# EAGLE RIVER CREDIT UNION LIMITED

Notes to Financial Statements

Year Ended December 31, 2017

## 1. REPORTING ENTITY

Eagle River Credit Union Limited (the "Credit Union") commenced its operations in June 1984 and operates 6 branches. It is incorporated under The Credit Union Act, 2009 and is subject to the Credit Union Act and regulations. Products and services offered to its members include personal and commercial loans and mortgages, chequing and savings accounts, term deposits, RRSPs, RRIFs, debit and credit cards, and internet banking. Membership in the Credit Union is open to residents of Newfoundland and Labrador. The registered head office of the Credit Union is L'anse Au Loup, Newfoundland and Labrador.

## 2. BASIS OF PREPARATION

***Statement of compliance***

These financial statements are general purpose financial statements which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The financial statements for the year ended December 31, 2017 were authorized for issue by the Credit Union's Board of Directors on March 13, 2018.

***Basis of preparation***

These financial statements are presented in Canadian dollars which is the Credit Union's functional currency. They are prepared on the historical cost basis, except for available-for-sale investments and other financial assets and liabilities held for trading, which are stated at their fair value.

***Use of significant accounting judgments, estimates and assumptions***

The preparation of these financial statements in conformity with IFRS requires management to make judgements, estimates, and assumptions that affect the application of policies and reported amounts of assets and liabilities, and disclosures of contingent assets and contingent liabilities at the date of these financial statements, and the reported amounts of revenues and expenses during the year. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from estimates made in these financial statements.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRS have a significant effect on these financial statements. Outlined below are areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to the Credit Union's financial statements:

*(a) Fair Value of Financial Instruments*

Where the fair values of financial assets and financial liabilities recorded on the Statement of Financial Position cannot be derived from observable markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, judgment is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives, discount rates and prepayment rates. The valuation of financial instruments is discussed in more detail in Note 16.

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## 2. BASIS OF PREPARATION *(continued)*

*(b) Impairment Losses on Loans and Mortgages*

The Credit Union reviews its individually significant loans and advances at each Statement of Financial Position date to assess whether an impairment loss should be recorded in the Statement of Comprehensive Income. In particular, management judgment is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors such as the length of time payments are past due and the amount of the security held on the loan. Actual results may differ materially, resulting in future changes to the allowance.

Loans and mortgages have been assessed individually and collectively for impairment. The impairment loss on loans and mortgages is disclosed in more detail in Note 7.

*(c) Impairment of Available for Sale Investments*

The Credit Union reviews its equity investments classified as available for sale at each Statement of Financial Position date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and mortgages.

The Credit Union also records impairment charges on available for sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is "significant" or "prolonged" requires judgment.

*(d) Economic Lives of Property, Plant and Equipment*

Management determines the estimated useful lives of its property, plant and equipment based on historical experience of the actual lives of property, plant and equipment of similar nature and functions, and reviews these estimates at the end of each reporting period.

*(e) Provisions*

The amount recognized as accounts payable and accrued liabilities is the best estimate of the consideration required to settle the related liability, taking into account the risks and uncertainties surrounding the obligation.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including reasonable expectations of future events. Management believes the estimates used in preparing these financial statements are reasonable. Actual results in the future may differ materially from those reported.

***Amendments to IFRS that are mandatorily effective for the current year***

Amendments to IAS 7- Disclosure Initiatives and Amendments to IAS 12 - Recognition of Deferred Tax Assets for Unrealized Losses became effective for annual periods beginning on or after January 1, 2017 and did not have a material impact on the Credit Union's annual audited financial statements.

***New standards and interpretations not yet adopted***

Certain new standards, interpretations, amendments and improvements to the existing standards have been issued by the IASB but are not yet effective for the year ended December 31, 2017, and have not been applied in preparing these financial statements:

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## 2. BASIS OF PREPARATION *(continued)*

*(a)* *Financial Instruments*

In November 2009 and October 2010, the IASB issued IFRS 9 - Financial Instruments ("IFRS 9"), Classification and Measurement of Financial Assets and Financial Liabilities. IFRS 9 will replace IAS 39 - Financial Instruments: Recognition and Measurement ("IAS 39") in its entirety. IFRS 9 uses a single approach to determine whether a financial asset or liability is measured at amortized cost or fair value, replacing the multiple rules in IAS 39.

