Financial Statements of

NORTHERN CREDIT UNION LIMITED

Year ended December 31, 2018

KPMG LLP
111 Elgin Street, Suite 200
Sault Ste. Marie ON P6A 6L6
Canada
Telephone (705) 949-5811
Fax (705) 949-0911

INDEPENDENT AUDITORS' REPORT

To the Members of Northern Credit Union Limited

Opinion

We have audited the accompanying financial statements of Northern Credit Union Limited (the "Credit Union"), which comprise:

- the statement of financial position as at December 31, 2018
- the statement of income for the year then ended
- the statement of comprehensive income for the year then ended
- the statement of changes in members' equity for the year then ended
- the statement of cash flows for the year then ended
- and notes to the financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Credit Union as at December 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "Auditors' Responsibilities for the Audit of the Financial Statements" section of our auditors' report.

We are independent of the Credit Union in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

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

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Credit Union's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Credit Union or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Credit Union's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Credit Union's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Credit Union's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusion is based on the audit evidence obtained up to the date of our auditors report. However, future events or conditions may cause the Credit Union to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Sault Ste. Marie, Canada
February 20, 2019

NORTHERN CREDIT UNION LIMITED

Statement of Financial Position

December 31, 2018, with comparative information for 2017

(in thousands of Canadian dollars)		2018		2017
Assets				
Cash and cash equivalents (note 5)	$	30,033	$	11,548
Investments (note 6)		95,307		87,653
Other assets (note 7)		3,780		2,072
Loans to members (notes 8 and 9)		1,310,617		1,194,771
Deferred income taxes (note 16)		1,433		-
Property and equipment (note 10)		17,536		18,040
Intangible assets (note 10)		1,484		1,930
Total assets	$	1,460,190	$	1,316,014
Liabilities and Members' Equity				
Members' deposits (note 11)	$	1,160,433	$	1,044,851
Accounts payable and accrued liabilities		7,106		6,776
Short-term borrowings (note 12)		-		12,000
Securitized liabilities (note 13)		204,192		162,796
Liabilities qualifying as regulatory capital:				
Share capital (note 14)		32,272		32,124
Deferred income taxes (note 16)		-		396
Total liabilities		1,404,003		1,258,943
Members' equity:				
Contributed surplus		19,134		19,134
Retained earnings		35,245		36,824
Accumulated other comprehensive income		1,808		1,113
Total members' equity		56,187		57,071
Commitments and contingencies (note 17)				
Total liabilities and members' equity	$	1,460,190	$	1,316,014

See accompanying notes to financial statements.

On behalf of the Board:

____________________ Director

Folgo Dell'Acedora

____________________ Director

NORTHERN CREDIT UNION LIMITED

Statement of income

Year ended December 31, 2018, with comparative information for 2017

(in thousands of Canadian dollars)		2018		2017
Revenue:				
Interest - residential mortgage loans	$	23,632	$	21,352
- personal loans		18,254		14,202
- commercial loans		9,850		9,992
Investment income		1,816		1,040
		53,552		46,586
Cost of financing:				
Interest - demand deposits		2,538		1,767
- term deposits		6,586		5,618
- registered savings plans		5,888		4,686
Distribution to members (note 14)		1,052		842
Interest on external borrowings		4,176		2,942
		20,240		15,855
Net interest income		33,312		30,731
Impairment loss on loans (note 9)		2,942		2,434
Net interest income after impairment loss on loans		30,370		28,297
Non-interest revenue (note 18)		12,462		11,715
		42,832		40,012
Operating expenses:				
Salaries, wages and benefits		20,628		18,942
Board, delegate and committee		553		521
Data processing and clearing		1,171		1,069
General and administration		13,388		11,340
Insurance		1,146		937
Occupancy		2,677		2,792
Depreciation and amortization		2,722		2,652
		42,285		38,253
Operating income		547		1,759
Unrealized gains (losses):				
Unrealized loss on interest rate swaps		(86)		(35)
Unrealized loss on investments (note 6)		-		(7)
Income before income taxes		461		1,717
Income taxes (recovery) (note 16):				
Current		1,012		353
Deferred recovery		(1,255)		(496)
		(243)		(143)
Net income	$	704	$	1,860

See accompanying notes to financial statements.

NORTHERN CREDIT UNION LIMITED

Statement of Comprehensive Income and Statement of Changes in Members Equity

Statement of Comprehensive Income

Year ended December 31, 2018, with comparative information for 2017

(in thousands of Canadian dollars)		2018		2017
Net income	$	704	$	1,860
Other comprehensive income, net of income taxes:				
Items that are or may be reclassified subsequently to profit or loss:				
Net gain (loss) on cash flow hedges, net of income tax of $19 (2017 - $17)		54		(48)
Items that will never be reclassified to profit or loss:				
Defined benefit plan actuarial gains (losses), net of income tax of $231 (2017 - $42)		641		(118)
Comprehensive income	$	1,399	$	1,694

Statement of Changes in Members' Equity

Year ended December 31, 2018, with comparative information for 2017

(in thousands of Canadian dollars)		2018		2017
Contributed surplus				
As at January 1 and December 31	$	19,134	$	19,134
Retained earnings				
As at January 1 (as previously reported)		36,824		34,964
Cumulative effect of adopting IFRS 9, net of income tax of $824 (note 24)		(2,283)		-
Restated balance as at January 1		34,541		34,964
Net income		704		1,860
As at December 31		35,245		36,824
Accumulated other comprehensive income:				
Representing the fair value reserve:				
As at January 1		1,113		1,279
Net gain (loss) on cash flow hedges, net of income tax		54		(48)
Defined benefit plan actuarial gains (losses), net of income tax		641		(118)
Balance, end of year		1,808		1,113
Member's equity, end of year	$	56,187	$	57,071

See accompanying notes to financial statements.

NORTHERN CREDIT UNION LIMITED

Statement of Cash Flows

Year ended December 31, 2018, with comparative information for 2017

(in thousands of Canadian dollars)	2018	2017
Cash flows from operating activities:		
Net income	$ 704	$ 1,860
Adjustments for:		
Change in non-cash items:		
Net interest income	(33,312)	(30,731)
Provision for impaired loans	2,942	2,434
Provision (recovery) for income tax	(243)	(143)
Depreciation and amortization	2,722	2,652
Unrealized losses on investments	-	7
Unrealized losses on interest rate swaps	86	35
Loss on disposal of property and equipment	48	98
	(27,053)	(23,788)
Changes in other assets:		
Changes in other assets	(1,708)	(520)
Changes in accounts payable and accrued liabilities	646	437
	(1,062)	(83)
Changes in member activities (net):		
Changes in member loans	(121,698)	(125,295)
Changes in member deposits	113,919	77,091
	(7,779)	(48,204)
Cash flows related to interest, dividends and income taxes:		
Interest received on member loans	51,539	45,350
Interest received on investments	1,706	984
Interest paid on member deposits	(13,349)	(11,075)
Interest paid on external borrowings	(4,176)	(2,942)
Dividends paid	(1,052)	(842)
Income taxes paid	(469)	(348)
	34,199	31,127
	(1,695)	(40,948)
Cash flows from financing activities:		
Issuance of membership shares	71	53
Redemption of Class A patronage shares	(57)	(44)
Issuance (redemption) of Class B investment shares	134	(42)
Repayment of Central 1 Credit Union loan	(12,000)	(13,000)
Proceeds from securitized loans	41,396	58,108
	29,544	45,075
Cash flows from investing activities:		
Purchase of investments	(12,377)	(15,085)
Proceeds from sale of investments	4,833	8,665
Proceeds on disposal of property and equipment	-	841
Additions to intangible assets	(135)	(597)
Additions to property and equipment	(1,685)	(2,216)
	(9,364)	(8,392)
Net increase (decrease) in cash and cash equivalents	18,485	(4,265)
Cash and cash equivalents, beginning of year	11,548	15,813
Cash and cash equivalents, end of year	$ 30,033	$ 11,548

See accompanying notes to financial statements.

1. Reporting entity:

Northern Credit Union Limited (the "Credit Union"), was incorporated under the laws of Ontario and operates in compliance with the Credit Union ("Unions") and Caisse Populaires ("Caisses") Act of Ontario (the "Act"). The Credit Union is a member of the Deposit Insurance Corporation of Ontario ("DICO") and of the Central 1 Credit Union ("Central 1"). The Credit Union is domiciled in Canada. The address of the Credit Union's registered office is 280 McNabb Street, Sault Ste. Marie, Ontario. The Credit Union is primarily involved in corporate and retail banking.

2. Basis of preparation:

(a) Statement of compliance:

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (the IASB).

These financial statements have been authorized for issue by the Board of Directors on February 20, 2019.

(b) Functional and presentation currency:

The Credit Union's functional and presentation currency is the Canadian dollar. The financial statements are presented in Canadian dollars. They are prepared on the historical cost basis except for the following material items:

Items	Measurement Basis
Financial instruments at fair value through profit/loss (FVTPL)	Fair Value
Financial instruments at fair value through OCI (FVOCI) – applicable from January 1, 2018	Fair Value
Available-for-sale financial assets (applicable Before January 1, 2018)	Fair value
Net defined benefit (asset) liability	Fair value of plan assets less the present value of the defined benefit obligation

(c) Use of estimates and judgments:

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Credit Union's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 4.

3. Significant accounting policies:

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

(a) Loans receivable from members:

Loans receivable from members in the statement of financial position comprising personal loans, residential mortgages, commercial mortgages and loans and agricultural mortgages and loans include:

- loans to members measured at amortized cost; they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortized cost using the effective interest method;
- loans to members mandatorily measured at FVTPL or designated as at FVTPL; these are measured at fair value with changes recognized immediately in profit or loss;

Prior to January 1, 2018, loans receivable from members were recognized when the cash is advanced to the borrower. All loans to members are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and have been classified as loans and receivables, which are subsequently measured at amortized cost using the effective interest method.

(i) Loan interest:

Interest income from loans is recorded on the effective yield basis. Accrued but uncollected interest is provided for when loans are determined to be impaired.

(ii) Provision for credit losses:

The Credit Union maintains a provision for credit losses, which, in management's opinion, is considered adequate to provide for credit-related losses.

The Credit Union considers evidence of impairment for loans receivable at both a specific asset and collective level. All individually significant receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Receivables that are not individually significant are collectively assessed for impairment by grouping together receivables with similar risk characteristics.

In assessing collective impairment the Credit Union uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

3. Significant accounting policies (continued):

(a) Loans receivable from members (continued):

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(b) Interest income and expense:

Interest income and expense are recognized in the statement of income using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability to its fair value at inception. For financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortized cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis. For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortized cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

The calculation of the effective interest rate includes all fees and points paid or received and transaction costs and discounts or premiums that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

(c) Non-interest revenue:

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees, are recognized as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, the related loan commitment fees are recognized on a straight-line basis over the commitment period.

Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

Net income from other financial instruments designated at fair value through profit or loss relates to non-trading derivatives held for risk management purposes that do not form part of qualifying hedge relationships and financial assets and liabilities so designated, and includes all realized and unrealized fair value changes, interest, dividends and foreign exchange differences.

