Financial Statements of

NORTHERN CREDIT UNION LIMITED

Year ended December 31, 2017

KPMG

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

We have audited the accompanying financial statements of Northern Credit Union Limited, which comprise the statement of financial position as at December 31, 2017, and the statements of income, comprehensive income, changes in members' equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Northern Credit Union Limited as at December 31, 2017 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Sault Ste. Marie, Canada
February 21, 2018

NORTHERN CREDIT UNION LIMITED

Statement of Financial Position

December 31, 2017, with comparative information for 2016

(in thousands of Canadian dollars)		2017		2016
Assets				
Cash and cash equivalents (note 7)	$	11,548	$	15,813
Investments (note 9)		87,653		81,043
Other assets (note 10)		2,072		2,142
Loans to members (notes 5 and 6)		1,194,771		1,071,714
Property and equipment (note 11)		18,040		18,899
Intangible assets (note 11)		1,930		1,849
Total assets	$	1,316,014	$	1,191,460
Liabilities and Members' Equity				
Members' deposits (note 12)	$	1,044,851	$	966,764
Accounts payable and accrued liabilities		6,776		6,523
Short-term borrowings (note 13)		12,000		25,000
Securitized liabilities (note 8)		162,796		104,688
Liabilities qualifying as regulatory capital:				
Share capital (note 14)		32,124		32,157
Deferred income taxes (note 17)		396		951
Total liabilities		1,258,943		1,136,083
Members' equity:				
Contributed surplus		19,134		19,134
Retained earnings		36,824		34,964
Accumulated other comprehensive income		1,113		1,279
Total members' equity		57,071		55,377
Commitments and contingencies (note 16)				
Total liabilities and members' equity	$	1,316,014	$	1,191,460

See accompanying notes to financial statements.

On behalf of the Board:

____________________________ Director

Folgo Dell'Acqua ____________________________ Director

NORTHERN CREDIT UNION LIMITED

Statement of income

Year ended December 31, 2017, with comparative information for 2016

(in thousands of Canadian dollars)		2017		2016
Revenue:				
Interest - residential mortgage loans	$	21,352	$	20,325
- personal loans		14,202		11,162
- commercial loans		9,992		10,530
Investment income		1,040		845
		46,586		42,862
Cost of financing:				
Interest - demand deposits		1,767		1,617
- term deposits		5,618		4,547
- registered savings plans		4,686		4,299
Distribution to members (note 14)		842		835
Interest on external borrowings		2,942		1,929
		15,855		13,227
Net interest income		30,731		29,635
Net impairment loss on loans (note 6)		2,434		1,542
Net interest income after provision for impaired loans		28,297		28,093
Non-interest revenue (note 18)		11,715		11,053
		40,012		39,146
Operating expenses:				
Salaries, wages and benefits		18,942		18,013
Board, delegate and committee		521		623
Data processing and clearing		1,069		1,192
General and administration		11,340		10,831
Insurance		937		912
Occupancy		2,792		2,762
Depreciation and amortization		2,652		2,518
		38,253		36,851
Operating income		1,759		2,295
Unrealized gains (losses):				
Unrealized loss on interest rate swaps		(35)		(26)
Unrealized (loss) gain on investments (note 9)		(7)		44
Income before income taxes		1,717		2,313
Income taxes (recovery) (note 17):				
Current		353		330
Deferred recovery		(496)		(6)
		(143)		324
Net income	$	1,860	$	1,989

See accompanying notes to financial statements.

NORTHERN CREDIT UNION LIMITED

Statement of Comprehensive Income

Year ended December 31, 2017, with comparative information for 2016

(in thousands of Canadian dollars)		2017		2016
Net income	$	1,860	$	1,989
Other comprehensive income, net of income taxes:				
Items that are or may be reclassified subsequently to profit or loss:				
Net loss on cash flow hedges, net of income tax of $17 (2016 - $Nil)		(48)		-
Items that will never be reclassified to profit or loss:				
Defined benefit plan actuarial losses, net of income tax of $42 (2016 - $74)		(118)		(207)
Comprehensive income	$	1,694	$	1,782

Statement of Changes in Members' Equity

Year ended December 31, 2017, with comparative information for 2016

(in thousands of Canadian dollars)		2017		2016
Contributed surplus				
Balance, beginning of year	$	19,134	$	17,803
Acquisition of Espanola and District Credit Union (note 24)		-		1,331
Balance, end of year		19,134		19,134
Retained earnings				
Balance, beginning of year		34,964		32,975
Net income		1,860		1,989
Balance, end of year		36,824		34,964
Accumulated other comprehensive income:				
Representing the fair value reserve:				
Balance, beginning of year		1,279		1,486
Net loss on cash flow hedges, net of income tax		(48)		-
Defined benefit plan actuarial losses, net of income tax		(118)		(207)
Balance, end of year		1,113		1,279
Member's equity, end of year	$	57,071	$	55,377

See accompanying notes to financial statements.