In November 2014, the IASB announced the completion of a package of three amendments to the accounting requirements for financial statements set out in IFRS 9. The amendments are as follows:

(i) bring into effect a substantial overhaul of hedge accounting that will allow entities to better reflect their risk management activities in the financial statements;

(ii) allow the changes to address the so-called 'own credit' issue that were already included in IFRS 9 to be applied in isolation without the need to change any other accounting for financial instruments; and

(iii) remove the January 1, 2015 mandatory effective date of IFRS 9, to provide sufficient time for preparers of financial statements to make the transition to the new requirements.

The Credit Union is assessing the potential impact of this standard. IFRS 9 is effective for annual periods beginning on or after January 1, 2018 with earlier adoption permitted.

(b) *Revenue for Contracts with Customers*

In May 2014, IFRS 15 was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognize 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. Specifically, the Standard introduces a 5-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognizes revenue when (or as) a performance obligation is satisfied, i.e. when "control" of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

IFRS 15 is applicable for annual periods beginning on or after January 1, 2018, with earlier application permitted. Management of the Credit Union is assessing the potential impact of this new standard.

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## 2. BASIS OF PREPARATION *(continued)*

*(c) Leases*

On January 13, 2016, the IASB issued IFRS 16 Leases which provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It supersedes IAS 17 Leases and its associative interpretative guidance. Significant changes were made to lessee accounting with the distinction between operating and finance leases removed and assets and liabilities recognized in respect of all leases (subject to limited exceptions for short-term leases and leases of low value assets.) In contrast, IFRS 16 does not include significant changes to the requirements for lessors. IFRS 16 is effective January 1, 2019, with earlier application permitted for companies that have also adopted IFRS 15 Revenue from Contracts with Customers. Management of the Credit Union is assessing the potential impact of this new standard.

## 3. SIGNIFICANT ACCOUNTING POLICIES

***Financial instruments***

The following significant accounting policies have been applied consistently by the Credit Union.

Financial assets and financial liabilities are recognized when the Credit Union becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose, for which the financial instruments were acquired or issued, their characteristics and the Credit Union’s designation of such instruments.

The Credit Union is required to classify all financial assets either as fair value through profit or loss ("FVTPL"), available for sale, held to maturity or loans and receivables. Financial liabilities are classified as either fair value through profit or loss, or other liabilities. The standards require that all financial assets and financial liabilities, including all derivatives, be subsequently measured at fair value with the exception of loans and receivables, debt securities classified as held to maturity, available for sale financial assets that do not have quoted prices in an active market and whose fair value cannot be reliably estimated, and other liabilities.

(a) *Classification*

The Credit Union has classified its current financial instruments as follows:

| | |
|---|---|
| Cash and cash equivalents | Loans and receivables |
| Investments - liquidity reserves | Loans and receivables |
| Investments - shares in credit union related entities | Available for sale |
| Loans and mortgages | Loans and receivables |
| Other assets - receivables | Loans and receivables |
| Members' deposits | Other liabilities |
| Accounts payable and accrued liabilities | Other liabilities |

(b) *Fair Value Through Profit or Loss ("FVTPL")*

Financial assets and financial liabilities are classified as FVTPL when the financial asset or financial liability is held for trading or is designated as FVTPL as certain criteria are met. The Credit Union does not have any financial assets or liabilities classified as FVTPL.

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**3. SIGNIFICANT ACCOUNTING POLICIES *(continued)***

(c) *Available for Sale Financial Assets*

Available for sale financial assets are non-derivative financial assets that are designated as available for sale and are initially recognized at fair value. Subsequent to initial recognition, available for sale financial assets are measured at fair value, and the gains and losses on such assets are recorded as other comprehensive income until the investment is derecognized or until the investment is identified as being subject to impairment.

Dividend income is recognized in profit or loss when the Credit Union's right to receive the dividends is established. Interest income is recognized in income using the effective interest method.