3. Significant accounting policies (continued):

(c) Non-interest revenue (continued):

Dividend income is recognized when the right to receive income is established. Usually this is the ex-dividend date for equity securities. Dividends are reflected as a component of net trading income, net income from other financial instruments at fair value through profit or loss or other operating income is based on the underlying classification of the equity investment.

Revenue from account service and servicing fees, commission income, wealth management and other fees is recognized over time as the services are provided. Revenue related to transactions is recognized at the point in time when the transaction takes place.

(d) Cash and cash equivalents:

Cash and cash equivalents includes cash on hand, current accounts, cheques and other items in transit. Cash is carried at FVTPL in the statement of financial position.

(e) Financial instruments:

The Credit Union initially recognizes loans and advances, deposits and mortgage securitization liabilities on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognized on the trade date, which is the date on which the Credit Union becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

(i) Classification:

On initial recognition, a financial asset is classified and measured at: amortized cost, FVOCI or FVTPL.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(i) Classification (continued):

- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Credit Union may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified and measured at FVTPL.

In addition, on initial recognition, the Credit Union may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI as FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Credit Union makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realizing cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Credit Union's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Credit Union's stated objective for managing the financial assets is achieved and how cash flows are realized.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(i) Classification (continued):

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

The Credit Union has established specific criteria for financial assets that are originated or acquired for the purpose of securitization in a subsequent period. If, at origination or acquisition, based on this established criteria the financial asset is expected to be securitized as part of a portfolio that:

- qualifies for derecognition as detailed below, the business objective of holding the financial asset to collect contractual cash flows is not met. Such financial assets are measured at FVTPL; or
- does not qualify for derecognition, the Credit Union has elected, as its accounting policy, to determine the business model based on the accounting result of the securitization. As such, the held-to-collect business model is considered to be met.

<u>Assessment whether contractual cash flows are solely payments of principal and interest</u>

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Credit Union considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Credit Union considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Credit Union's claim to cash flows from specified assets (e.g. nonrecourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

3. **Significant accounting policies (continued):**

(e) Financial instruments (continued):

(i) Classification (continued):

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Credit Union changes its business model for managing financial assets. There were no changes to any of the Credit Union business models during the current year.

Prior to January 1, 2018, the Credit Union classified all financial assets either as fair value through profit or loss ("FVTPL"), available-for-sale, held-to-maturity, or loans and receivables, and, financial liabilities were classified as FVTPL or other liabilities. Under IAS 39, the standards required that all financial assets and financial liabilities, including all derivatives, be subsequently measured at fair value with the exception of loans and receivables, debt securities classified as held-to-maturity, available-for-sale financial assets that do not have quoted market prices in an active market and whose fair value cannot be reliably estimated and other liabilities.

The classifications prior to January 1, 2018 are noted below:

Financial asset/liability	Classification
Cash and cash equivalents	FVTPL
Investments – debt securities and equity instruments	
Central 1 liquidity reserve deposits	Loans and receivables
CUCO Cooperative Association	FVTPL
Class A & E shares – Central 1 Credit Union Limited	Available-for-sale (cost)
Other investments	Available-for-sale (cost)
Loans to members	Loans and receivables
Other assets	
Accounts receivable	Loans and receivables
Derivative financial instruments	FVTPL
Members' deposits	Other financial liabilities
Short-term borrowings	Other financial liabilities
Other liabilities	
Accounts payable and accrued liabilities	Other financial liabilities
Derivative financial instruments	FVTPL
Securitized liabilities	Other financial liabilities

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(ii) Fair value through profit or loss:

Financial assets

At initial recognition, the Credit Union has designated certain financial assets as FVTPL because this designation eliminates or significantly reduces an accounting mismatch, which would otherwise arise.

Before January 1, 2018, the Credit Union also designated certain financial assets as FVTPL because the assets were managed, evaluated and reported internally on a fair value basis.

Financial liabilities

The Credit Union has designated certain financial liabilities as FVTPL in either of the following circumstances:

- the liabilities are managed, evaluated and reported internally on a fair value basis; or
- the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The accompanying policy notes set out each class of financial asset or financial liability that has been designated as FVTPL. A description of the basis for each designation is set out in the notes for the relevant asset or liability class.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(iii) Held to maturity:

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Credit Union has the positive intent and ability to hold to maturity, other than those that the entity upon initial recognition designates as fair value through profit or loss or as available for sale.

Prior to January 1, 2018, subsequent to initial recognition and designation by the Credit Union, held-to-maturity financial assets are measured at amortized cost using the effective interest method, net of impairment losses.

(iv) Available-for-sale financial assets:

Available-for-sale financial assets are non-derivative financial assets that are either designated as available-for-sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Prior to January 1, 2018, Central 1 Class A shares, Central 1 Class E shares and other investments held by the Credit Union that are not traded in an active market are classified as available-for-sale. Available-for-sale equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

Subsequent to initial recognition, available-for-sale financial assets are measured at fair value, and the gains and losses on such assets are recorded in other comprehensive income (loss) until the investment is derecognized or until the investment is identified as being subject to impairment.

Dividend income is recognized in net income when the Credit Union’s right to receive the dividends is established. Interest income is recognized in income using the effective interest method.

Upon adoption of IFRS 9 on January 1, 2018, all financial assets previously classified as available for sale have been reclassified, see note 24.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(v) Loans and receivables:

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which the Credit Union does not intend to sell immediately or in the near term.

Prior to January 1, 2018, loans and receivables included cash, liquidity reserve deposits held with Central, loans to members and its associated accrued interest on loans, and accounts receivable, are measured at amortized cost using the effective interest method, net of impairment losses. Upon adoption of IFRS 9 on January 1, 2018, all financial assets previously classified as loans and receivable have been reclassified, see note 24.

(vi) Effective interest method:

Interest income and expense are recognized in profit or loss using the effective interest method. The ‘effective interest rate’ is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortized cost of the financial liability.

When calculating the effective interest rate for financial instruments other than credit impaired assets, the Credit Union estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses (“ECL”). For credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit losses.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Prior to January 1, 2018, the effective interest method is a method of calculating the amortized cost of a financial asset or financial liability and of allocating interest income and expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees or points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the asset/liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(vii) Impairment of financial assets:

Effective January 1, 2018, the Credit Union recognizes loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments (loans from members);
- loan commitments issued.

No impairment loss is recognized on equity investments.

The Credit Union measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition (see note 9).

The Credit Union considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of 'investment grade'. 12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the Credit Union in accordance with the contract and the cash flows that the Credit Union expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cashflows;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Credit Union if the commitment is drawn down and the cash flows that the Credit Union expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Credit Union expects to recover.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(vii) Impairment of financial assets (continued):

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognized and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Credit Union assesses whether financial assets carried at amortized cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is ‘credit-impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Credit Union on terms that the Credit Union would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganization; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower’s condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered impaired.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(vii) Impairment of financial assets (continued):

In making an assessment of whether an investment in debt securities is credit-impaired, the Credit Union considers the following factors:

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The issuer's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.

<u>Presentation of allowance for ECL in the statement of financial position</u>

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Credit Union cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Credit Union presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- debt instruments measured at FVOCI: no loss allowance is recognized in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognized in the fair value reserve.

<u>Write-offs</u>

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Credit Union determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Credit Union's procedures for recovery of amounts due.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(vii) Impairment of financial assets (continued):

Impairment of financial assets prior to January 1, 2018

Financial assets, other than those at fair value through profit or loss, were assessed for indicators of impairment at each statement of financial position date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the asset have been affected.

For financial assets carried at amortized cost and available-for-sale debt securities, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans to members, where the carrying amount is reduced through the use of an allowance account. When a loan to a member is considered uncollectible, it is written off against the allowance for impaired loans. Subsequent recoveries of amounts previously written off are credited against the allowance for impaired loans. Changes in the carrying amount of the allowance for impaired loans are recognized in income.

The impairment loss on financial assets is based on a review of all outstanding amounts at period end. The Credit Union has established percentages for the allowance for doubtful accounts, which are based on historical collection trends for each payer type and age of the receivables. Accounts that are considered uncollectible are reserved for in the allowance until they are written off or collected.

When an available-for-sale financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to income in the period.

For financial assets other than available-for-sale equity securities, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through income to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(viii) Derecognition of financial assets:

Financial assets

The Credit Union derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Credit Union neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognized) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in OCI is recognized in profit or loss.

From January 1, 2018, any cumulative gain/loss recognized in OCI in respect of equity investment securities designated as at FVOCI is not recognized in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Credit Union is recognized as a separate asset or liability.

In transactions in which the Credit Union neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Credit Union continues to recognize the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions, the Credit Union retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognized if it meets the derecognition criteria. An asset or liability is recognized for the servicing contract if the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(viii) Derecognition of financial assets (continued):

The Credit Union periodically enters into asset transfer agreements with third parties including securitization of residential mortgages into special purpose entities, such as programs sponsored by Canada Mortgage Housing Corporation that issue bonds to third party investors. This includes securitization of insured residential mortgages by participating in the National Housing Act (NHA) mortgage-backed securities (MBS) program. Through the program, the Credit Union issues securities backed by residential mortgages that are insured against borrower's default. All securitization transactions are reviewed and assessed based on the above-noted derecognition criteria. In instances where the Credit Union's securitizations do not qualify for derecognition based on the above criteria, the Credit Union does not derecognize the transferred financial assets but records a secured borrowing with respect to any consideration received. These secured borrowings are measured at amortized cost under IFRS 9.

For securitizations that result in derecognition, retained interests are recognized as investment securities and carried at FVOCI. Gains or losses on securitization are recorded in other revenue.

Financial liabilities

The Credit Union derecognizes a financial liability when its contractual obligations are discharged or cancelled, or expire.

(ix) Transaction costs:

Prior to January 1, 2018, transaction costs related to financial assets and liabilities recorded at fair value through profit or loss were expensed as incurred. Transaction costs include fees and commissions paid to agents, advisors, broker and dealers and levies by regulatory agencies related to available-for-sale financial assets, held-to-maturity financial assets, other liabilities and loans and receivables and are netted against the carrying value of the asset or liability and are amortized over the expected life of the instrument using the effective interest method. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative costs.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(x) Derivative instruments:

Derivative financial instruments are financial contracts that require or provide an option to exchange cash flows or payments determined by applying certain rates, indices or changes therein to notional contract amounts. The Credit Union periodically enters into derivative contracts to manage financial risks associated with movements in interest rates and other financial indices such as interest rate swaps and equity swap agreements. The Credit Union's policy is not to utilize derivative financial instruments for trading or speculative purposes.

Derivative financial instruments are recorded on the statement of financial position at fair value, including those derivatives that are embedded in financial or non-financial contracts that are closely related to the host contracts. Changes in the fair value of those derivative instruments are recognized in net income for the year.

(xi) Hedge accounting:

The Credit Union formally documents all relationships between hedging instruments and hedged items; as well as risk management objectives and strategies for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities recognized on the statement of financial position or specific firm commitments or forecasted transactions that are highly probable to occur and prevent exposure to variations in cash flows that could ultimately affect reported net income. The Credit Union also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risk.