NORTHERN CREDIT UNION LIMITED

Statement of Cash Flows

Year ended December 31, 2017, with comparative information for 2016

(in thousands of Canadian dollars)	2017	2016
Cash flows from operating activities:		
Net income	$ 1,860	$ 1,989
Adjustments for:		
Change in non-cash items:		
Net interest income	(30,731)	(29,635)
Provision for impaired loans	2,434	1,542
Provision (recovery) for income tax	(143)	324
Depreciation and amortization	2,652	2,518
Unrealized losses (gains) on investments	7	(44)
Unrealized losses on interest rate swaps	35	26
Loss on disposal of property and equipment	98	47
	(23,788)	(23,233)
Changes in other assets:		
Changes in other assets	(520)	494
Changes in accounts payable and accrued liabilities	437	(72)
	(83)	422
Changes in member activities (net):		
Changes in member loans	(125,295)	(142,351)
Changes in member deposits	77,091	58,923
	(48,204)	(83,428)
Cash flows related to interest, dividends and income taxes:		
Interest received on member loans	45,350	41,896
Interest received on investments	984	985
Interest paid on member deposits	(11,075)	(10,070)
Interest paid on external borrowings	(2,942)	(1,929)
Dividends paid	(842)	(835)
Income taxes paid	(348)	(647)
	31,127	29,400
	(40,948)	(76,839)
Cash flows from financing activities:		
Issuance of membership shares	53	223
Redemption of Class A patronage shares	(44)	(48)
(Redemption) issuance of Class B investment shares	(42)	1,201
(Repayment) proceeds of Central 1 Credit Union loan	(13,000)	25,000
Proceeds from securitized loans	58,108	33,596
	45,075	59,972
Cash flows from investing activities:		
Purchase of investments	(6,420)	(533)
Proceeds on disposal of property and equipment	841	-
Additions to intangible assets	(597)	(478)
Additions to property and equipment	(2,216)	(1,094)
Net cash inflow from purchase of Espanola and District Credit Union Limited (note 24)	-	6,011
	(8,392)	3,906
Net decrease in cash and cash equivalents	(4,265)	(12,961)
Cash and cash equivalents, beginning of year	15,813	28,774
Cash and cash equivalents, end of year	$ 11,548	$ 15,813

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 21, 2018.

(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.

(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 are initially measured at fair value plus incremental direct transaction costs less loan fees received and subsequently remeasured at their amortized cost using the effective interest method. Loans receivable from members are reported net of an allowance for credit losses.

(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.

3. Significant accounting policies (continued):

(a) Loans receivable from members (continued):

(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.

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. The effective interest rate is established on initial recognition of the financial asset or liability and is not revised subsequently.

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.

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

(c) Non-interest revenue (continued):

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.

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 based on the underlying classification of the equity investment.

(d) Cash and cash equivalents:

Cash and cash equivalents includes cash on hand, current accounts, cheques and other items in transit. Given their short-term nature, the carrying value of cash and cash equivalents equals fair value.

(e) Financial instruments - non-derivative financial instruments:

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

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

The Credit Union has the following non-derivative financial assets: financial assets at fair value through profit or loss, held-to-maturity financial assets, loans and receivables and available-for-sale financial assets.

Non-derivative financial instruments comprise cash and cash equivalents, investments, loans to members, members' deposits, accounts payable and accrued liabilities and liabilities qualifying as regulatory capital.

3. Significant accounting policies (continued):

(e) Financial instruments - non-derivative financial instruments (continued):

Fair value through profit and loss:

Financial assets and liabilities designated as fair value through profit and loss (“FVTPL”) are financial instruments either classified as held for trading (“HFT”) or are managed and evaluated on a fair value basis in accordance with a documented risk management strategy. HFT financial assets and liabilities are acquired or incurred principally for resale, generally within a short period of time.

FVTPL financial assets and liabilities are measured at fair value at each reporting date. Gains and losses realized on disposal together with dividends and interest earned on these instruments are reported in interest and investment income. Unrealized gains and losses from market fluctuations are reported separately in the statement of income. There are regulatory restrictions imposed by the Financial Services Commission of Ontario on the use of this designation including that loan financial assets are precluded from being designated at FVTPL and that the fair value designated financial instruments are managed on a fair value basis.

Offsetting:

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Credit Union has the legal right to set off the recognized amounts and it intends either to settle on a net basis or to realized the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions such as the Credit Union’s trading activities.

Held to maturity:

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments and a fixed maturity, other than loans and receivables that the Credit Union has the positive intention and ability to hold to maturity. These financial assets are initially recognized at fair value including direct and incremental transaction costs. They are subsequently accounted for at amortized cost using the effective interest rate method.

Available for sale:

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and that are not classified in any of the previous categories. The Credit Union’s investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses (see note 3(a) (ii)), are recognized in other comprehensive income and presented within equity in the fair value reserve. When an investment is derecognized, the cumulative gain or loss in other comprehensive income is transferred to profit or loss.

3. Significant accounting policies (continued):

(e) Financial instruments – non-derivative financial instruments (continued):

Loans and receivables:

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Loans and receivables comprise trade and other receivables.