The Credit Union holds shares in Atlantic Central, Concentra Financial Services Association, League Data Limited and League Savings and Mortgage that are not traded in an active market and are classified as available for sale. Available for sale equity assets that do not have quoted market prices in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

(d) *Loans and Receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which the Credit Union does not intend to sell immediately or in the near term. Loans and receivables, including cash and cash equivalents, liquidity reserve investments, loans and mortgages to members, accrued interest on loans and mortgages,accrued interest on investments and other receivables, are measured at amortized cost, using the effective interest rate method, net of impairment losses.

Interest income is recognized by applying the effective interest rate.

(e) *Effective Interest Method*

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

(f) *Impairment of Financial Assets and Allowance for Impaired Loans*

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

The amount of impairment on financial assets carried at amortized cost is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

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**3. SIGNIFICANT ACCOUNTING POLICIES *(continued)***

The impairment loss on financial assets is based on a review of all outstanding amounts at period end. The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of loans to members, where the carrying amount is reduced using an allowance account. The allowance for impaired loans is maintained in an amount considered adequate to absorb incurred losses in the loan portfolio. The allowance for impaired loans reflects management's best estimate of the losses existing in the loan portfolio and their judgments about economic conditions. If the circumstances under which these estimates and judgments were made change, there could be a change to the allowance for impaired loans currently recognized. The allowance for impaired loans consists of a specific provision component attributable to individually significant exposures. Changes in the carrying amount of the allowance for impaired loans account are recognized in profit or loss. Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and there is no realistic prospect of recovery. The methodology and assumptions used are reviewed regularly. Each component of the allowance for impaired loans is reviewed at least on the reporting date.

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

Subsequent to an impairment loss, events can occur that provide objective evidence that the financial asset is no longer impaired. When this occurs, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment, at the date the impairment is reversed, does not exceed the amortized cost that would have resulted had the impairment not been recognized.

(g) *Derivative Financial Instruments*

The Credit Union enters into derivative contracts including index-linked deposits. The premium related to the derivative transaction, which is included in other assets, is recognized over the term of the derivative contract as an adjustment to interest expense.

(h) *Other Financial Liabilities*

Other financial liabilities (including borrowings) are subsequently measured at amortized cost using the effective interest method.

(i) *Derecognition of Financial Assets*

The Credit Union derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

The Credit Union continues to recognize the transferred asset to the extent that the Credit Union neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset or when the Credit Union retains substantially all the risks and rewards of ownership. In the latter case, the Credit Union also recognizes collateralized borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received/receivable and any cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

(j) *Derecognition of Financial Liabilities*

The Credit Union derecognizes financial liabilities when, and only when, the Credit Union's obligations are discharged, cancelled or they expire.

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## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

***Cash and cash equivalents***

Cash and cash equivalents include cash on hand and deposits with Atlantic Central and other highly liquid investments with original maturities of three months or less. Cash and cash equivalents are classified as loans and receivables and are carried at amortized cost, which is considered equivalent to fair value due to the short term nature of these assets.

***Loans to members***

Loans to members include personal loans, lines of credit, mortgages and commercial loans, and are recognized when the cash is advanced to the borrower. All loans to members are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and have been classified as loans and receivables, which are subsequently measured at amortized cost using the effective interest method.

***Property, plant and equipment***

Property, plant and equipment is stated at cost or deemed cost less accumulated amortization and any accumulated impairment losses. When components of property, plant and equipment have different useful lives, they are accounted for as separate assets. Property, plant and equipment is amortized over its estimated useful life at the following rates and methods:

| | | |
|---|---|---|
| Paved areas | 8% | declining balance method |
| Buildings | 5% | declining balance method |
| Furniture and equipment | 5 years | straight-line method |
| Computer equipment | 3 years | straight-line method |
| Vehicles | 20% | straight-line method |
| HVAC in building (Happy Valley Goose Bay) | 20 years | straight-line method |
| Roof on building (Happy Valley Goose Bay) | 25 years | straight-line method |

Depreciation methods, useful lives and residual values are reassessed at the end of each reporting period.

***Deposits from members***

Deposits from members are disclosed in Note 9 and are the Credit Union's main source of funding. They are initially measured at fair value, net of transaction costs, and are subsequently measured at amortized cost using the effective interest rate method.

