

# DIVERSIFIED ROYALTY CORP.

Notes to Consolidated Financial Statements  
(Unaudited)  
(Expressed in Canadian dollars)

Year ended December 31, 2014

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## 2. Basis of preparation (continued):

(d) Use of estimates and judgments (continued):

(ii) Fair value of Class B, C and D Partnership units ("Exchangeable Partnership Units" or "Exchangeable units"):

The Company does not assign any value to the Exchangeable Partnership Units as they do not currently meet the relevant criteria for exchange into common shares of DIV (note 7).

(iii) Consolidation:

Applying the criteria outlined in IFRS 10, judgment is required in determining whether DIV controls the Partnership. Making this judgment involves taking into consideration the concepts of power over the Partnership, exposure and rights to variable returns, and the ability to use power to direct the relevant activities of the Partnership so as to generate economic returns. Using these criteria, management has determined that DIV ultimately controls the Partnership through its 90% ownership of the GP.

## 3. Significant accounting policies:

These annual consolidated financial statements have been prepared using the accounting principles and policies described below.

(a) Basis of consolidation:

These annual consolidated financial statements include the accounts of DIV, its wholly-owned subsidiary FW Royalties Limited Partnership (the "FW LP"), and its 90% owned subsidiary, FW Royalties GP Ltd. (the "FW GP"). The FW GP is the managing general partner of the FW LP. All significant intercompany transactions and balances have been eliminated on consolidation.

(b) Cash and cash equivalents:

Cash and cash equivalents consist of cash on hand, balances on deposit with banks, and short-term investments with terms of three months or less on the date of acquisition.

(c) Revenue recognition:

Royalty revenue is recognized on the accrual basis when earned. Royalty payments from Franworks to FW LP are 6% of system sales for such period reported by Franworks restaurants in the Royalty Pool plus a make-whole payment, if required by a restaurant closure, based on 6% of lost system sales. System sales for any period and for any Franworks restaurant located in Canada and the United States, as defined in the License and Royalty Agreement, means the gross sales by such Franworks restaurant for such period.