Other liabilities:

The Credit Union has designated all financial liabilities with the exception of derivatives as Other Liabilities. Financial liabilities designated as Other Liabilities are recorded at amortized cost. Interest incurred on these liabilities is included in interest expense. Transaction costs related to Other Liabilities are capitalized and then amortized over the life of the instrument using the effective interest method.

Financial liabilities classified as Other Liabilities are subsequently measured at amortized cost. Financial liabilities are initially recognized on the trade date the Credit Union becomes party to the contractual provision of the instrument. The Credit Union derecognizes a financial liability when its contractual obligations are discharged, cancelled or expire.

(f) Financial instruments - derivative financial 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.

3. Significant accounting policies (continued):

(f) Financial instruments – derivative financial instruments (continued):

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.

(g) Financial instruments – derecognition:

The Credit Union securitizes residential mortgages by legally selling them to funding partners. Securitized residential mortgages do not meet derecognition requirements under IAS 39 Financial Instruments: Recognition and Measurement as substantially all of the risks and rewards of the loans are held with the Credit Union. As a result, these loans are reported on the Statement of Financial Position and the securitization is reflected as a financing transaction and the related liability is initially recorded at fair value and subsequently measured at amortized costs, using the effective interest rate method.

3. Significant accounting policies (continued):

(h) Investments:

Investments are recorded at fair value unless the investment is designated as Loans and Receivables. Any gains and losses on disposal of investments are recorded in the year they occur and are included in other investment income in the Statement of Income. Classification of investment instruments is outlined in note 20.

(i) 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.

(j) 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.

(k) 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.

(l) Revenue recognition:

Loan interest and revenue is recognized on the effective yield basis.

3. Significant accounting policies (continued):

(m) 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.

(n) 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):

(o) 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.

(p) 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):

(p) 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.

(q) 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.

(r) 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):

(s) Future changes in accounting policy:

(i) In July 2014, the ISAB issued the final version of IFRS 9 – "Financial Instruments" ("IFRS 9 (2014)") which will replace IAS 39 "Financial Instruments: Recognition and Measurement". The final version of IFRS 9 is effective for annual periods beginning on or after January 1, 2018. The Credit Union adopted this policy on January 1, 2018.

IFRS 9 (2014) introduces new requirements for the classification and measurement of financial assets. Under IFRS 9 (2014), financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows.

The standard introduces additional changes relating to financial liabilities.

It also amends the impairment model by introducing a new 'expected credit loss' model for calculation impairment.

IFRS 9 (2014) also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgement to assess the effectiveness of a hedging relationship.

Special transitional requirements have been set for the application of the new general hedging model.

The Credit Union is using the expected credit loss model developed by Central 1 to determine the impact of the change. This model uses statistical data and various assumptions related to specific loan information to estimate expected credit losses on the Credit Union's commercial, consumer, and mortgage portfolios. The Credit Union, along with other credit unions, are working in collaboration to gain a thorough understanding of the model's assumptions in order to be certain of the results the model is producing and to ensure consistency amongst the credit union system. Without this, a reliable estimate cannot be determined as at the date of publication of the financial statements. Further collaboration between the Credit Union, Central 1 and other credit unions is taking place with the impact of the change from IAS 39 to IFRS 9 expected to be known in early 2018.

4. Significant accounting policies (continued):

(s) Future changes in accounting policy (continued):

(ii) IFRS 15 Revenue from contracts with customers (“IFRS 15”) replaces IAS 11, Construction contracts, IAS 18, Revenue and related interpretations. The core principal of IFRS 15 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

IFRS 15 also includes a cohesive set of disclosure requirements that will result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity’s contracts with customers.

The mandatory effective date of IFRS 15 is January 1, 2018 and is required to be applied retrospectively when initially applied. The Credit Union does not expect the standard to have a material impact on the financial statements.

(iii) 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 extent of the impact of adoption of the standard has not yet been determined.

3. Significant accounting policies (continued):

(s) Future changes in accounting policy (continued):

(iv) On June 7, 2017, the IASB issued IFRIC Interpretation 23 Uncertainty over Income Tax Treatments.

The Interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments.

The Interpretation is applicable for annual periods beginning on or after January 1, 2019. The Interpretation requires:

- an entity to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution;
- an entity to determine if it is probable that the tax authorities will accept the uncertain tax treatment; and
- if it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value, depending on whichever method better predicts the resolution of the uncertainty.

The Company intends to adopt the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the interpretation has not yet been determined.

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.

Member loan loss provision:

In determining whether an impairment loss should be recorded in the statement of comprehensive income, the Credit Union makes judgment on whether objective evidence of impairment exists individually for financial assets that are individually significant. Where this does not exist, the Credit Union uses 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 uses 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 6.

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 8 for securitizations and note 21 for hedging.