***Membership shares***

The Credit Union's membership shares are presented in the Statement of Financial Position as financial liabilities in accordance with the substance of the contractual terms of the instruments. These shares qualify as capital for regulatory purposes. All membership shares of the Credit Union are classified as liabilities. Payments of dividends and patronage rebates on membership shares presented as a financial liability are recognized as a distribution of profit or loss. Dividends and patronage rebates are recorded when declared by the Credit Union's Board of Directors.

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## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

***Revenue recognition***

Interest income is accrued monthly by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

Dividend income is recognized when the right to receive payment is established. Dividends are included in investment income on the Statement of Comprehensive Income.

Other investment income and commission income include account service fees, investment management fees, and insurance fees which are recognized over the period the services are provided.

***Leases***

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

***Short-term employee benefits***

Short-term employee benefits include salaries and wages, employee benefits, allowances and bonuses. Short-term employee benefits are expensed as the related service is provided.

***Foreign currency translation***

The financial statements are presented in Canadian dollars.

Transactions in foreign currencies are initially translated into Canadian dollars at the rate of exchange in effect at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange at the Statement of Financial Position date.

Translation gains and losses are recognized immediately in profit or loss and are included in the Statement of Comprehensive Income.

***Provisions***

Provisions are recognized when the Credit Union has a present obligation (legal or constructive), as a result of a past event, it is probable that the Credit Union will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

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## 3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

***Income taxes***

Income tax expense comprises current and deferred income tax.

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

Deferred income tax assets and liabilities are recognized in respect of temporary differences between the tax bases of assets and liabilities and their respective carrying amounts for financial reporting purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using income tax rates enacted or substantively enacted at the reporting date.

Current income tax and deferred income tax relating to items recognized directly in equity are also recognized in equity and not in the statement of comprehensive income.

## 4. CASH AND CASH EQUIVALENTS

The Credit Union's current accounts are held with Atlantic Central and positive balances are non-interest bearing.

| | **2017** | 2016 |
|---|---|---|
| Cash and cash equivalents | **$ 4,024,549** | $ 2,338,709 |
| Short term deposits with Atlantic Central | **6,500,000** | 10,000,000 |
| Atlantic Central cash management account | **1,025,436** | 1,025,583 |
| | **$ 11,549,985** | $ 13,364,292 |

The Credit Union has available short-term borrowings of $2,500,000 with Atlantic Central, bearing interest at prime, of which $0 was used at December 31, 2017 (2016 - $0). As security for the operating line of credit, the Credit Union has provided a continuing, specific and fixed first security interest, mortgage, hypothec and charge over all Property as defined in the line of credit agreement dated November 1, 2013.

## 5. INVESTMENTS

The following table provides information on the investments held by the Credit Union.

| | 2017 | 2016 |
|---|---|---|
| | $ | $ |
| *Loans and receivables* | | |
| Atlantic Central mandatory liquidity | **8,856,277** | 8,227,099 |
| Atlantic Central savings | **10,145,000** | 20,606,795 |
| League Savings and Mortgage term deposit | **1,697,100** | - |
| Concentra Financial term deposit | **10,000,000** | - |
| Concentra Financial mortgage pools | **7,267,482** | |
| Accrued interest | **90,822** | 145,050 |
| *Available for sale* | | |
| Atlantic Central common shares | **1,330,580** | 1,324,080 |
| Atlantic Central Class NS shares | **18,000** | 18,000 |
| Atlantic Central Class B shares | **192,000** | 192,000 |
| Atlantic Central Class NL shares | **99,000** | 99,000 |
| League Data Limited - Class B preferred shares | **65,180** | 65,180 |
| Concentra Financial Services Association - Class D shares | **250,000** | 250,000 |
| League Savings and Mortgage shares | **106,250** | 106,250 |
| Concentra Financial Services Association - term deposit | **-** | - |
| CUCNL shares | **210** | 210 |
| | **40,117,901** | 31,033,664 |

The Credit Union is required under the Credit Union Regulations, 2009 of the Credit Union Act, 2009 to maintain an amount equal to 6% of the total liabilities as at each month end. Note 17 provides the Credit Union's position in this regard. At maturity, these deposits are reinvested at market rates for various terms as determined by management. The deposit can be withdrawn only if there is a sufficient reduction in the Credit Union's assets or upon withdrawal of membership from Atlantic Central.