IFRS specifies the criteria that must be satisfied in order for hedge accounting to be applied and prescribes the accounting treatment for those permitted hedging strategies applicable to the Credit Union – cash flow hedges.

In a cash flow hedge, the effective portion of changes in fair value of the derivative is recognized in other comprehensive income ("OCI") and presented in the cash flow hedging reserve in equity. The amount recognized in OCI is reclassified and included on the statement of income in the same period that the hedged cash flows affect income. This will be offset by net interest income on assets and liabilities that are hedged. The Credit Union utilizes cash flow hedges primarily to convert floating rate liabilities to fixed rate. Any hedge ineffectiveness is measured and is immediately recognized in the statement of income.

When a cash flow hedge is discontinued, any cumulative adjustment to either the hedged item or other comprehensive income (loss) is recognized in income as the hedged item impacts earnings or immediately if the forecast transaction is no longer expected to occur.

3. Significant accounting policies (continued):

(e) Financial instruments (continued):

(xii) Embedded derivatives:

Derivatives may be embedded in another contractual arrangement (a host contract). The Credit Union accounts for an embedded derivative separately from the host contract when:

- the host contract is not an asset in the scope of IFRS 9;
- the host contract is not itself carried at FVTPL;
- the terms of the embedded derivative would meet the definition of a derivative if they
- were contained in a separate contract; and
- the economic characteristics and risks of the embedded derivative are not closely
- related to the economic characteristics and risks of the host contract.

Separated embedded derivatives are measured at fair value, with all changes in fair value recognized in profit or loss unless they form part of a qualifying cash flow hedging relationship. Separated embedded derivatives are presented in the statement of financial position together with the host contract.

Prior to January 1, 2018, derivatives embedded in non-derivative host contracts were treated as separate derivatives when their risks and characteristics were not closely related to those of the host contracts and the host contracts are not measured at FVTPL. As at December 31, 2018, the Credit Union does not have any embedded derivatives that require separation.

(f) Other assets:

Included in other assets are costs incurred in equity swap agreement hedge premiums and prepaid software maintenance costs. Hedge premiums are recorded as expense using the effective interest rate method over the term of the agreement.

(g) Intangible assets:

Computer software that is not an integral part of other property and equipment is accounted for as intangible assets. Computer software is stated at cost less accumulated amortization and is presented as part of property and equipment on the statement of financial position. Amortization of computer software is calculated by applying the straight-line method at rates based on estimated useful lives between 3 and 10 years.

3. Significant accounting policies (continued):

(h) Property and equipment:

Property and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets as follows:

Buildings and improvements	5 to 50 years
Parking areas	3 to 10 years
Furniture, office and computer equipment	3 to 20 years
Automated banking machines	5 to 10 years
Leasehold improvements	5 to 15 years

Depreciation methods, useful lives and residual values are reviewed annually and adjusted if necessary.

(i) Impairment of non-financial assets:

Non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly.

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash flows. The Credit Union has 30 cash-generating units. Impairment charges are included in net income.

3. Significant accounting policies (continued):

(j) Income taxes:

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

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither accounting or taxable profit or loss.

Recognition of deferred tax assets for unused tax (losses), tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available which allow the deferred tax asset to 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.

The amount of the deferred tax asset or liability is measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the reporting date and are expected to apply when the liabilities / (assets) are settled / (recovered).

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, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

3. Significant accounting policies (continued):

(k) Foreign currency translation:

The financial statements are presented in Canadian dollars, which is the Credit Union's presentation and functional currency. Assets and liabilities denominated in foreign currencies, primarily US dollars, are translated into Canadian dollars at rates prevailing at the year-end date. Income and expenses are translated at the exchanges rates in effect on the date of the transactions. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments are recognized in other comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(l) Employee retirement benefits:

i) Defined benefit plans:

The Credit Union's net obligation in respect of defined benefit plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of any plan assets.

The calculation of defined benefit obligations is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for the Credit Union, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in OCI. The Credit Union determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in personnel expenses in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in profit or loss. The Credit Union recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs.

3. Significant accounting policies (continued):

(l) Employee retirement benefits (continued):

ii) Defined contribution plans:

The Credit Union also has defined contribution plans providing pension benefits for eligible employees not included in the defined benefit plan.

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. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in profit or loss in the periods during which services are rendered by employees. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in future payments is available. Contributions to a defined contribution plan that are due more than 12 months after the end of the period in which the employees render the service are discounted to their present value.

(m) Leased assets:

Leases in terms of which the Credit Union assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are operating leases and, except for investment property, the leased assets are not recognized in the Credit Union’s statement of financial position.

(n) Provisions:

A provision is recognized if, as a result of a past event, the Credit Union has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as financing cost.

3. Significant accounting policies (continued):

(o) Future changes in accounting policy:

(i) On January 13, 2016 the IASB issued IFRS 16 Leases. The new standard is effective for annual periods beginning on or after January 1, 2019, earlier application is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial adoption of IFRS 16. IFRS 16 will replace IAS 17 Leases.

This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided.

The Credit Union intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The Credit Union estimates that it will recognize additional property and equipment and a corresponding lease liability of approximately $4,000,000 as a result of the adoption of the standard.

4. Critical accounting estimates and judgments:

The Credit Union makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only; or in the period of the change and future periods, if the change affects both.

Fair value of financial instruments:

The Credit Union determines the fair value of financial instruments that are not quoted in an active market, using valuation techniques. Those techniques are significantly affected by the assumptions used, including discount rates and estimates of future cash flows. In that regard, the derived fair value estimates cannot always be substantiated by comparison with independent markets and, in many cases, may not be capable of being realized immediately.

The methods, and assumptions applied, and the valuation techniques used, for financial instruments that are not quoted in an active market are disclosed in note 20.

With the adoption of IFRS 9 on January 1, 2018, the classification of financial assets includes an assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.
Member loan loss provision:

Upon implementation of IFRS 9, effective January 1, 2018, impairment of financial instruments is assessed on whether credit risk on the financial asset (loans to members) has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of expected credit loss (“ECL”).

Previously under IAS 39, in determining whether an impairment loss should be recorded in the statement of comprehensive income, the Credit Union made judgments on whether objective evidence of impairment existed individually for financial assets that were individually significant. Where this did not exist, the Credit Union used its judgment to group member loans with similar credit risk characteristics to allow a collective assessment of the group to determine any impairment loss. In determining the collective loan loss provision management used estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment.

Further details on the estimates used to determine the allowance for impaired loans collective provision are provided in note 9.

4. Critical accounting estimates and judgments (continued):

Impairment of available-for-sale investments:

Prior to January 1, 2018, the Credit Union reviewed its investments classified as available-for-sale at each statement of financial position date to assess whether they were impaired. This required similar judgment as applied to the individual assessment of loans. The Credit Union recorded impairment charges on available-for-sale investments when there had been a significant or prolonged decline in the fair value below their cost. The determination of what is ‘significant’ or ‘prolonged’ requires judgment. Effective, January 1, 2018, the available-for-sale classification was eliminated with the adoption of IFRS 9.

Employee retirement benefits:

The Credit Union estimates the present value of employee retirement benefits, which depends on a number of assumptions including discount rates, expected salary and other cost increases, and mortality rates. 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 liability. Refer to information provided in note 19.

Securitizations and hedging:

The Credit Union enters into securitization and hedging transactions which require management’s best estimates of key assumptions that market participants would use in determining fair value. For more information relating to these estimates refer to note 13 for securitizations and note 21 for hedging.

(in thousands of Canadian dollars)

5. Cash and cash equivalents:

		2018		2017
Cash on hand	$	11,773	$	11,580
Cash at Central 1		18,260		(32)
	$	30,033	$	11,548

6. Investments:

		2018		2017
Amortized cost (IFRS 9):				
Central 1 liquidity reserve deposits	$	87,214	$	–
Accrued interest on investments		274		–
Other investment		150		–
		87,638		–
Fair value through other comprehensive income (IFRS 9):				
Central 1 Credit Union Limited:				
Class A shares		513		–
Class E shares		2,544		–
Class F shares		4,432		–
		7,489		–
Other investments		125		–
		7,614		–
Fair value through profit and loss (IFRS 9 / IAS 39):				
CUCO Cooperative Association		55		55
Available for sale (IAS 39):				
Central 1 Credit Union Limited:				
Class A shares		–		4,365
Class E shares		–		3,389
		–		7,754
Other investments (IAS 39)		–		7
Loans and receivables (IAS 39):				
Central 1 liquidity reserve deposits		–		79,273
Accrued interest on investments		–		164
Other investment		–		400
	$	95,307	$	87,653

(in thousands of Canadian dollars)

6. Investments (continued):

The following summarizes the Credit Union's investments by the contractual repricing or maturity date, whichever is earlier:

		2018			2017	
		Principal Balance	Average Yield		Principal Balance	Average Yield
Within 1 year	$	82,333	2.20%	$	73,003	1.49%
Over 1 year		4,881	2.30%		6,270	1.44%
		87,214	2.21%		79,273	1.48%
Non-rate sensitive		7,819			8,216	
Accrued interest		274			164	
	$	95,307		$	87,653	

a) Shares in Central 1:

As a member of Central 1, the Credit Union is required to maintain an investment in Central 1 shares equal to its share of the level of capital required by Central 1. The Credit Union's Share of Central 1 capital requirements are based on asset size relative to other Class "A" members. Central 1 rebalances the investment annually. During 2018, the Credit Union purchased $3 (2017 - $463) Central 1 Class A shares, redeemed $3,855 (2017 - $306) and received $nil (2017 - $187) in dividends.

When Credit Union Central of Ontario Limited ("CUCO") and Credit Union Central of British Columbia ("CUCBC") merged to form Central 1, CUCO sold substantially all of its assets to Central 1 in exchange for Class A and Class E shares. In 2018, 8,457 Class E shares at $100 per share were redeemed for $845.

During the year the Credit Union acquired Class F shares as a result of Central 1 issuance of Class F shares to fund a mandatory liquidity pool. The Credit Union purchased 4,431,933 shares at $1 per share.

As there is no active market for these shares, the shares are not sellable, and, as a result of continued investment in these shares, the Credit Union receives significant benefits from Central 1, fair market value is not reliably determinable as future cash flows cannot be adequately predicted with a standard valuation technique. As a result, these shares are measured at fair value through other comprehensive income. At January 1, 2018, the Credit Union selected the irrevocable election to designate these shares as FVOCI.

The shares may be surrendered upon withdrawal from membership for proceeds equal to the paid-in value, to be received in accordance with a Central 1 by-law providing for the redemption of its share capital. The Credit Union does not intend to dispose of the shares in the near future.

6. Investments (continued):

b) Investment in CUCO Cooperative Association:

As a result of the merger between CUCO and CUCBC to form Central 1 in 2008, member credit unions were required to invest in a limited partnership ("ABCP LP") in order to acquire third-party asset-backed commercial paper ("ABCP"). Members of CUCO were required to purchase units in the ABCP LP based on their proportionate asset size.