(in thousands of Canadian dollars)

5. Loans to members:

	Principal and interest	Allowance for impaired loans	Net
			2017
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

	Principal and interest	Allowance for impaired loans	Net
			2016
Residential mortgage loans	$ 623,995	$ 94	$ 623,901
Personal loans	217,816	2,428	215,388
Commercial loans	233,097	672	232,425
	$ 1,074,908	$ 3,194	$ 1,071,714

Commercial loans consist of the following loan types:

	2017	2016
Commercial	$ 159,823	$ 161,678
Syndicated	20,452	25,222
Agricultural	29,145	41,610
Institutional	4,156	4,223
Unincorporated associations	868	364
Allowance for impaired loans	(492)	(672)
	$ 213,952	$ 232,425

(in thousands of Canadian dollars)

5. Loans to members (continued):

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, 2017, is $162,796 (2016 - $104,688).

Total fees paid to third parties associated with lending activities capitalized in other assets were $3,340 as at December 31, 2017 (2016 - $2,246). Charges amortized into interest expense in respect of these fees was $940 (2016 - $792).

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

	2017		2016	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Floating	$ 229,923	5.71%	$ 228,258	5.27%
Within 1 year	136,388	4.12%	180,185	4.36%
Over 1 year	832,468	3.72%	666,465	3.77%
	1,198,779	4.15%	1,074,908	4.19%
Allowance for impaired loans	4,008		3,194	
	$ 1,194,771		$ 1,071,714	

6. Allowance for impaired loans:

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

	Residential Mortgage Loans	Personal Loans	Commercial Loans	2017 Total	2016 Total
Balance, beginning of year	$ 94	2,428	672	3,194	$ 3,028
Recoveries	–	212	–	212	155
Loans written-off	(172)	(1,576)	(84)	(1,832)	(1,579)
Provision for impaired loans during the year	156	2,374	(96)	2,434	1,542
Provision from acquisitions	–	–	–	–	48
Balance, end of year	$ 78	3,438	492	4,008	$ 3,194

For the year ended December 31, 2017, accrued interest of $210 was recorded on impaired loans (2016 - $182).

(in thousands of Canadian dollars)

6. Allowance for impaired loans (continued):

Details of the impaired loans, net of specific allowances are as follows:

2017	Residential Mortgage Loans	Personal Loans	Commercial Loans	Total
Impaired loans	$ 17,129	6,028	1,692	$ 24,849
Specific allowance	78	3,371	352	3,801
Net	$ 17,051	2,657	1,340	$ 21,048

2016	Residential Mortgage Loans	Personal Loans	Commercial Loans	Total
Impaired loans	$ 15,087	5,056	14,227	$ 34,370
Specific allowance	94	2,408	351	2,853
Net	$ 14,993	2,648	13,876	$ 31,517

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 15% (2016 - 15%) of the commercial loan portfolio.

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

	2017	2016
Hospitality	19%	18%
Retail and Commercial Buildings	38%	36%
Agriculture	14%	18%
Other	29%	28%

Past due but not impaired loans:

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

	2017	2016
31 to 90 days past due	$ 3,812	$ 2,487

(in thousands of Canadian dollars)

6. 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 $30,131 as at December 31, 2017 (2016 - $42,728).

Credit risk:

The following tables illustrate the credit quality of loans that are neither past due nor impaired:

Credit quality of loans – December 31, 2017			
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%

(in thousands of Canadian dollars)

6. Allowance for impaired loans (continued):

Credit quality of loans – December 31, 2016			
Retail Mortgage and Personal Loans		Commercial Loans	
Rating	% of Portfolio	Rating	% of Portfolio
Undoubted	7%	Undoubted	8%
Superior	19%	Superior	14%
Satisfactory	73%	Satisfactory	76%
Watch List	1%	Watch list	2%

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

7. Cash and cash equivalents:

	2017	2016
Cash on hand	$ 11,580	$ 11,413
Cash at Central 1	(32)	4,400
	$ 11,548	$ 15,813

8. 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 thousands of Canadian dollars)

8. Securitized liabilities (continued):

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 $162,796 (2016 - $104,688) bearing a weighted average fixed interest rate of 2.0747% (2016 – 1.5999%), expected weighted average maturity date of 2021 were outstanding under this arrangement.

9. Investments:

	2017	2016
Available for sale:		
Central 1 Credit Union Limited:		
Class A shares	$ 4,365	$ 4,207
Class E shares	3,389	3,559
Cost, net of distributions received	7,754	7,766
Other investments	7	7
Fair value through profit and loss:		
CUCO Cooperative Association	55	1,932
Loans and receivables:		
Central 1 liquidity reserve deposits	79,273	70,942
Accrued interest on investments	164	116
Other investment	400	280
	$ 87,653	$ 81,043

(in thousands of Canadian dollars)

9. Investments (continued):

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

	2017		2016	
	Principal Balance	Average Yield	Principal Balance	Average Yield
Within 1 year	$ 73,003	1.49%	$ 70,942	0.99%
Over 1 year	6,270	1.44%	–	–
	79,273	1.48%	70,942	0.99%
Non-rate sensitive	8,216		9,985	
Accrued interest	164		116	
	$ 87,653		$ 81,043	

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 2017, the Credit Union purchased $463 (2016 - $504) Central 1 Class A shares, redeemed $306 and received $187 (2016 - $144) 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. 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 carried at cost. The Credit Union does not intend to dispose of the shares in the near future. In 2017, 1,690 shares at $100 per share were redeemed for $169.