***Equity instruments***

Equity investments are recorded at cost as they do not have available quoted market prices in an active market. The shares in Atlantic Central, issued at par value, are required as a condition of membership and are redeemable at par value upon withdrawal of membership or at the discretion of the Board of Directors of Atlantic Central. The common shares of Atlantic Central are subject to an annual re-balancing mechanism. Dividends on these shares are at the discretion of the Board of Directors of Atlantic Central.

## 6. LOANS AND MORTGAGES RECEIVABLE

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | $ | $ |
| Personal term loans and chequing overdrafts | **24,406,101** | 31,081,753 |
| Personal lines of credit | **6,977,679** | 7,433,897 |
| Personal mortgages | **57,725,880** | 51,616,200 |
| Commercial loans and mortgages | **11,036,187** | 7,054,207 |
| Accrued interest - personal loans | **113,838** | 103,106 |
| Accrued interest - mortgages | **86,911** | 76,698 |
| Accrued interest - commercial loans and mortgages | **40,392** | 14,169 |
| | **100,386,988** | 97,380,030 |
| Allowance for impaired loans | **(420,621)** | (305,924) |
| Net loans to members | **99,966,367** | 97,074,106 |

### Credit Quality of Loans

Security held on a portfolio basis is as follows:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | $ | $ |
| Mortgages secured by property | **64,232,588** | 57,767,488 |
| Other secured loans | **25,973,741** | 29,104,168 |
| Unsecured loans | **10,180,659** | 10,508,374 |
| | **100,386,988** | 97,380,030 |

### Terms and Conditions

Member loans can have either a variable or fixed rate of interest and they mature within five years. Variable rate loans are based on a "prime rate" formula such as prime plus x%. The rate is determined by the type of security offered and the members' credit worthiness. The Credit Union's prime rate at December 31, 2017 was 3.20%. The interest rate offered on fixed rate loans varies with the type of security offered and the member's credit worthiness.

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## 6. LOANS AND MORTGAGES RECEIVABLE *(continued)*

Residential mortgages are loans secured by residential property and are repayable in blended payments of principal and interest either on a weekly, bi-weekly or monthly basis, over a maximum term of five years.

Personal loans and lines of credit are repayable to the Credit Union in monthly blended principal and interest installments over a maximum term of seven years, except for the line of credit loans which are renewable over a maximum term of five years on a revolving credit basis and require minimum monthly payments. All loans are open and, at the option of the borrower, may be repaid at any time without notice. At December 31, 2017, $10,180,659 (2016: $10,508,374) of the loan portfolio represented "character" loans which are unsecured; where collateral for loans is obtained, it includes member's personal property such as vehicles, cash and marketable securities, personal guarantees, etc.

**Mortgages Under Administration**

Loans and mortgages receivable include $45,369,473 (2016: $42,990,137) that are administered by League Savings and Mortgage Company.

## 7. ALLOWANCE FOR IMPAIRED LOANS AND MORTGAGES

The activity in the allowance for impaired loans is summarized as follows:

| | 2017 | | | 2016 |
|---|---|---|---|---|
| | **Mortgage** | **Personal** | **Total** | **Total** |
| | **$** | **$** | **$** | $ |
| Balance, January 1 | 98,171 | 207,753 | 305,924 | 494,231 |
| Less: Loans written off | 100,825 | 38,122 | 138,947 | 625,780 |
| Add: Provision for impaired loans | 32,627 | 221,017 | 253,644 | 437,473 |
| Balance, December 31 | **29,973** | **390,648** | **420,621** | **305,924** |

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## 7. ALLOWANCE FOR IMPAIRED LOANS AND MORTGAGES *(continued)*

The credit quality of member loans is summarized as follows:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | $ | $ |
| Neither past due nor impaired (Note 1) | **97,142,087** | 95,784,791 |
| Past due but not impaired (Note 2) | **1,485,015** | 620,436 |
| Impaired (Note 2) | **1,759,886** | 974,803 |
| | **100,386,988** | 97,380,030 |
| Less: Individual provision | **420,621** | 305,924 |
| | **99,966,367** | 97,074,106 |

(1) A loan is considered to be past due when the counterparty has not made a payment by the day of the contractual expiry date.

(2) Past due but not impaired and impaired loans are shown net of collateral held by the Credit Union.