On August 31, 2011, ABCP LP sold all of its assets to the CUCO Cooperative Association (“CUCO Co-op”) in exchange for CUCO Co-op Class B Investment Shares. Subsequently, on September 2, 2011, ABCP transferred to the Credit Union its proportionate share of CUCO Co-op Class B Investment Shares. As a result, the Credit Union received 1,081,848,866 Class B Shares. These investments have been designated as FVTPL.

There were no changes in the carrying value of the investment or dividends or return of capital received in 2018. An independent valuation was completed in 2017 on the underlying investments of the CUCO Co-op utilizing valuation techniques based on discounting expected future cash flows. The valuation was based on conditions existing at the statement of financial position date. As a result of this valuation and distributions from CUCO Co-op, the carrying value of the investment in the CUCO Co-op on the Credit Union’s balance sheet was decreased to $55. During 2017, the Credit Union received $1,876 from the CUCO Co-op which was recorded as a return of the initial capital invested. As these investments are designated as FVTPL a fair value loss of $7 was recorded in income for 2017.

c) Central 1 Liquidity reserve deposits:

The Credit Union is a member of Central 1. As a condition of maintaining membership in Central 1 in good standing, the Credit Union is required to maintain on deposit an amount equal to 6% of its assets as at each preceding month end. The deposits bear interest at varying rates, dependent upon the term of the investment, and have been designated as amortized cost.

d) Other shares:

The Credit Union maintains other instruments which are non-interest bearing. At January 1, 2018, the Credit Union selected the irrevocable election to designate these shares as FVOCI.

(in thousands of Canadian dollars)

7. Other assets:

	2018	2017
Other	$ 52	$ 75
Derivative financial instruments (note 21)	157	269
Prepayments	3,571	1,728
	$ 3,780	$ 2,072

Other assets and prepayments are assets are classified and measured at amortized cost under IFRS 9. Derivative financial instruments are assets classified as FVTPL under IFRS, see note 21.

8. Loans to members:

			2018
	Principal and interest	Allowance for impaired loans	Net
Residential mortgage loans	$ 761,152	$ 241	$ 760,911
Personal loans	346,553	6,433	340,120
Commercial loans	210,957	1,371	209,586
	$ 1,318,662	$ 8,045	$ 1,310,617

			2017
	Principal and interest	Allowance for impaired loans	Net
Residential mortgage loans	$ 693,959	$ 78	$ 693,881
Personal loans	290,376	3,438	286,938
Commercial loans	214,444	492	213,952
	$ 1,198,779	$ 4,008	$ 1,194,771

(in thousands of Canadian dollars)

8. Loans to members (continued):

Commercial loans consist of the following loan types:

	2018	2017
Commercial	$ 160,280	$ 159,823
Syndicated	13,253	20,452
Agricultural	32,464	29,145
Institutional	3,678	4,156
Unincorporated associations	1,282	868
Allowance for impaired loans	(1,371)	(492)
	$ 209,586	$ 213,952

The loan classifications set out above are as defined in the Regulations to the Act. Loans to members are classified and measured at amortized cost under IFRS 9.

Certain Residential Mortgage Loans are securitized and have been legally transferred to other entities for funding purposes. These loans are administered by the Credit Union and recognized on the statement of financial position to the extent of the Credit Union's continuing involvement. The remaining balance of loans securitized at December 31, 2018, is $204,192 (2017 - $162,796).

Total fees paid to third parties associated with lending activities capitalized in the related assets were $3,787 as at December 31, 2018 (2017 - $3,340). Charges amortized into interest expense in respect of these fees was $1,176 (2017 - $940).

The following summarizes the Credit Union's loan portfolio by the contractual repricing or maturity date, whichever is earlier:

	2018		2017	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Floating	$ 233,233	6.64%	$ 229,923	5.71%
Within 1 year	124,221	4.02%	136,388	4.12%
Over 1 year	961,208	3.86%	832,468	3.72%
	1,318,662	4.37%	1,198,779	4.15%
Allowance for impaired loans	(8,045)		(4,008)	
	$ 1,310,617		$ 1,194,771	

9. Allowance for impaired loans:

Measurement of ECL

The ECL impairment model measures the credit losses using the following three-stage approach based on the extent of credit deterioration of the financial assets since initial recognition:

- 12 month ECL (stage 1) – Where there has not been a significant increase in credit risk ("SICR") since initial recognition of a financial instrument, an amount equal to twelve months ECL is recorded. The ECL is computed using a probability of default ("PD") occurring over the next twelve months.
- Lifetime ECL – non-credit impaired (stage 2) – When a financial instrument experiences a SICR subsequent to initial recognition but is not considered to be in default, it is included in stage 2. This requires the computation of ECL based on the PD over the remaining estimated life of the financial instrument.
- Lifetime ECL – credit impaired (stage 3) – Financial instruments that are considered to be in default are included in this stage.

The PD, exposure at default ("EAD"), and loss given default ("LGD") are inputs used to estimate the ECL, and are modelled based on macroeconomic factors that are closely related with credit losses in the relevant portfolios, and are probability-weighted using three scenarios.

Details of these statistical parameters/inputs are as follows:

- PD is an estimate of the likelihood of default over a given time horizon, and is expressed as a percentage.
- EAD is the expected exposure in the event of default at a future default date, and is expressed as an amount.
- LGD is an estimate of the loss arising in case where a default occurs at a given time and is based on the difference between the contractual cash flows due and those that the Credit Union would expect to receive, including from the realization of any collateral. It is expressed as a percentage of the EAD.

(in thousands of Canadian dollars)

9. Allowance for impaired loans (continued):

	12-month ECL (Stage 1)	Lifetime non-credit impaired (Stage 2)	Lifetime credit impaired (Stage 3)	IFRS 9 2018 Total
Balance, beginning of year, IAS 39 (note 24)				$ 4,008
Transition adjustment, IFRS 9				3,107
Balance at January 1 per IFRS 9	$ 2,502	$ 2,949	$ 1,664	$ 7,115
Transfer to (from):				
Stage 1	904	(895)	(9)	–
Stage 2	(208)	339	(131)	–
Stage 3	(32)	(356)	388	–
Re-measurement	(1,032)	597	2,328	1,893
Originations	1,070	661	142	1,873
Discharges	(385)	(278)	(161)	(824)
Realized losses	–	–	(2,012)	(2,012)
Balance, end of year	$ 2,819	$ 3,017	$ 2,209	$ 8,045

Provision for impaired loans amounting to $2,942 is comprised of ECL related to re-measurement changes of $1,893 and loan originations of $1,873 less loan discharges of $824.

	Gross amount	Allowance for credit losses Stage1	Stage 2	Stage 3	Total	IFRS 9 Net amount
Residential mortgage loans	$ 761,152	$ (103)	$ (102)	$ (36)	$ (241)	$ 761,911
Personal loans	346,553	(2,455)	(2,394)	(1,584)	(6,433)	340,120
Commercial loans	210,957	(261)	(521)	(589)	(1,371)	209,586
Balance, end of year	$ 1,318,662	$ (2,819)	$ (3,017)	$ (2,209)	$ (8,045)	$ 1,310,617

Details of the activity in the provision for impaired loans are as follows:

	Residential Mortgage Loans	Personal Loans	Commercial Loans	IFRS 9 2018 Total	IAS 39 2017 Total
Balance, beginning of year	$ 271	5,574	1,270	7,115	$ 3,194
Net loans written-off	(146)	(1,854)	(12)	(2,012)	(1,620)
Provision for impaired loans during the year	116	2,713	113	2,942	2,434
Balance, end of year	$ 241	6,433	1,371	8,045	$ 4,008

(in thousands of Canadian dollars)

9. Allowance for impaired loans (continued):

Details of the impaired loans, net of expected credit loss (IFRS 9) and specific allowances (IAS 39) are as follows:

2018	Residential Mortgage Loans	Personal Loans	Commercial Loans	IFRS 9 Total
Impaired loans	$ 19,948	8,074	2,479	$ 30,501
Expected credit loss	(75)	(1,967)	(500)	(2,542)
Balance, end of year	$ 19,873	$ 6,107	$ 1,979	$ 27,959

2017	Residential Mortgage Loans	Personal Loans	Commercial Loans	IAS 39 Total
Impaired loans	$ 17,129	6,028	1,692	$ 24,849
Specific allowance	(78)	(3,371)	(352)	(3,801)
Balance, end of year	$ 17,051	$ 2,657	$ 1,340	$ 21,048

The Credit Union's commercial loan portfolio contains Member concentration risk, whereby a large amount of the loans are connected to certain individuals. Collectively, the largest five commercial Members by loan dollar value are associated with approximately 16% (2017 - 15%) of the commercial loan portfolio.

The Credit Union's commercial loan portfolio consists of the following industry sectors:

	IFRS 9 2018	ISA 39 2017
Hospitality	15%	19%
Retail and Commercial Buildings	42%	36%
Agriculture	16%	18%
Other	27%	28%

Past due but not impaired loans:

The Credit Union has the following loans that are past due but not impaired:

	2018	2017
31 to 90 days past due	$ 3,502	$ 3,812

(in thousands of Canadian dollars)

9. Allowance for impaired loans (continued):

Collateral:

There are documented policies and procedures in place for the valuation of financial and non-financial collateral. The fair valuation exercise of non-financial collateral is performed if there has been a significant change in the terms and conditions of the loan and (or) the loan is considered impaired. For impaired loans, an assessment of the collateral is taken into consideration when estimating the net realizable amount of the loan.

The amount and type of collateral and other credit enhancements required depend upon the Credit Union's assessment of counterparty credit quality and repayment capacity. The Credit Union complies with industry standards for collateral valuation, frequency of recalculation of the collateral requirements, documentation, registration and perfection procedures and monitoring.

Non-financial assets accepted by the Credit Union as collateral include vehicles, residential real estate, real estate under development, commercial real estate and certain business assets (accounts receivable, inventory, property and equipment). Financial collateral includes cash and negotiable securities issued by governments and investment grade issuers. Guarantees and are also accepted to reduce credit risk. The Credit Union also uses credit insurance on mortgage loans to reduce the credit risk.

The fair value of collateral held with respect to assets that are either past due greater than 30 days or impaired is $37,416 as at December 31, 2018 (2017 - $30,131).

Credit risk:

The following table sets out information about the credit quality of financial assets measured at amortized cost.

	12 month ECL	Lifetime not credit-impaired	Lifetime ECL credit-impaired	IFRS 9 2018 Total
Grade 1: Little or no risk	$ 37,878	$ 2,036	$ –	$ 39,914
Grade 2: Low Risk	185,012	3,684	–	188,696
Grade 3: Average Risk	1,006,869	35,917	–	1,042,786
Grade 4: Cautionary Risk	4,075	12,073	617	16,765
Grade 5: Impaired	10,497	11,310	8,694	30,501
	1,244,331	64,840	9,491	1,318,662
Allowance for impairment	(2,819)	(3,017)	(2,209)	(8,045)
Balance, end of year	$ 1,241,512	$ 61,823	$ 7,282	$1,310,617

For the year ended December 31, 2018, accrued interest of $218 was recorded on impaired loans (2017 - $210).