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.

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.

(in thousands of Canadian dollars)

9. Investments (continued):

b) Investment in CUCO Cooperative Association (continued):

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.

An independent valuation was completed 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 (2016 - $1,932). During the year, the Credit Union received $1,876 from the CUCO Co-op, of which $1,876 (2016- $294) has been recorded as a return of the initial capital invested and $Nil (2016 - $Nil) has been recorded as interest income. In addition, as these investments have been designated as FVTPL a fair value loss of $7 has been recorded in income for 2017 (2016 – gain of $44).

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 Loans and Receivables.

d) Other shares:

The Credit Union maintains other instruments which are non-interest bearing. These shares have been designated as Available for Sale, but carried at cost as they are not traded in an active market and fair value cannot be measured reliably.

10. Other assets:

	2017	2016
Other	$ 344	$ 441
Prepayments	1,728	1,701
	$ 2,072	$ 2,142

(in thousands of Canadian dollars)

11. Property and equipment and intangible assets:

						2017
		Cost		Accumulated depreciation		Carrying amount
Land	$	2,181	$	–	$	2,181
Parking areas		247		161		86
Buildings and improvements		17,786		8,718		9,068
Leasehold improvements		5,929		2,897		3,032
Furniture, office and computer equipment		16,570		13,379		3,191
Automated banking machines		1,420		938		482
Tangible assets		44,133		26,093		18,040
Intangible assets (software)		4,106		2,176		1,930
	$	48,239	$	28,269	$	19,970

						2016
		Cost		Accumulated depreciation		Carrying amount
Land	$	2,611	$	–	$	2,611
Parking areas		198		145		53
Buildings and improvements		18,084		8,698		9,386
Leasehold improvements		5,333		2,598		2,735
Furniture, office and computer equipment		15,822		12,541		3,281
Automated banking machines		1,428		851		577
Construction in progress		256		–		256
Tangible assets		43,732		24,833		18,899
Intangible assets (software)		3,489		1,640		1,849
	$	47,221	$	26,473	$	20,748

(in thousands of Canadian dollars)

11. Property and equipment and intangible assets (continued):

Depreciation and amortization in respect of the above assets for the year amounts to $2,652 (2016 - $2,518). Reconciliations of the carrying amount for each class of fixed asset are summarized below.

		2017		2016
Land				
Carrying amount at the beginning of the year	$	2,611	$	2,570
Additions		–		41
Disposals		(430)		–
Carrying amount at the end of the year	$	2,181	$	2,611
Parking areas				
Carrying amount at the beginning of the year	$	53	$	59
Additions		49		8
Depreciation		(16)		(14)
Carrying amount at the end of the year	$	86	$	53
Buildings and improvements				
Carrying amount at the beginning of the year	$	9,386	$	9,743
Additions		749		312
Disposals		(387)		–
Depreciation		(680)		(669)
Carrying amount at the end of the year	$	9,068	$	9,386
Leasehold improvements				
Carrying amount at the beginning of the year	$	2,735	$	3,050
Additions		595		–
Disposals		–		(48)
Depreciation		(298)		(267)
Carrying amount at the end of the year	$	3,032	$	2,735

(in thousands of Canadian dollars)

11. Property and equipment and intangible assets (continued):

		2017		2016
Furniture, office and computer equipment				
Carrying amount at the beginning of the year	$	3,281	$	3,220
Additions		1,015		1,018
Disposals		(114)		(8)
Depreciation		(991)		(949)
Carrying amount at the end of the year	$	3,191	$	3,281
Automated banking machines				
Carrying amount at the beginning of the year	$	577	$	730
Additions		46		–
Disposal		(9)		–
Depreciation		(132)		(153)
Carrying amount at the end of the year	$	482	$	577
Construction in progress				
Carrying amount at the beginning of the year	$	256	$	–
Additions		–		256
Transfer to service		(256)		–
Carrying amount at the end of the year	$	–	$	256
Intangible assets (computer software)				
Carrying amount at the beginning of the year	$	1,849	$	1,837
Additions		616		478
Amortization		(535)		(466)
Carrying amount at the end of the year	$	1,930	$	1,849
Total carrying amount	$	19,970	$	20,748

(in thousands of Canadian dollars)

12. Members' deposits:

		2017		2016
Non-interest bearing deposits	$	1,215	$	1,333
Deposits with variable interest rates:				
Chequing		267,517		263,043
Savings		212,800		193,692
Registered retirement plans		35,829		34,296
		516,146		491,031
Deposits with fixed interest rates:				
Term deposits		287,778		258,817
Registered retirement plans		233,974		210,841
Accrued interest		5,738		4,742
		527,490		474,400
	$	1,044,851	$	966,764

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

		2017			2016	
		Principal Balance	Average Yield		Principal Balance	Average Yield
Floating	$	516,146	0.51%	$	491,031	0.37%
Within 1 year		194,507	1.90%		281,761	1.88%
Over 1 year		327,245	2.07%		187,897	2.08%
		1,037,898	1.26%		960,689	0.96%
Non-rate sensitive		6,953			6,075	
	$	1,044,851		$	966,764	

13. 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 (2016 - $49,500). These credit facilities are secured by a general security agreement and an assignment of book debts. At the end of the year, $12,000 (2016 - $25,000) was outstanding under this facility.

