926)	(3,303)	-	-	(5,229)
Other	10	645	-	135	790
	\$ (30,185)	\$ (2,333)	\$ (18)	\$ (6,023)	\$ (38,559)

## 18. Employee future benefits:

The Company offers a pension benefit plan for its employees, which includes a defined benefit option and a defined contribution option. Under the defined contribution option, each member is required to contribute a percentage of earnings. The Company matches this required contribution. Each member may elect to make an optional contribution in addition to the required contribution. The Company contributes 50% of the optional contributions. For members who had completed at least 10 years of service on December 31, 2010, their contributions follow the grandfathered provisions.

The defined benefit option was closed effective January 1, 1998 and included 57 members as at December 31, 2015, comprising active employees, retirees, and deferred vested members. All other employees are covered by the defined contribution option of the plan.

The pension benefit plan is administered by Morneau Shepell Ltd. and is registered under the Pension Benefits Act (Ontario).

### (a) Funding

The defined benefit option is funded by the Company based on the pension plan's actuaries' calculation. The members are not required to contribute to the defined benefit option.

The Company expects to contribute \$158 to the defined benefit option during the upcoming fiscal year.

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## (b) Amounts recognized in the consolidated financial statements

The amounts recognized in the consolidated statements of financial position in respect of the defined benefit option are determined as follows:

	December 31, 2015	December 31, 2014
Present value of funded obligations	\$ 4,640	\$ 4,641
Fair value of plan assets	(4,580)	(4,294)
Impact of minimum funding requirement/asset ceiling	97	11
Liability in the consolidated statements of financial position	\$ 157	\$ 358

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

	2015	2014
Defined benefit obligations at January 1	\$ 4,641	\$ 3,980
Included in profit or loss:		
Current service cost	29	21
Interest cost	171	185
	200	206
Included in other comprehensive income:		
Actuarial losses (gains) arising from experience adjustments	–	44
Actuarial losses arising from changes in demographic assumptions	–	216
Changes in financial assumptions	–	512
	–	772
Other:		
Benefits paid by the plan	(201)	(317)
Defined benefit obligations at December 31	\$ 4,640	\$ 4,641

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

	2015	2014
Fair value of plan assets at January 1	\$ 4,294	\$ 3,998
Included in profit or loss:		
Estimated interest income on plan assets	160	187
Included in other comprehensive income:		
Return on plan assets in excess of estimated interest income	87	245
Other:		
Employer contributions	240	181
Benefits paid	(201)	(317)
	39	(136)
Fair value of plans assets at December 31	\$ 4,580	\$ 4,294

The movement in the impact of the minimum funding requirement/asset ceiling is as follows:

	2015	2014
Minimum funding requirement/ asset ceiling at January 1	\$ 11	\$ 900
Included in profit or loss:		
Interest on asset ceiling	–	43
Included in other comprehensive income:		
Change in asset ceiling, excluding amounts recognized in interest expense	86	(932)
Minimum funding requirement/ asset ceiling at December 31	\$ 97	\$ 11

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## (c) Plan Assets

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

	December 31, 2015	December 31, 2014
Pooled Equities Fund	52%	42%
Pooled Bond Fund	43%	44%
Pooled Low Volatility Fund	5%	14%
	100%	100%

Pooled funds are valued at the unit values supplied by the pooled fund administrator, which represent the pension plan's proportionate share of the fair value of the underlying net assets.

The strategic investment policy of the defined benefit option of the pension plan, implemented in 2013, can be summarized as follows:

A strategic asset mix comprising 29% to 73% equity securities (return and yield funds), 30% to 45% fixed income investments, and 0% to 23% low volatility investments (mortgages, real estate and infrastructure), with a target asset mix of 44% equity securities, 43% fixed income investments and 13% low volatility investments.

## (d) Actuarial assumptions:

The principal actuarial assumptions were as follows:

	2015	2014
Discount rate at the end of the current fiscal period used to determine the accrued benefit obligation	3.75%	3.75%
Discount rate at the end of preceding period used to determine the benefit cost	3.75%	4.75%
Rate of compensation increase used to determine the accrued benefit obligation	3.50%	3.50%
Rate of compensation increase used to determine the benefit cost	3.50%	3.50%

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(e) Mortality assumptions:

Assumptions regarding future mortality experience are based on published statistics and mortality tables.

The calculation of the defined benefit obligation is sensitive to mortality assumptions. For the Company, an increase in life expectancy of one year across all age groups would result in a \$106 increase in the defined benefit obligation as of December 31, 2015.

## 19. Long-term incentive plan:

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

(a) Retirement DSU:

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

(b) Post-Retirement DSU:

Post-Retirement DSUs vest at such times as determined by the Company, with each being redeemable for one common share issued from treasury of the Company. Except in certain circumstances or in the retirement of a participant, any unvested LTIP Units will terminate on their termination date.

The value of the award is determined as at grant date, and related salary expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied.