(in thousands of Canadian dollars)

9. Allowance for impaired loans (continued):

Prior to January 1, 2018, the credit quality of loans that are neither past due nor impaired are illustrated in the following table:

Credit quality of loans – December 31, 2017			IAS 39
Retail Mortgage and Personal Loans		Commercial Loans	
Rating	% of Portfolio	Rating	% of Portfolio
Undoubted	5%	Undoubted	7%
Superior	17%	Superior	16%
Satisfactory	77%	Satisfactory	73%
Watch List	1%	Watch list	4%

Refer to note 23 – Financial Risk Management for a detailed explanation of the credit risk rating process of both portfolios.

Forward-looking information ("FLI")

The Credit Union incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The estimation and application of FLI requires significant judgement. The Credit Union relies on a broad range of FLIs, such as expected GDP growth, unemployment rates, interest rates, and house price indices. The economic scenarios used as at December 31, 2018 included the following ranges of Canadian key indicators for the year ending December 31, 2018.

	2018
Unemployment rates:	
Base	5.76%
Range	4.43% to 7.43%
Interest rates:	
Base	1.75%
Range	0.25% to 2.26%
GDP growth:	
Base	1.74%
Range	(4.10%) to 3.40%
House prices:	
Base	0.45%
Range	(8.98%) to 3.24%

9. Allowance for impaired loans (continued):

Assessment of significant increase in credit risk ("SICR")

The determination of whether the ECL on a financial instrument is calculated on a twelve month period or lifetime basis is dependent on the stage the financial asset falls into at the reporting date. A financial instrument moves across stages based on an increase or decrease in its risk of default at the reporting date compared to its risk of default at initial recognition.

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Credit Union considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Credit Union's historical experience and expert credit assessment, delinquency and monitoring. With regards to delinquency and monitoring, there is a rebuttable presumption that the risk of default of the financial instrument has increased since initial recognition when contractual payments are more than 30 days overdue. The monitoring typically involves use of the following data:

Commercial loans
- Information obtained during periodic reviews of customer files
- Data from credit references agencies, changes in external credit ratings
- Actual and expected significant changes to business activities and/or environment

Personal loans and residential mortgage loans
- External data from credit reference agencies including industry standard credit scores
- Affordability metrics

All loans
- Payment history including overdue status
- Utilization of the granted limit
- Requests for and granting of forbearances
- Existing and forecasted changes in business, financial and economic condition

(in thousands of Canadian dollars)

10. Property and equipment and intangible assets:

		Land	Parking areas	Buildings and improvements	Leasehold improvements	Furniture, office and computer equipment	Automated banking machines	Construction in progress	Total Property and equipment	Intangible assets (software)		2018 Total
Cost												
Balance, beginning of the year	$	2,181	247	17,786	5,929	16,570	1,420	-	44,133	4,106	$	48,239
Additions		-	21	849	34	550	98	133	1,685	135		1,820
Disposals/transfers		-	-	836	(836)	(70)	(54)	-	(124)	36		(88)
Balance, end of year	$	2,181	268	19,471	5,127	17,050	1,464	133	45,694	4,277	$	49,971
Accumulated depreciation												
Balance, beginning of the year	$	-	161	8,718	2,897	13,379	938	-	26,093	2,176	$	28,269
Disposals/transfers		-	-	306	(306)	-	(40)	-	(40)	-		(40)
Amortization expense		-	18	714	289	924	160	-	2,105	617		2,722
Balance, end of year	$	-	179	9,738	2,880	14,303	1,058	-	28,158	2,793	$	30,951
Carrying amount - 2018	$	2,181	89	9,733	2,247	2,747	406	133	17,536	1,484	$	19,020
Carrying amount - 2017		2,181	86	9,068	3,032	3,191	482	-	18,040	1,930		19,970

(in thousands of Canadian dollars)

11. Members' deposits:

	2018	2017
Non-interest bearing deposits	$ 1,153	$ 1,215
Deposits with variable interest rates:		
Chequing	281,074	267,517
Savings	247,549	212,800
Registered retirement plans	37,314	35,829
	565,937	516,146
Deposits with fixed interest rates:		
Term deposits	316,177	287,778
Registered retirement plans	269,765	233,974
Accrued interest	7,401	5,738
	593,343	527,490
	$ 1,160,433	$ 1,044,851

All member deposits are classified as measured at amortized cost under IFRS 9.

The following summarizes the Credit Union's Members' deposits by the contractual repricing or maturity date, whichever is earlier:

	2018		2017	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Floating	$ 565,937	0.71%	$ 516,146	0.51%
Within 1 year	260,262	2.38%	194,507	1.90%
Over 1 year	325,680	2.27%	327,245	2.07%
	1,151,879	1.53%	1,037,898	1.26%
Non-rate sensitive	8,554		6,953	
	$ 1,160,433		$ 1,044,851	

12. Short-term borrowings with Central 1 Credit Union:

The Credit Union has authorized credit facilities available with Central 1 in the aggregate amount of $59,650 (2017 - $59,650). These credit facilities are secured by a general security agreement and an assignment of book debts. At the end of the year, $Nil (2017 - $12,000) was outstanding under this facility. These borrowings are classified as measured at amortized cost under IFRS 9.

(in thousands of Canadian dollars)

13. Securitized liabilities:

As part of its program of liquidity, capital, and interest rate risk management, the Credit Union enters into arrangements to fund loan growth by selling residential mortgages to unrelated third parties.

As part of these mortgage receivable transfers, the Credit Union retains mortgage servicing responsibilities but does not receive an explicit servicing fee for its servicing responsibilities. The Credit Union's retained interest in the mortgages sold also consists of their right to future cash flows arising from any excess of the mortgage cash flows over and above the contractual return due to the mortgage pool investors. The Credit Union's retained interests are subject to credit, prepayment, and interest rate risks on the securitized mortgages.

The third parties, as holders of the securitized mortgages, have recourse only to a cash collateral account and cash flow from the securitized mortgages. The investors and the third parties have no recourse to the Credit Union's other assets.

In accordance with the Credit Union's accounting policy, the transferred financial assets continue either to be recognized in their entirety or to the extent of the continuing involvement, are derecognized in their entirety.

i) Transferred Financial Assets that are recognized in their entirety:

At year end, Mortgage Backed Securities secured by residential mortgage loans of $204,192 (2017 - $162,796) bearing a weighted average fixed interest rate of 2.3000% (2017 – 2.0747%), expected weighted average maturity date of 2022 were outstanding under this arrangement.

14. Liabilities qualifying as regulatory capital:

	2018	2017
Membership shares	$ 1,833	$ 1,762
Patronage shares	1,155	1,212
Investment shares	29,284	29,150
	$ 32,272	$ 32,124

Patronage and Investment shares are recognized as a liability, equity or compound instrument based on the terms and in accordance with IAS 32, Financial Instrument Presentation and IFRIC 2 Members' Shares in Cooperative Entities and Similar Instruments. If they are classified as equity, they are recognized at cost net of transaction costs. If they are recognized as liability, they are initially recognized at fair value net of any transaction costs directly attributable to the issuance of the instrument and subsequently carried at amortized cost using the effective interest rate method.

14. Liabilities qualifying as regulatory capital (continued):

Terms and Conditions

Membership Shares

Membership shares have a par value of $5 per share and members eighteen years of age and over are required to have a minimum of five shares. Members under the age of eighteen are required to have one share. Membership share balances can be withdrawn only upon termination of membership and approval of the directors. At December 31, 2018, there were 72,850 members of the Credit Union holding 366,621 membership shares (2017 – 70,837 members holding 352,322 shares). Dividends are at the discretion of the Board of Directors.

Funds invested by members in member shares are not insured by DICO. The withdrawal of member shares is subject to the Credit Union maintaining adequate regulatory capital (see note 15), as is the payment of any dividends on these shares. Membership shares are available for redemption and based on their features are classified as a liability.

Patronage Shares

The Credit Union is authorized to issue an unlimited number of non-voting, non-participating, Class A non-cumulative, redeemable patronage shares. Class A non-cumulative redeemable patronage shares can only be withdrawn subject to any restrictions imposed by the Credit Unions and Caisses Populaires Act, 1994. Issued and outstanding shares as at December 31, 2018 were 1,154,358 (2017 – 1,211,633). Patronage shares are available for redemption and based on their features are classified as a liability.

Patronage share redemptions are at the discretion of the Directors to a maximum of 10% of the shares outstanding at the previous year end.

Investment Shares

Class B investment shares pay dividends at the discretion of the Board of Directors in the form of cash or additional shares. The Credit Union has the option to redeem these shares in whole or in part or on a pro-rata basis any time after five years from the date of issuance to a maximum of 10% of the shares outstanding at the previous year end. Issued and outstanding shares as at December 31, 2018 were 29,284,065 (2017 – 29,150,238). Investment shares are non-voting, are available for redemption and based on their features are classified as a liability.

On December 6, 2018, the Board of Directors declared a dividend of 3.53% (2017 – 2.93%) on Class B investment shares. The value of the declared dividend was $1,037 (2017 - $857).

(in thousands of Canadian dollars)

15. Capital management:

The Credit Union maintains policies and procedures relative to capital management so as to ensure that capital levels are sufficient to cover risks inherent in the business.

The Credit Union's objectives when managing capital are to implement a policy that:

- ensures that the quantity, quality and composition of capital needed that reflects the inherent risks of the Credit Union and to support the current and planned operations; and
- provides distributions of dividends and redemptions of capital instruments to members.

The Credit Union Act requires credit unions to maintain minimum regulatory capital, as defined by the Act. Regulatory capital is calculated as a percentage of total assets, and of risk-weighted assets. Risk-weighted assets are calculated by applying risk weight percentages, as prescribed by the Act, to various asset categories, operational and interest rate risk criteria. The prescribed risk weights are dependent upon the degree of risk inherent in the asset.

The Act requires credit unions to maintain a capital ratio of 4.00% and a risk-weighted capital ratio of 8.00%. The Credit Union has a stated policy that it will maintain at all times capital equal to the minimum required by the Act plus a prudent cushion. The current minimum ratios per board policy are a capital ratio of 6.00% and a risk-weighted capital ratio of 10.50%. The Credit Union is in compliance with the Act as indicated by the table below:

	Regulatory	Capital leverage		Risk weighted	
	Capital	minimum	actual	minimum	actual
December 31, 2018	$ 92,487	4.00%	6.33%	8.00%	12.97%
December 31, 2017	$ 88,289	4.00%	6.71%	8.00%	13.46%

The Credit Union manages its Tier 1 and Tier 2 capital in accordance with internal policies and regulatory requirements. Tier 1 capital is the highest quality and consists of retained earnings, membership shares and the portion of the value of Class A and B investment and patronage shares that are not redeemable within 12 months. Tier 2 capital is comprised of the value of Class A and B investment and patronage shares ineligible as Tier 1 capital and the eligible portion of the allowance for impaired loans.