(in thousands of Canadian dollars)

14. Liabilities qualifying as regulatory capital:

		2017		2016
Membership shares	$	1,762	$	1,709
Patronage shares		1,212		1,256
Investment shares		29,150		29,192
	$	32,124	$	32,157

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.

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, 2017, there were 70,837 members of the Credit Union holding 352,322 membership shares (2016 – 68,538 members holding 341,725 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, 2017 were 1,211,633 (2016 – 1,255,804). 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.

(in thousands of Canadian dollars)

14. Liabilities qualifying as regulatory capital (continued):

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, 2017 were 29,150,238 (2016 – 29,192,222). Investment shares are non-voting, are available for redemption and based on their features are classified as a liability.

On December 7, 2017, the Board of Directors declared a dividend of 2.93% on Class B investment shares. The value of the declared dividend was $857 (2016 - $835).

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 12.50%. 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, 2017	$ 88,289	4.00%	6.71%	8.00%	13.46%
December 31, 2016	$ 86,596	4.00%	7.27%	8.00%	14.11%

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:

	2017	2016
Tier 1 Capital		
Retained earnings	$ 36,824	$ 34,964
Contributed surplus	19,134	19,134
Membership shares	1,762	1,709
Class A non-cumulative redeemable patronage shares (90%)	1,130	1,174
Class B non-cumulative, non-voting, non-participating investments shares (90%)	27,105	26,889
Tier 2 Capital		
Class A non-cumulative redeemable patronage shares (10%)	82	82
Class B non-cumulative, non-voting, non-participating investment shares (10%)	2,045	2,303
Non-specific collective allowance for impaired loans	207	341
Total regulatory capital	$ 88,289	$ 86,596

16. Commitments and contingencies:

(a) As at December 31, 2017, commitments for authorized but not issued loans to members amounted to approximately $15,077 (2016 - $16,835).

(b) As at December 31, 2017, commitments for unused lines and letters of credit amounted to approximately $160,782 and $2,157 respectively (2016 - $149,372 and $1,749, 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:

2018	$ 849
2019	654
2020	613
2021	532
2022	303
Thereafter	599

(in thousands of Canadian dollars)

16. Commitments and contingencies (continued):

(d) The Credit Union 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.

17. Income taxes:

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

		2017		2016
Current income tax expense	$	353	$	330
Deferred income tax recovery		(496)		(6)
Total income tax expense (recovery)	$	(143)	$	324

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory rate of 26.5% (2016 - 26.5%) to income before income taxes. The reasons for the difference are as follows:

		2017		2016
Income before income tax	$	1,717	$	2,313
Statutory tax rate		26.5%		26.5%
Computed tax expense	$	455	$	613
Increase (decrease) resulting from:				
Lower rate on preferred rate amount		(132)		(124)
Non-deductible expense		12		13
Non-taxable dividend on CUCO Cooperative Association redemption		(447)		–
Other		(31)		(178)
Total income tax expense (recovery)	$	(143)	$	324

(in thousands of Canadian dollars)

17. Income taxes (continued):

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

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)

2016		Opening Balance	Recognized in OCI	Recognized Directly in Equity	Recognized in Profit or loss	Closing Balance
Deferred tax assets:						
Employee retirement benefits	$	449	74	–	145	668
Allowance for impaired loans		212	–	–	(46)	166
Reserves		–	–	–	71	71
Non-capital loss		1,512	–	324	(1,512)	324
Total deferred tax assets	$	2,173	74	324	(1,342)	1,229
Deferred tax liabilities:						
Investments	$	299	–	–	3	302
Property, equipment and intangible assets		300	–	–	85	385
Bargain purchase gain		2,521	–	408	(1,436)	1,493
Total deferred tax liabilities	$	3,120	–	408	(1,348)	2,180
Total movement taken to income tax expense	$	(947)	74	(84)	6	(951)

(in thousands of Canadian dollars)

17. 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 $256 (2016 - $154) 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.