(c) RSU:

RSUs generally vest three years after the date of grant. RSUs are redeemable either for one common share or for an amount in cash equal to the fair market value of one common share (at the option of the Company). The value of the award is determined at grant date, and the related salary expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied. Participants are entitled to receive cash bonuses or additional Units equivalent to the dividends payable had those Units

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been common shares. The number of RSUs awarded as bonus is determined based on the fair market value of those RSUs on the date credited.

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

The change in the number of awards outstanding, and their related weighted average grant prices for the years ended December 31, 2015 and 2014 were as follows:

	RSU	Retirement DSU	Post- retirement DSU	Total
Awards outstanding, January 1, 2014	30,442	1,842,957	72,307	1,945,706
Granted (at \$15.51 per unit)	23,586	396,788	20,787	441,161
Exercised	–	(32,249)	–	(32,249)
Forfeited	–	(3,067)	–	(3,067)
Awards outstanding, December 31, 2014	54,028	2,204,429	93,094	2,351,551
Granted (at \$17.11 per unit)	28,326	249,473	24,674	302,473
Exercised	(36,129)	(205,741)	–	(241,870)
Forfeited	(629)	(20,855)	–	(21,484)
Awards outstanding, December 31, 2015	45,596	2,227,306	117,768	2,390,670
Total vested awards, December 31, 2014	–	1,184,175	93,094	1,277,269
Total vested awards, December 31, 2015	–	1,347,270	117,768	1,465,038
Share-based compensation expense, year ended December 31, 2014				\$ 4,515
Share-based compensation expense, year ended December 31, 2015				\$ 5,194

## 20. Equity:

### (a) Share capital

#### (i) Common shares:

The Company is authorized to issue an unlimited number of common shares, with no par value.

#### (ii) Preferred shares:

The Company is authorized to issue 10 million preferred shares, with no limit on their value. As of December 31, 2015 and 2014, no preferred shares were issued or outstanding.

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## (iii) Dividends:

Dividends are declared in Canadian dollars. The monthly dividend rate was \$0.065 for the year ended December 31, 2015 (2014 - \$0.065). The Company continued to declare the same monthly dividend amount in January and February of 2016.

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

	Number of common shares	Share capital	Contributed surplus
Balance, January 1, 2014	47,962,793	\$ 474,088	\$ 16,514
LTIP issuance	–	–	4,630
Shares issued on redemption of LTIP	32,187	332	(332)
Shares issued on conversion of convertible debentures	4,732	70	–
Balance, December 31, 2014	47,999,712	474,490	20,812
LTIP issuance	–	–	5,486
Shares issued on redemption of LTIP	271,071	2,986	(2,986)
Shares issued on conversion of convertible debentures	1,666	24	–
Balance, December 31, 2015	48,272,449	\$ 477,500	\$ 23,312

## (b) Accumulated other comprehensive income

The changes in the components of accumulated other comprehensive income, net of tax, are as follows:

	Cash flow hedge reserve	Post-employment benefit plans	Foreign exchange translation reserve	Total
Balance, January 1, 2014	\$ (1,295)	\$ (770)	\$ 226	\$ (1,839)
Actuarial loss on post-employment benefit plans	–	300	–	300
Effective portion of change in interest rate cash flow hedges	(237)	–	–	(237)
Foreign currency translation differences for foreign operations	–	–	3	3
Reclassification of foreign currency translation differences on divestiture of foreign operations	–	–	289	289
Balance, December 31, 2014	(1,532)	(470)	518	(1,484)
Actuarial gain on post-employment benefit plans	–	1	–	1
Effective portion of change in interest rate cash flow hedges	(1,138)	–	–	(1,138)
Foreign currency translation differences for foreign operations	–	–	(229)	(229)
Balance, December 31, 2015	\$ (2,670)	\$ (469)	\$ 289	\$ (2,850)

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## 21. Earnings per share:

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

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

The following details the earnings per share, basic and diluted, calculations for the years ended December 31, 2015 and 2014:

	2015	2014
Profit attributable to common shares (basic and diluted)	\$ 16,418	\$ 25,140
Weighted average number of common shares (in actual number of shares):		
January 1	47,999,712	47,962,793
Shares issued on redemption of LTIP	43,794	13,989
Shares issued upon redemption of convertible debentures	1,598	1,588
Vested LTIP awards	1,446,049	1,165,110
Basic	49,491,153	49,143,480
Dilutive effect of unvested LTIP awards	613,105	602,473
Diluted	50,104,258	49,745,953
Earnings per share:		
Basic	\$ 0.33	\$ 0.51
Diluted	\$ 0.33	\$ 0.51

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

## 22. Segmented information:

The Company provides health and productivity, administrative and retirement solutions to assist employers in managing the financial security, health and productivity of their employees. As at December 31, 2015, aggregation

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of operating segments was applied to determine that the Company had only one reportable segment. The primary factors considered in the application of the aggregation criteria included that the long-term average gross margins and growth rates across the segments are similar, the nature of the services provided by the segments are all related to helping employers with their human resources needs, and the similarity in the regulatory environments that the segments operate in.