(in thousands of Canadian dollars)

15. Capital management (continued):

The amount of composition of Tier 1 and Tier 2 capital was as follows:

	2018	2017
Tier 1 Capital		
Retained earnings	$ 35,245	$ 36,824
Contributed surplus	19,134	19,134
Membership shares	1,833	1,762
Class A non-cumulative redeemable patronage shares (90%)	1,091	1,130
Class B non-cumulative, non-voting, non-participating investments shares (90%)	27,091	27,105
Tier 2 Capital		
Class A non-cumulative redeemable patronage shares (10%)	64	82
Class B non-cumulative, non-voting, non-participating investment shares (10%)	2,193	2,045
Non-specific collective allowance for impaired loans	5,836	207
Total regulatory capital	$ 92,487	$ 88,289

(in thousands of Canadian dollars)

16. Income taxes:

The components of income tax expense (recovery) are as follows:

	2018	2017
Current income tax expense	$ 1,012	$ 353
Deferred income tax recovery	(1,255)	(496)
Total income tax expense (recovery)	$ (243)	$ (143)

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory rate of 26.5% (2017 - 26.5%) to income before income taxes. The reasons for the difference are as follows:

	2018	2017
Income before income tax	$ 461	$ 1,717
Statutory tax rate	26.5%	26.5%
Computed tax expense	$ 122	$ 455
Increase (decrease) resulting from:		
Lower rate on preferred rate amount	(438)	(132)
Non-deductible expense	12	12
Non-taxable dividend on CUCO Cooperative Association redemption	-	(447)
Other	61	(31)
Total income tax expense (recovery)	$ (243)	$ (143)

(in thousands of Canadian dollars)

16. Income taxes (continued):

The movements of deferred tax assets and liabilities are presented below:

2018		Opening Balance	Recognized in OCI	Recognized Directly in Equity	Recognized in Profit or loss	Closing Balance
Deferred tax assets:						
Employee retirement benefits	$	848	(231)	–	242	859
Allowance for impaired loans		156	–	824	625	1,605
Reserves		20	–	–	(20)	–
Investments		173	(19)	–	(9)	145
Non-capital loss		–	–	–	–	–
Total deferred tax assets	$	1,197	(250)	824	838	2,609
Deferred tax liabilities:						
Property, equipment and intangible assets	$	450	–	–	(110)	340
Bargain purchase gain		1,143	–	–	(307)	836
Total deferred tax liabilities	$	1,593	–	–	(417)	1,176
Total movement taken to income tax expense	$	(396)	(250)	824	1,255	1,433

2017		Opening Balance	Recognized in OCI	Recognized Directly in Equity	Recognized in Profit or loss	Closing Balance
Deferred tax assets:						
Employee retirement benefits	$	668	42	–	138	848
Allowance for impaired loans		166	–	–	(10)	156
Reserves		71	–	–	(51)	20
Non-capital loss		324	–	–	(324)	–
Total deferred tax assets	$	1,229	42	–	(247)	1,024
Deferred tax liabilities:						
Investments	$	302	(17)	–	(458)	(173)
Property, equipment and intangible assets		385	–	–	65	450
Bargain purchase gain		1,493	–	–	(350)	1,143
Total deferred tax liabilities	$	2,180	(17)	–	(743)	1,420
Total movement taken to income tax expense	$	(951)	59	–	496	(396)

(in thousands of Canadian dollars)

16. Income taxes (continued):

The ultimate realization of deferred tax assets is dependent upon generation of taxable income during future periods in which the unused tax losses are available.

The Credit Union has net capital loss carryforwards of $513 (2017 - $256) with no expiry date which are available to reduce future taxable income. The tax benefit of the losses will be recognized in the year that it is determined that it is probable that they will be realized.

17. Commitments and contingencies:

(a) As at December 31, 2018, commitments for authorized but not issued loans to members amounted to approximately $28,997 (2017 - $15,077).

(b) As at December 31, 2018, commitments for unused lines and letters of credit amounted to approximately $168,394 and $1,614 respectively (2017 - $160,782 and $2,157, respectively).

(c) The Credit Union has commitments for the rental of branch premises under long-term non-cancelable operating leases, other rental agreements and various community sponsorships which expire on various dates to 2028. Future annual minimum payments are approximately as follows:

2019	$ 1,153
2020	1,110
2021	989
2022	727
2023	365
Thereafter	191

(d) The Credit Union, in the normal course of business, is involved in certain legal matters and litigation from time to time, the outcomes of which are not presently determinable. The effects, if any, from such contingencies will be accounted for in the periods in which the matters are probable.

(in thousands of Canadian dollars)

18. Non-interest revenue:

The components of non-interest revenue were as follows:

	2018	2017
Service charges	$ 6,766	$ 6,749
Insurance commissions	1,522	1,518
Loan and commitment fees	1,764	1,493
Wealth management	807	852
Rental income	44	10
Foreign exchange	492	484
Other	1,067	609
	$ 12,462	$ 11,715

19. Employee future benefits:

The Credit Union has a defined benefit pension plan for certain management employees. All other employees of the Credit Union may elect to participate in the Canadian Credit Union Employees Pension Plan, a defined contribution plan, as provided by CUMIS Life Insurance Company.

The total expense for the pension plans are as follows:

	2018	2017
Defined benefit pension plan net benefit expense	$ 972	$ 980
Defined contribution pension plan	412	339
	$ 1,384	$ 1,319

Information about the Credit Union's defined benefit plan is as follows:

	2018	2017
Accrued benefit obligation:		
Balance, beginning of year	$ 17,028	$ 14,881
Current service cost	1,103	1,097
Interest cost	606	613
Benefits paid	(400)	(335)
Actuarial (gains) losses	(1,464)	861
Administration fees	(100)	(89)
Balance, end of year	$ 16,773	$ 17,028

(in thousands of Canadian dollars)

19. Employee future benefits (continued):

		2018		2017
Plan assets:				
Fair value, beginning of year	$	14,269	$	12,742
Expected return on plan assets		490		503
Employer contributions		535		520
Employee contributions		247		227
Benefits paid		(400)		(335)
Actuarial (losses) gains		(592)		701
Administration fees		(100)		(89)
Fair value, end of year	$	14,449	$	14,269

Experience adjustments incurred were as follows:

		Defined Benefit Pensions 2018		2017
Accrued benefit obligation gain (loss)	$	1,464	$	(861)
Plan assets (loss) gain		(592)		701
Total for the year	$	872	$	(160)

The accrued benefit liability is included in accounts payable and accrued liabilities.

The following table provides the amount recognized in the statement of financial position:

		Defined Benefit Pensions 2018		2017
Funded status (deficit) being accrued benefit liability included in other liabilities	$	(2,324)	$	(2,758)
Net amount recognized	$	(2,324)	$	(2,758)

(in thousands of Canadian dollars)

19. Employee future benefits (continued):

The significant actuarial assumptions adopted in measuring the Credit Union's accrued benefit obligations are as follows:

	Defined Benefit Pensions 2018	2017
Discount rate	3.90%	3.40%
Rate of compensation increase	3.00%	3.00%
Expected long-term rate of return on plan assets	3.90%	3.40%
Rate of maximum pension increase	3.00%	3.00%

The expected rate of return on plan assets is based on the risks and associated returns expected of the underlying plan assets. Plan assets are held in balanced funds which include equities and fixed income investments.

The Credit Union's net benefit plan expense is as follows:

	Defined Benefit Pensions 2018	2017
Current service cost, net of employees' contributions	$ 856	$ 870
Interest cost	606	613
Expected return on plan assets	(490)	(503)
Net benefit plan expense	$ 972	$ 980

These net benefit plan expenses are included in salaries and employee benefits on the statement of income. Aggregate contributions relating to the defined benefit pensions plan for the year ended December 31, 2018 is $535 (2017 - $520).

The defined benefit plan assets comprise:

	2018	2017
Mawer balanced fund	$ 11,010	$ 10,773
Guardian balanced income fund	3,422	3,480
CUMIS retirement security fund	17	16
	$ 14,449	$ 14,269

The actual return on plan assets for the year-ended December 31, 2018 was ($102) (2017 - $1,204).

19. Employee future benefits (continued):

A 1% decrease in the discount rate would increase the pension benefit obligation at December 31, 2018 by 17.0% or $2,852 to $19,625 (2017 – 18.2% or $3,098 to $20,126). In addition, a 1% decrease in the discount rate would increase the fiscal 2018 net service cost by 22.7% or $201 to $1,087 (2017 – by 24.3% or $243 to $1,246).

A 1% decrease in the salary scale would decrease the pension benefit obligation at December 31, 2018 by 2.5% or $417 to $16,356 (2017 – 4.1% or $695 to $16,333). In addition, a 1% decrease in the salary scale would decrease the fiscal 2018 net service cost by 6.4% or $56 to $830 (2017 – 8.5% or $85 to $918).

20. Fair value of financial instruments:

The following table represents the fair values of the Credit Union's financial instruments. The fair values disclosed do not include the value of assets that are not considered financial instruments, such as fixed assets.

While the fair value amounts are intended to represent estimates of the amounts at which these instruments could be exchanged in a current transaction between willing parties, some of the Credit Union's financial instruments lack an available trading market. Consequently, the fair values presented are estimates derived using present value and other valuations techniques and may not be indicative of the net realizable values.

Due to the judgment used in applying a wide range of acceptable valuation techniques and estimates in calculating fair value amounts, fair values are not necessarily comparable among financial institutions. The calculation of estimated fair values is based on market conditions at a specific point in time and may not be reflective of future fair values.

(in thousands of Canadian dollars)

20. Fair value of financial instruments (continued):

	December 31, 2018			December 31, 2017		
	Carrying Value	Fair Value	Difference	Carrying Value	Fair Value	Difference
Amortized Cost						
Loans to members	$ 1,310,617	$1,303,825	$ (6,792)	$1,194,771	$1,194,938	$ 167
Investments	87,638	88,396	758	79,437	80,201	764
Fair Value through Profit and Loss						
Cash resources	30,033	30,033	–	11,548	11,548	–
Investments	55	55	–	55	55	–
Fair Value through OCI						
Investments	7,614	7,614	–	8,161	8,161	–
Total financial assets	$1,435,957	$1,429,923	$ (6,034)	$1,293,972	$1,294,903	$ 931
Amortized Cost						
Member deposits	$ 1,160,433	$1,157,775	$ (2,658)	$1,044,851	$1,043,747	$ (1,104)
Accounts payable and accrued liabilities	7,106	7,106	–	6,776	6,776	–
Loans payable	–	–	–	12,000	12,001	1
Securitized liabilities	204,192	203,875	(317)	162,796	162,946	150
Total financial liabilities	$1,371,731	$1,368,756	$ (2,975)	$1,226,423	$1,225,470	$ (953)

Interest rate sensitivity is the main cause of change in fair values of the Credit Union's financial instruments.

The following methods and assumptions were used to estimate the fair value of financial instruments:

(a) The fair values of cash and accounts payable and accrued liabilities are assumed to approximate their book values, due to their short–term nature.

(b) The estimated fair value of floating rate loans, demand deposits and floating rate deposits are assumed to be equal to book value as the interest rates on these loans and deposits reprice to market on a periodic basis.

(c) The estimated fair values of fixed rate investments, fixed rate loans and fixed rate deposits are determined by discounting the expected future cash flows of these investments, loans, deposits and borrowings at current market rates for products with similar terms and credit risks.