18. Non-interest revenue:

The components of non-interest revenue were as follows:

	2017	2016
Service charges	$ 6,749	$ 6,520
Insurance commissions	1,518	1,377
Loan and commitment fees	1,493	1,237
Wealth management	852	816
Rental income	10	8
Foreign exchange	484	461
Other	609	634
	$ 11,715	$ 11,053

(in thousands of Canadian dollars)

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:

	2017	2016
Defined benefit pension plan net benefit expense	$ 980	$ 933
Defined contribution pension plan	339	289
	$ 1,319	$ 1,222

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

	2017	2016
Accrued benefit obligation:		
Balance, beginning of year	$ 14,881	$ 13,382
Current service cost	1,097	1,014
Interest cost	613	575
Benefits paid	(335)	(576)
Actuarial losses	861	570
Administration fees	(89)	(84)
Balance, end of year	$ 17,028	$ 14,881

(in thousands of Canadian dollars)

19. Employee future benefits (continued):

		2017		2016
Plan assets:				
Fair value, beginning of year	$	12,742	$	12,017
Expected return on plan assets		503		492
Employer contributions		520		440
Employee contributions		227		164
Benefits paid		(335)		(576)
Actuarial gains		701		289
Administration fees		(89)		(84)
Fair value, end of year	$	14,269	$	12,742

Experience adjustments incurred were as follows:

		Defined Benefit Pensions 2017		2016
Accrued benefit obligation	$	(861)	$	(570)
Plan assets		701		289
Total for the year	$	(160)	$	(281)

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 2017		2016
Funded status (deficit) being accrued benefit liability included in other liabilities	$	(2,758)	$	(2,139)
Net amount recognized	$	(2,758)	$	(2,139)

(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 2017	2016
Discount rate	3.40%	3.90%
Rate of compensation increase	3.00%	3.00%
Expected long-term rate of return on plan assets	3.40%	3.90%
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 2017	2016
Current service cost, net of employees' contributions	$ 870	$ 850
Interest cost	613	575
Expected return on plan assets	(503)	(492)
Net benefit plan expense	$ 980	$ 933

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, 2017 is $520 (2016 - $440).

The defined benefit plan assets comprise:

	2017	2016
Mawer balanced fund	$ 10,773	$ 9,513
Guardian balanced income fund	3,480	3,214
CUMIS retirement security fund	16	15
	$ 14,269	$ 12,742

The actual return on plan assets for the year-ended December 31, 2017 was $1,204 (2016 - $781).

19. Employee future benefits (continued):

A 1% decrease in the discount rate would increase the pension benefit obligation at December 31, 2017 by 18.2% or $3,098 to $20,126. In addition, a 1% decrease in the discount rate would increase the fiscal 2017 net service cost by 24.3% or $243 to $1,246.

A 1% decrease in the salary scale would decrease the pension benefit obligation at December 31, 2017 by 4.1% or $695 to $16,333. In addition, a 1% decrease in the salary scale would decrease the fiscal 2017 net service cost by 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, 2017			December 31, 2016		
	Carrying Value	Fair Value	Difference	Carrying Value	Fair Value	Difference
Loans and Receivables						
Loans to members	1,194,771	1,194,938	167	$1,071,714	$1,076,212	$ 4,498
Held to Maturity						
Investments	79,437	80,201	764	71,058	71,423	365
Fair Value through Profit and Loss						
Cash resources	11,548	11,548	–	15,813	15,813	–
Investments	55	55	–	1,932	1,932	–
Available for Sale						
Investments	8,161	8,161	–	8,053	8,053	–
Total financial assets	1,293,972	1,294,903	931	$1,168,570	$1,173,433	$ 4,863
Other Liabilities						
Member deposits	1,044,851	1,043,747	(1,104)	$ 966,764	$ 969,194	$ 2,430
Accounts payable and accrued liabilities	6,776	6,776	–	6,523	6,523	–
Loans payable	12,000	12,001	1	25,000	25,002	2
Securitized liabilities	162,796	162,946	150	104,688	104,688	–
Total financial liabilities	1,226,423	1,225,470	(953)	$1,102,975	$1,105,407	$ 2,432

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:

				2017
	Level 1	Level 2	Level 3	Total
Assets				
Investments – FVTPL securities	$ –	$ 55	$ –	$ 55
Liabilities				
Derivative financial instruments	$ –	$ 190	$ –	$ 190

				2016
	Level 1	Level 2	Level 3	Total
Assets				
Investments – FVTPL securities	$ –	$ 1,932	$ –	$ 1,932
Liabilities				
Derivative financial instruments	$ –	$ 49	$ –	$ 49

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

(in thousands of Canadian dollars)

20. Fair value of financial instruments (continued):

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, 2017 with comparative information for December 31, 2016. 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:

	2017	2016
Assets		
Loans to members	$ 1,194,938	$ 1,076,212
Investments	88,417	81,408
Fair value of assets held at amortized cost	$ 1,283,355	$ 1,157,620
Liabilities		
Members' deposits	$ 1,043,747	$ 969,194
Loans payable	12,001	25,002
Securitized liabilities	162,946	104,688
Fair value of liabilities held at amortized cost	$ 1,218,694	$ 1,098,884

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.

(in thousands of Canadian dollars)

21. Derivative financial instruments (continued):

b) Interest rate risk management (continued):

The following table indicates the swaps and options in place at December 31, 2017 and the interest rate.