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

	2015	2014
Revenue:		
Canada	\$ 494,486	\$ 490,783
United States	72,800	45,083
Consolidated total	\$ 567,286	\$ 535,866

	2015	2014
Total assets:		
Canada	\$ 704,684	\$ 726,871
United States	50,964	29,784
Consolidated total	\$ 755,648	\$ 756,655

## 23. Supplementary cash flow information:

Change in non-cash operating working capital for the years ended December 31, 2015 and 2014 was as follows:

	2015	2014
Trade and other receivables	\$ 11,027	\$ (8,896)
Unbilled fees, current and non-current	(3,578)	(2,591)
Prepaid expenses and other	(1,636)	(614)
Deferred implementation costs, current and non-current <sup>1</sup>	6,244	(5,793)
Trade and other payables	(6,755)	5,108
Dividends payable	–	4
Deferred revenue	(314)	(1,816)
	\$ 4,988	\$ (14,598)

<sup>1</sup> Includes write-down of deferred implementation costs

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## 24. Related parties:

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

### (a) Compensation of key management personnel:

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

	2015	2014
Salaries and other benefits	\$ 8,316	\$ 8,031
Share-based payments	3,720	3,060
	\$ 12,036	\$ 11,091

### (b) Unconsolidated structured entities:

The Company's wholly owned subsidiary, Morneau Shepell Asset & Risk Management Ltd. is the sponsor and manages the financial and operating activities of the Company's funds. In exchange, each fund pays an administrative fee of 0.08% of the fund's net asset value to cover regulatory filing fees and other day-to-day operating expenses. The Company does not hold any units of the funds.

The Company is considered to sponsor the funds as it was significantly involved in their design and formation, and has continuing involvement as described above. The Company does not control the funds and therefore, does not consolidate them. The Company has no interests in the funds apart from the agreements outlined above. The Company did not transfer any assets to the funds during the reporting periods.

## 25. Salary, benefits and contractors:

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

	2015	2014
Salaries and other benefits	\$ 332,239	\$ 309,347
Contractors	59,882	59,380
	\$ 392,121	\$ 368,727

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## 26. Commitments:

The Company has lease commitments for office premises and equipment with options for renewal. As at December 31, 2015 the minimum payments not including operating expenses, due in each of the next five years and thereafter, are expected to be as follows for each year ending December 31:

	Gross commitment	Sublease income	Net commitment
2016	\$ 16,352	\$ (854)	\$ 15,498
2017	14,602	(766)	13,836
2018	13,499	(582)	12,917
2019	12,648	(510)	12,138
2020	12,437	(459)	11,978
Thereafter	38,793	(726)	38,067
Total	\$ 108,331	\$ (3,897)	\$ 104,434

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

## 27. Write-down of deferred implementation costs and impairment

As a result of the wind down of business directive issued by the New York State Department of Financial Services, the Centers for Medicare and Medicaid Services, and the New York State of Health to Health Republic Insurance of New York (HRINY), one of the Company's US Health Exchange outsourcing clients, the Company determined that deferred implementation costs specifically related to HRINY were no longer recoverable and recorded a pre-tax write-down in the amount of \$12,210 (\$8,608 after-tax). Furthermore, the Company also assessed the recoverable amount of certain of the Company's capital assets and intangible assets in the US Health Exchange Services business. As a result of this assessment, it was determined that the carrying amount of the Company's internally developed assets exceeded their recoverable amount and a pre-tax impairment loss of \$2,890 (\$2,121 after-tax) was recognized. The write-down of deferred implementation assets and impairment are included in the "Write-down of deferred implementation costs and impairment" in the consolidated statement of income and comprehensive income.

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## 28. Contingencies:

### (a) Lawsuits and legal claims:

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

### (b) Business combinations:

The Company has obligations to pay additional consideration for prior acquisitions, typically based upon performance measures contractually agreed at the time of purchase.

For the acquisitions of BDA (see note 4(a)) and the U.S. health and welfare benefits administration business of Ceridian (see note 4(b)), contingent consideration based on financial performance arose at the time of purchase and is expected to be settled through future payments of cash due by May 1, 2017 and March 31, 2017, respectively.

For the acquisition of Dion Durrell Workers' Compensation, contingent consideration based on financial performance was agreed at the time of purchase and is expected to be settled through remaining future payments of cash and LTIP units due within 45 days of June 30 in 2016.

As at December 31, 2015, the fair value of the contingent consideration has been recognized as future consideration related to acquisitions on the consolidated statements of financial position.

## 29. Management of capital:

The Company views its capital as the combination of its cash (bank indebtedness), long-term debt, convertible debentures and shareholders' equity. As at December 31, 2015 the Company's capital is \$618,620 (2014 - \$618,501), comprised of \$317,506 (2014 - \$300,481) cash and debt, and \$301,114 (2014- \$318,020) equity. The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern while maintaining dividends to its shareholders and the growth of the Company's business through organic growth and new acquisitions.

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

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

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

The Company is subject to externally imposed capital requirements to maintain certain financial covenants as mentioned above. The Company complied with all the required financial covenants at December 31, 2015.



For more information about Morneau Shepell and to view our digital annual report visit us at [morneaushepell.com/annualreport](http://morneaushepell.com/annualreport)

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