(in thousands of Canadian dollars)

20. Fair value of financial instruments (continued):

The estimated fair values of derivative instruments are determined through valuation models on the derivative notional amounts, maturity dates and rates.

Fair value measurements can be classified in a hierarchy in order to discern the significance of management assumptions and other inputs incorporated into the measurements. The three levels of fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are consider less than active; or other valuation techniques where all significant inputs are directly or indirectly observable form market data.

Level 3 – Inputs for the asset or liability that are not based on observable market data. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments are required to reflect differences between the instruments.

The following table summarizes the classification of the Credit Union's financial instruments held and reported on the Statement of Financial Position at fair value:

			2018	
	Level 1	Level 2	Level 3	Total
Assets				
Investments – FVTPL securities	$ –	$ 55	$ –	$ 55
Investments – FVOCI securities	–	7,614	–	7,614
Derivative financial instruments	–	157	–	157
	$ –	$ 7,826	$ –	$ 7,826

(in thousands of Canadian dollars)

20. Fair value of financial instruments (continued):

2017

	Level 1	Level 2	Level 3	Total
Assets				
Investments – FVTPL securities	$ –	$ 55	$ –	$ 55
Derivative financial instruments	–	269	–	269
	$ –	$ 324	$ –	$ 324
Liabilities				
Derivative financial instruments	$ –	$ 190	$ –	$ 190

Fair value of financial instruments held at amortized cost using the fair value hierarchy.

The following table illustrates the Credit Union's financial instruments which are not carried at fair value on the balance sheet as at December 31, 2018 with comparative information for December 31, 2017. The table does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value. The Credit Union's financial instruments held at amortized cost are all classified as Level 2 as identified below:

	2018	2017
Assets		
Loans to members	$ 1,303,825	$ 1,194,938
Investments	88,396	88,417
Fair value of assets held at amortized cost	$ 1,392,221	$ 1,283,355
Liabilities		
Members' deposits	$ 1,157,775	$ 1,043,747
Accounts payable	7,106	6,776
Loans payable	–	12,001
Securitized liabilities	203,875	162,946
Fair value of liabilities held at amortized cost	$ 1,368,756	$ 1,225,470

(in thousands of Canadian dollars)

21. Derivative financial instruments:

a) Notional amounts of derivatives:

The notional amounts of derivatives shown in the tables below do not represent amounts exchanged by the parties and, thus, are not a measure of the exposure of the Credit Union through its use of derivatives. The amounts exchanged are calculated on the basis of the notional amounts and the other terms of the derivatives, which relate to interest rates.

The Credit Union is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but it does not expect any counterparties to fail to meet their obligations given their high credit ratings. The credit exposure of interest rate contracts is represented by the fair value of contracts with a positive fair value at the reporting date.

b) Interest rate risk management:

The Credit Union has entered into interest rate contracts to manage interest rate risk and variable rates to alter interest rate exposure. Interest rate swaps allow the Credit Union to finance transactions and effectively swap them into fixed rate terms. Under interest rate swaps, the Credit Union agrees with the counterparty to exchange, at the maturity date, the difference between fixed-rate and floating-rate interest amounts calculated by reference to the notional amount.

The following table indicates the swaps and options in place at December 31, 2018 and the interest rate.

					2018
Date Agreement Entered	Notional Principal	Fixed Rate	Start Date	Expiry Date	Fair Value
Interest Rate Swaps					
June 19, 2017	3,000	1.335%	Jan 22, 2018	Jan 22, 2019	$ (16)
June 19, 2017	5,000	1.345%	Feb 20, 2018	Feb 20, 2019	(28)
January 23, 2018	75,000	1.950%	Jan 23, 2018	Jan 23, 2019	47
May 18, 2018	8,000	2.115%	May 18, 2018	Jul 22, 2019	(4)
May 18, 2018	12,000	2.220%	May 18, 2018	Nov 18, 2019	(3)
May 18, 2018	15,000	2.345%	May 18, 2018	Jun 15, 2020	20
July 10, 2018	50,000	2.190%	Sep 17, 2018	Sep 16, 2019	(9)
					$ 7

(in thousands of Canadian dollars)

21. Derivative financial instruments (continued):

b) Interest rate risk management (continued):

					2017
Date Agreement Entered	Notional Principal	Fixed Rate	Start Date	Expiry Date	Fair Value
Interest Rate Swaps					
January 5, 2016	3,000	0.820%	Jan 20, 2017	Jan 20, 2018	$ (10)
January 5, 2016	5,000	0.840%	Feb 17, 2017	Feb 20, 2018	(15)
January 5, 2016	8,100	0.800%	Mar 15, 2016	Mar 15, 2018	(26)
March 10, 2017	6,000	1.060%	Jun 15, 2017	Jun 15, 2018	(19)
March 10, 2017	10,000	1.080%	Jul 22, 2017	Jul 23, 2018	(45)
June 19, 2017	6,000	1.285%	Nov 20, 2017	Nov 20, 2018	(28)
June 19, 2017	3,000	1.335%	Jan 22, 2018	Jan 20, 2019	(17)
June 19, 2017	5,000	1.345%	Feb 20, 2018	Feb 17, 2018	(30)
					$ (190)

c) Foreign exchange forward contracts:

As part of its ongoing program of managing foreign currency exposure, the Credit Union enters into forward rate agreements to purchase US dollars. These agreements function as a hedge against the Credit Union's net US dollar denominated liability position. The net fair value of these contracts as at December 31, 2018 was $12 (2017 – ($1)).

d) Index-linked term deposits:

At December 31, 2018, the Credit Union has issued $1,953 (2017 - $2,482) of index-linked term deposit products to its members. These term deposits have maturities of 3 and 5 years and pay interest to the depositors at the end of the term, based on the performance of various Toronto Stock Exchange ("TSX") indices.

The Credit Union has entered into hedge agreements with Central to offset the exposure to the indices associated with these products. The Credit Union pays Central a fixed amount on the face value of these term deposit products. At the end of the respective terms, the Credit Union receives payments from Central equal to the amount required to be paid to the depositors based on the performance of the specified TSX indices.

The purpose of these agreements is to provide a hedge against market fluctuations. These agreements have a fair value that varies based on the particular contract and changes in the interest rates. The fair value of these swap agreements is $138 (2017 - $269) at December 31, 2018 and has been accounted for as a derivative in accordance with the Credit Union's accounting policy classified as FVTPL under IFRS 9.

(in thousands of Canadian dollars)

22. Related party transactions:

The Credit Union entered into the following transactions with key management personnel, which are defined by IAS 24, Related Party Disclosures, as those persons that have authority and responsibility for planning, directing and controlling the activities of the Credit Union.

		2018		2017
Compensation:				
Salaries and other short-term employee benefits	$	1,014	$	944
Total pension and other post-employment benefits		635		214
	$	1,649	$	1,158

		2018		2017
Loans to key management personnel:				
Aggregate value of loans advanced	$	576	$	670
Interest received on loans advanced		19		18
Aggregate value of unadvanced loans		84		86

The Credit Union's policy for lending to key management personnel is that the loans are approved and deposits accepted on the same terms and conditions which apply to members for each class of loan or deposit.

		2018		2017
Deposits from key management personnel:				
Aggregate value of term and savings deposits	$	959	$	873
Total interest paid on term and saving deposits		16		12

The Credit Union's policy for receiving deposits from key management personnel is that all transactions are approved and deposits accepted on the same terms and conditions which apply to members for each type of deposit. There are no benefits or concessional terms and conditions applicable to key management personnel or close family members.

(in thousands of Canadian dollars)

22. Related party transactions (continued):

The total remuneration paid to the directors and committee members amounted to $156 (2017 - $167). The aggregate value of loans to related parties is as follows:

		2018		2017
Directors and officers	$	1,048	$	1,124

All loans issued to related parties conform to the Credit Union's policies for terms, interest rates, limits and credit.

In accordance with the required disclosure under Ontario Regulation 237/09, section 28, of the Credit Unions and Caisses Populaires Act 1994, the Act requires disclosure of the five highest paid officers and employees of the Credit Union where total remuneration exceeds $150. The names, positions and remuneration paid during the year ended December 31, 2018 of those employees are as follows:

		Salary and variable compensation		Benefits		Total
Albert W. Suraci, President and Chief Executive Officer	$	384	$	82	$	466
Tony Dunham, Senior Vice-President Strategy, Innovation and Operations		224		53		277
Richard Adam, Senior Vice-President Finance and Administration		224		53		277
Brandy Heikoop, Senior Vice-President Human Resources		182		39		221
Steven Hatzipantelis, Assistant Vice-President Retail Sales and Service		141		28		169

23. Financial risk management:

The Board of Directors has overall responsibility for the establishment and oversight of the Credit Union's risk management framework. The Board has established the Audit Committee and charged them with the responsibility for, among other things, the development and monitoring of risk management policies. An Asset Liability Committee (ALCO) has been established consisting of senior management and an external consultant. This committee meets on a monthly basis to review the results of income simulation models and duration analysis and reports regularly to the Board on its activities.

a) Liquidity risk:

Liquidity risk arises in the course of managing our assets and liabilities. It is the risk that the entity is unable to meet its financial obligations in a timely manner and at reasonable prices. The Credit Union's liquidity risk management strategies seek to maintain sufficient liquid financial resources to continually fund our balance sheet under both normal and stressed market environments. The Credit Union's liquidity risk is subject to extensive risk management controls and is managed within the framework of polices and limits approved by the Board. These policies and limits ensure, among other things, that the Credit Union is in full adherence to the regulatory requirements prescribed in the Credit Union Act as well as DICO's standards of Sound Business and Financial Practices. The Board receives regular reports on risk exposures and performance against approved limits.

The Credit Union believes that liquidity risk management is a necessary part of prudent financial administration, and is committed to engaging in proper liquidity risk management practices to comply with regulatory requirements and to guarantee the orderly funding of member needs and obligations. The Credit Union will ensure responsible liquidity risk management at all times to provide a cushion for unforeseen liquidity needs.

The key elements of the Credit Union's liquidity risk management framework establishes an overall framework of liquidity risk management which ensures that the Credit Union faces limited exposure to all material risks as well as addressing limits on the sources, quality and amount of liquid assets to meet normal operational, contingency funding for significant deposit withdrawals, and regulatory requirements.

The Credit Union targets to maintain operating liquidity within the range of 6% to 14%. The low end of the range has been established to maintain membership in Central 1. A cap has been placed on the range in recognition of the fact that too much excess liquidity has a negative impact on earnings. As at December 31, 2018, the Credit Union's liquidity ratio was 8.64% (2017 – 7.48%).

Assets held for liquidity purposes consist of cash resources designated as FVTPL in the amount of $30,033 and liquidity reserve deposits and term deposits held by Central 1 designated as amortized cost totaling $87,214.

(in thousands of Canadian dollars)

23. Financial risk management (continued):

a) Liquidity risk (continued):

The table below sets out the period in which the Credit Union's monetary assets and liabilities will mature and be eligible for renegotiation or withdrawal. In addition to the cash flows detailed below, the Credit Union is exposed to potential cash outflows in the form of commitments and contingencies as set out in note 17.