						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)

						2016
Date Agreement Entered	Notional Principal	Fixed Rate	Start Date	Expiry Date		Fair Value
Interest Rate Swaps						
July 9, 2015	3,000	0.774%	Jan 20, 2016	Jan 20, 2017	$	(3)
July 9, 2015	5,000	0.770%	Feb 17, 2016	Feb 17, 2017		(6)
January 5, 2016	3,000	0.820%	Jan 20, 2017	Jan 22, 2018		(5)
January 5, 2016	5,000	0.840%	Feb 17, 2017	Feb 20, 2018		(8)
January 5, 2016	8,100	0.800%	Mar 15, 2016	Mar 15, 2018		(22)
March 14, 2016	6,000	0.860%	May 18, 2016	Nov 20, 2017		(5)
					$	(49)

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, 2017 was $1 (2016 - $1).

d) Equity swap agreements:

The fair value of the index linked swap contracts at year end is approximately $269 (2016 - $349).

(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.

		2017		2016
Compensation:				
Salaries and other short-term employee benefits	$	944	$	876
Total pension and other post-employment benefits		214		177
	$	1,158	$	1,053

		2017		2016
Loans to key management personnel:				
Aggregate value of loans advanced	$	670	$	725
Interest received on loans advanced		18		18
Aggregate value of unadvanced loans		86		81

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.

		2017		2016
Deposits from key management personnel:				
Aggregate value of term and savings deposits	$	873	$	761
Total interest paid on term and saving deposits		12		9

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 $167 (2016 - $166). The aggregate value of loans to related parties is as follows:

		2017		2016
Directors and officers	$	1,124	$	881
Staff		23,861		17,966
	$	24,985	$	18,847

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 12 months ended December 31, 2017 of those employees are as follows:

		Salary		Benefits		Total
Albert W. Suraci, President and Chief Executive Officer	$	340	$	79	$	419
Tony Dunham, Senior Vice-President Strategy, Innovation and Operations		224		49		273
Richard Adam, Senior Vice-President Finance and Administration		215		48		263
Brandy Heikoop, Senior Vice-President Human Resources		166		37		203
Steven Hatzipantelis, Assistant Vice-President Retail Sales and Service		135		27		162

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, 2017, the Credit Union's liquidity ratio was 7.48% (2016 – 7.95%).

Assets held for liquidity purposes consist of cash resources designated as held for trading in the amount of $11,548 and liquidity reserve deposits and term deposits held by Central 1 designated as loans and receivables totaling $79,273.

(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 16.

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

(in thousands of Canadian dollars)

23. Financial risk management (continued):

a) Liquidity risk (continued):

December 31, 2016

	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	$ 15,813	–	–	–	–	15,813
Investments	77,730	3,313	–	–	–	81,043
Loans to members	275,217	130,032	645,159	21,306	–	1,071,714
	368,760	133,345	645,159	21,306	–	1,168,570
Non-financial assets:						
Other assets	–	–	–	–	22,890	22,890
Total assets	$ 368,760	133,345	645,159	21,306	22,890	1,191,460
Liabilities and Members' Equity						
Members' deposits	$ 574,462	204,405	187,897	–	–	966,764
External borrowing	27,263	17,167	85,258	–	–	129,688
Other liabilities	49	–	–	–	7,425	7,474
Share capital	32,157	–	–	–	–	32,157
Members' equity	55,377	–	–	–	–	55,377
Total liabilities and members' equity	$ 689,308	221,572	273,155	–	7,425	1,191,460

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 $1,317 and a decrease in interest rates of 1% across all maturities and currencies would decrease net interest income by approximately $466 over the next twelve months using the following assumptions:

(i) accrued interest receivable and payable as at December 31, 2017 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		
		2017		2016
Fixed rate instruments				
Financial assets	$	972,495	$	850,717
Financial liabilities		684,548		574,345
	$	287,947	$	276,372
Variable rate instruments				
Financial assets	$	308,025	$	292,936
Financial liabilities		561,673		549,569
	$	(253,648)	$	(256,633)

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 $296 (2016 - $2,898).

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	$ (433)
1.0% shock up	750	1,317

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, 2017, the Credit Union was in compliance with Board policy on financial risk management.

(in thousands of Canadian dollars)

24. Acquisition of Espanola and District Credit Union Limited:

Effective January 1, 2016, the Credit Union acquired the net assets and operations of Espanola and District Credit Union Limited. This acquisition was accounted for by the purchase method and the results of operations have been included in the financial statements from the date of the acquisition.

A summary of the acquisition is as follows:

Assets acquired:		
Cash and cash equivalents	$	6,011
Loans		38,820
Investments		461
Other assets		23
Fixed assets		533
Total assets	$	45,848
Liabilities assumed:		
Members' deposits	$	43,572
Other liabilities		862
Deferred tax liability		84
Total liabilities	$	44,518
Fair value of net assets and consideration paid	$	1,331
Comprised of:		
Contributed surplus	$	1,415
Deferred tax liability		(84)
	$	1,331

25. Comparative amounts:

Certain 2016 comparative amounts have been reclassified to conform to the financial statement presentation adopted for 2017.