The Credit Union has determined the likely impairment loss on loans which have not maintained the loan repayments in accordance with the loan contract, or where there is other evidence of potential impairment such as industrial restructuring, job losses or other economic circumstances. In identifying the impairment likely from these events, the Credit Union considers the loan type, industry, geographic location, type of loan security, the length of time the loans are past due and the historical loss experience. The circumstances may vary for each loan over time, resulting in higher or lower impairment (losses). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Board of Directors to reduce any differences between loss estimates and actual loss experience. An estimate of the collective provision is based on the period of repayments that are past due. For purposes of the collective provision, loans are classified into separate groups with similar risk characteristics, based on type of product and type of security.

## 8. PROPERTY, PLANT AND EQUIPMENT

| | 2017 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Land | Buildings | Roof | Paved areas | HVAC | Furniture & Equipment | Computers | Vehicle | Total |
| | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| **Rate** | | | | | | | | | |
| **Cost** | | | | | | | | | |
| Balance,beginning | 230,080 | 3,821,707 | 155,501 | 207,529 | 227,288 | 1,171,563 | 277,723 | 17,540 | **6,108,931** |
| Additions | | - | - | - | - | 48,667 | 18,197 | - | **66,864** |
| Disposals | - | - | | - | | - | - | - | **-** |
| Balance, ending | 230,080 | 3,821,707 | 155,501 | 207,529 | 227,288 | 1,220,230 | 295,920 | 17,540 | **6,175,795** |
| **Accumulated depreciation** | | | | | | | | | |
| Balance,beginning | - | 1,583,871 | 18,332 | 88,077 | 33,344 | 922,000 | 233,768 | 13,155 | **2,892,547** |
| Depreciation | - | 111,816 | 6,220 | 9,556 | 11,364 | 67,766 | 34,518 | 3,508 | **244,748** |
| Adjustments | - | - | - | - | - | - | - | - | **-** |
| Balance, ending | - | 1,695,687 | 24,552 | 97,633 | 44,708 | 989,766 | 268,286 | 16,663 | **3,137,295** |
| **Net book value** | **230,080** | **2,126,020** | **130,949** | **109,896** | **182,580** | **230,464** | **27,634** | **877** | **3,038,500** |

## 8 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

| | 2016 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Land | Buildings | Roof | Paved areas | HVAC | Furniture & Equipment | Computers | Vehicle | Total |
| | $ | $ | $ | $ | $ | $ | $ | $ | $ |
| **Rate** | | | | | | | | | |
| **Cost** | | | | | | | | | |
| Balance,beginning | 239,196 | 3,996,707 | 155,501 | 149,586 | 227,288 | 1,216,958 | 534,754 | 17,540 | 6,537,530 |
| Additions | | - | - | 57,943 | - | 184,965 | 1,869 | - | 244,777 |
| Disposals | 9,116 | 175,000 | | - | | 230,360 | 258,900 | - | 673,376 |
| Balance, ending | 230,080 | 3,821,707 | 155,501 | 207,529 | 227,288 | 1,171,563 | 277,723 | 17,540 | 6,108,931 |
| **Accumulated depreciation** | | | | | | | | | |
| Balance,beginning | - | 1,535,854 | 12,440 | 81,469 | 22,728 | 1,112,706 | 453,823 | 9,647 | 3,228,667 |
| Depreciation | - | 93,017 | 5,892 | 6,608 | 10,616 | 31,530 | 38,845 | 3,508 | 190,016 |
| Adjustments | - | 45,000 | - | - | - | 222,236 | 258,900 | - | 526,136 |
| Balance, ending | - | 1,583,871 | 18,332 | 88,077 | 33,344 | 922,000 | 233,768 | 13,155 | 2,892,547 |
| **Net book value** | **230,080** | **2,237,836** | **137,169** | **119,452** | **193,944** | **249,563** | **43,955** | **4,385** | **3,216,384** |

## 9. MEMBERS' DEPOSITS

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | $ | $ |
| Chequing accounts | **56,146,605** | 52,047,803 |
| Term deposits plus accrued interest | **19,053,172** | 21.108.516 |
| Savings accounts | **41,204,060** | 34,745,165 |
| RRSP funds plus accrued interest | **17,398,329** | 18,030,069 |
| Equity shares | **1,919,534** | 1,912,962 |
| RRIF funds administered by Concentra Financial plus accrued interest | **1,182,220** | 1,140,286 |
| Tax-free savings accounts | **8,780,760** | 7,441,350 |
| Non-equity share accounts | **1,340,129** | 1,178,991 |
| | **147,024,809** | **137,605,142** |