December 31, 2018

	Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Not specified	Total
Assets						
Financial assets:						
Cash and cash equivalents	$ 30,033	–	–	–	–	30,033
Investments	80,386	10,040	4,881	–	–	95,307
Loans to members	266,328	83,080	825,870	135,339	–	1,310,617
	376,747	93,120	830,751	135,339	–	1,435,957
Non-financial assets:						
Other assets	–	–	–	–	24,233	24,233
Total assets	$ 376,747	93,120	830,751	135,339	24,233	1,460,190
Liabilities and Members' Equity						
Members' deposits	$ 616,863	217,890	325,680	–	–	1,160,433
External borrowing	–	11,810	192,382	–	–	204,192
Other liabilities	–	–	–	–	7,106	7,106
Share capital	32,272	–	–	–	–	32,272
Members' equity	56,187	–	–	–	–	56,187
Total liabilities and members' equity	$ 705,322	229,700	518,062	–	7,106	1,460,190

(in thousands of Canadian dollars)

23. Financial risk management (continued):

a) Liquidity risk (continued):

December 31, 2017

		Within 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Not specified	Total
Assets							
Financial assets:							
Cash and cash equivalents	$	11,548	–	–	–	–	11,548
Investments		81,383	–	6,270	–	–	87,653
Loans to members		265,737	96,544	710,092	122,398	–	1,194,771
		358,668	96,544	716,362	122,398	–	1,293,972
Non-financial assets:							
Other assets		–	–	–	–	22,042	22,042
Total assets	$	358,668	96,544	716,362	122,398	22,042	1,316,014
Liabilities and Members' Equity							
Members' deposits	$	559,613	157,992	327,246	–	–	1,044,851
External borrowing		12,000	9,766	153,030	–	–	174,796
Other liabilities		190	–	–	–	6,982	7,172
Share capital		32,124	–	–	–	–	32,124
Members' equity		57,071	–	–	–	–	57,071
Total liabilities and members' equity	$	660,998	167,758	480,276	–	6,982	1,316,014

It is estimated that immediate and sustained parallel increase in interest rates of 1% across all maturities and currencies would increase net interest income by approximately $1,177 and a decrease in interest rates of 1% across all maturities and currencies would decrease net interest income by approximately $754 over the next twelve months using the following assumptions:

(i) accrued interest receivable and payable as at December 31, 2018 are excluded from the calculation;
(ii) no hedging or interest rate exposures are made;
(iii) instruments reprice evenly within their respective time bands, and;
(iv) existing credit commitments will not be drawn upon.

23. Financial risk management (continued):

b) Credit risk:

Credit risk is the potential for financial loss to the Credit Union if a borrower or guarantor fails to meet payment obligations in accordance with agreed terms. Every loan, extension of credit or transaction that involves settlements between the Credit Union and other parties or financial institutions exposes the Credit Union to some degree of credit risk.

The Credit Union's primary objective is to create a methodological approach to its credit risk assessment in order to better understand, select and manage our exposures to deliver stable ongoing earnings. The strategy is to ensure central oversight of credit risk, fostering a culture of accountability, independence and balance. The responsibility for credit risk management is organization-wide in scope, and is managed through an infrastructure based upon:

- Ensuring that credit quality is not compromised for growth;
- Diversifying credit risks in transactions, relationships and portfolios;
- Using our credit risk weighting and scoring systems, policies and tools;
- Pricing appropriately for the credit risk taken;
- Mitigating credit risk through preventive and detective controls;
- Transferring credit risk to third parties where appropriate through approved credit; and, risk mitigation techniques including insurance coverage.

c) Interest rate risk:

Interest rate risk is the sensitivity of the Credit Union's financial position to movements in interest rates. The Credit Union is exposed to interest rate risk when it enters into banking transactions with our members, primarily deposit and lending activities. When asset and liability principal and interest cash flows have different payment or maturity dates, this results in mismatched positions. An interest-sensitive asset or liability is re-priced when interest rates change, when there is cash flow from final maturity, normal amortization, or when members exercise prepayment, conversion or redemption options offered for the specific product. The Credit Union's exposure to interest rate risk depends on the size and direction of interest rate changes, and on the size and maturity of the mismatched positions. It is also affected by new business volumes, renewals of loans or deposits, and how actively members exercise options, such as prepaying a loan before its maturity date.

The Credit Union's interest rate risk is subject to extensive risk management controls and is managed within the framework of policies and limits approved by the Board. These policies and limits ensure, among other things, that the entity is in full adherence to the regulatory requirements prescribed in the Act as well as DICO's standards of Sound Business and Financial Practices. Overall responsibility for asset/liability management rests with the Board.

(in thousands of Canadian dollars)

23. Financial risk management (continued):

c) Interest rate risk (continued):

At the reporting date, the interest rate profile of the Credit Union's interest-bearing financial instruments was:

	Carrying amount 2018	Carrying amount 2017
Fixed rate instruments		
Financial assets	$ 1,096,564	$ 972,495
Financial liabilities	(790,134)	(684,548)
	$ 306,430	$ 287,947
Variable rate instruments		
Financial assets	$ 310,474	$ 308,025
Financial liabilities	(599,361)	(561,673)
	$ (288,887)	$ (253,648)

Fair value sensitivity analysis for fixed rate instruments:

The Credit Union does not account for any fixed rate financial assets and liabilities at fair value through profit or loss, and the Credit Union does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model; therefore a change in interest rates at the reporting date would not affect profit or loss.

A change of 100 basis points in interest rates would have increased or decreased equity by $1,723 (2017 - $296).

d) Market risk:

Market risk is the risk that changes in market prices, such as interest rates, equity rates, foreign exchange rates and credit spreads, will affect the Credit Union's income or the value of its holdings of financial instruments. The objective of market risk is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

The Credit Union uses income simulation modeling to measure exposure to changes in interest rates over short term periods. Earnings at risk, is calculated by forecasting the net interest margin for the next 12 months using the most likely assumptions. These assumptions include management's estimates of future growth rates, and future interest rates and term preferences of members. Future growth rates are initially based on the board approved budget. Future interest rates are based on the most current interest rate path. These earnings at risk are then shocked by a change in rates sustained for a 12 month period. The resulting change in the forecast as a result of the rate shock then determines the earnings at risk. Maximum limits are established under these scenarios and are approved by the Board of Directors.

23. Financial risk management (continued):

d) Market risk (continued):

Long-term interest rate risk is measured using duration analysis. The duration of an asset, is an expression of its term to maturity taking into account the yield of the asset.

Maximum limits are established for both earnings at risk and duration of capital and are approved by the Board of Directors. The current maximum limit and projected change is indicated below:

	Maximum limit	Projected change
0.50% shock down	$ 750	$ (503)
1.0% shock up	750	1,177

e) Foreign currency risk:

Foreign currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Credit Union is exposed to foreign currency risk as a result of its members' activities in foreign currency denominated deposits and cash transactions. All foreign currency risk comes from U.S. dollar transactions. The Credit Union's foreign currency risk is subject to extensive risk management controls and is managed in accordance with the framework of policies and limits approved by the Board. These policies and limits ensure, among other things, that the entity is in full adherence to the regulatory requirements prescribed in the Act as well as DICO's standards of Sound Business and Financial Practices.

Prudent limits will be placed on unhedged liquid assets denominated in a foreign currency. Limits are established in relation to the size of the overall liquidity portfolio and are to apply at the time of purchase.

At December 31, 2018, the Credit Union was in compliance with Board policy on financial risk management.

24. Change in accounting policies:

IFRS 15 Revenue contracts with customers

The Credit Union adopted IFRS 15 Revenue from Contracts with Customers (“IFRS 15”), effective January 1, 2018. There is no material impact on the Credit Union’s financial statements and its accounting policies from the adoption of IFRS 15 the majority of the Credit Union’s revenue includes interest income from financial instruments which do not fall within the scope of this standard.

IFRS 9 Financial Instruments

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. Details are included within this note regarding how the Credit Union classifies financial assets under IFRS 9, see Transition.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognized in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

Details are included within this note regarding how the Credit Union classifies financial liabilities under IFRS 9, see Transition.

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with an ‘expected credit loss’ model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognized earlier than under IAS 39. For an explanation of how the Credit Union applies the impairment requirements of IFRS 9, see note 9.

24. Change in accounting policies (continued):

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings as at January 1, 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.

- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application:
  - The determination of the business model within which a financial asset is held.
  - The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
  - The designation of certain investments in equity instruments not held for trading as at FVOCI.
  - For financial liabilities designated as at FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.
  - If a debt security had low credit risk at the date of initial application of IFRS 9, then the Credit Union has assumed that credit risk on the asset had not increased significantly since its initial recognition to the date of initial application.

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments.

(in thousands of Canadian dollars)

24. Change in accounting policies (continued):

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments.

	As at December 31, 2017 IAS 39			As at January 1, 2018 IFRS 9	
Account	Measurement basis	Carrying amount	Remeasurement/ reclassification	Carrying amount	Measurement basis
Cash	FVTPL	$ 11,548	$ –	$ 11,548	FVTPL
Investments - debt securities:					
Liquidity reserves	Loans and receivables	79,437	–	79,437	Amortized cost
Other investments	Loans and receivables	150	–	150	Amortized cost
Investments – equity instruments:					
Class A & E shares – Central	Available-for-sale (cost)	8,161	–	8,161	FVOCI
Credit Union Central of Ontario ("CUCO") Co-op – ABCP Partnership	FVTPL	55	–	55	FVTPL
Other equity investments	Loans and receivables	245	–	245	FVOCI
Derivative financial instruments	FVTPL	79	–	79	FVTPL
Loans to members	Loans and receivables	1,194,771	(3,107) [(a)]	1,191,664	Amortized cost
Other assets	Loans and receivables	2,072	–	2,072	Amortized cost
Deposits from members	Other financial liabilities	(1,044,851)	–	(1,044,851)	Amortized cost
Accounts payable and accrued liabilities	Other financial liabilities	(6,776)	–	(6,776)	Amortized cost
Short-term borrowings	Other financial liabilities	(12,000)	–	(12,000)	Amortized cost
Securitized liabilities	Other financial liabilities	(162,796)	–	(162,796)	Amortized cost

(in thousands of Canadian dollars)

24. Change in accounting policies (continued):

The following table reconciles the closing allowance for credit losses in accordance with IAS 39 as at December 31, 2017 to the opening ECL allowance in accordance with IFRS 9 as at January 1, 2018:

		As at December 31, 2017				As at January 1, 2018			
				IAS 39					IFRS 9
		Specific	Collective	Total	Transition adjustments[a]	Total	Stage 1	Stage 2	Stage 3
Residential mortgage loans	$	78	–	78	193	271	97	113	61
Personal loans		3,371	67	3,438	2,136	5,574	2,156	2,385	1,033
Commercial loans		352	140	492	778	1,270	249	451	570
	$	3,801	207	4,008	3,107	7,115	2,502	2,949	1,664

a) The above changes increased the deferred tax balance (based on a tax rate of 26.5%) by $824 for a net adjustment to opening retained earnings of $2,283.

25. Comparative amounts:

Certain 2017 comparative amounts have been reclassified to conform to the financial statement presentation adopted for 2018.