*(continues)*

## 9. MEMBERS' DEPOSITS *(continued)*

***Terms and Conditions***

*Term deposits*

Term deposits for periods of 30 days to 5 years generally may not be withdrawn prior to maturity. Term deposits bear fixed rates of interest which can be paid annually, semi-annually, monthly or upon maturity. The interest rates offered on term deposits issued on December 31, 2017 range from 0.20% to 1.75%.

*Savings accounts*

Savings accounts are due on demand. The portfolio consists of fixed and variable rates up to 1.20%.

*Chequing accounts*

Chequing accounts are due on demand and bear interest at a variable rate up to 0.15% at December 31, 2017. Included in chequing deposits at December 31, 2017 is $22,097 (2016: $15,103) denominated in US dollars.

*RRSP accounts*

Registered retirement savings plans ("RRSP") accounts can have fixed or variable rates. RRSPs have terms ranging from one to five years and fixed rates of 0.25% and variable rates up to 1.75%.

*RRIF accounts*

Registered retirement income funds ("RRIF") accounts consist of both fixed and variable rate products with term and conditions similar to those of the RRSPs described above. Members may make withdrawals from a RRIF account on a monthly, semi-annual or annual basis. The regular withdrawal amounts vary according to individual needs and statutory requirements. RRIF accounts have fixed rates of 0.25% and variable rates up to 1.75%.

*(continues)*

## 9. MEMBERS' DEPOSITS *(continued)*

*Equity shares*

Member equity shares consist of 20 shares per adult member and 1 share per youth/student member at a par value of five dollars ($5.00) per share. The holders of member equity shares have all of the rights and privileges and are subject to the restrictions of a member as provided for in the Credit Union Act and Regulations and in the By-Laws of the Credit Union. Currently there are 7,296 (2016: 7,421) fully paid equity share accounts with an aggregate dollar value of $729,600 (2016: $742,100).

Since membership shares are redeemable on demand, they are presented as a liability on the Credit Union's Statement of Financial Position.

Share accounts are not insured by the Credit Union Deposit Guarantee Corporation; however, they do qualify as capital for regulatory purposes, notwithstanding their financial statement classification as liabilities.

*Dividends and patronage refunds*

The balance sheet reflect the recording of patronage refunds payable of $80,837 (2016- $90,193) and dividends payable on share accounts of $85,008  (2016- $85,464.) Any amounts unpaid from the prior year are netted against the dividends reported on the statement of retained earning in the current year..

Both the patronage dividends and the dividends paid on share accounts are subject to ratification at the annual general meeting to be held in March 2018.

*Deposit Referrals*

The Credit Union refers deposits to League Savings and Mortgage which are not recorded on the Statement of Financial Position. The balance outstanding at December 31, 2017 was $414,672 (2016 $453,849.) The Credit Union earns referral fees based on this deposit portfolio.

*Concentration of Risk*

Individual or related groups of members' deposits which exceed 1% of total deposits total $4,443,281.

## 10. CORPORATE SOCIAL RESPONSIBILITY RESERVE

ERCU is committed to the implementation of a Cooperative Social Responsibility policy that supports the way in which it integrates social, environmental and economic concerns into its values, culture, decision making, strategy and operations, establishing better practices within the credit union, and improving the communities in which it operates.

The activities and projects will be planned, purposeful and targeted. Projects could include items such as assistance with rent subsidy for the local food banks, contributions to the "Kids Eat Smart" breakfast program in local schools, and funding for Junior Achievement, elder abuse presentations, financial literacy, etc.

The Credit Union has set aside approximately $23,736  (2016 - $14,731) for projects and activities this year.

## 11. CAPITAL ADEQUACY

*Capital Management*

The Credit Union is subject to capital requirements set out in the Credit Union Act of Newfoundland and Labrador (the Act). The Credit Union is required to hold a capital reserve equal to 5% of total assets consisting of equity shares and retained earnings with the minimum retained earnings requirement being 3% of total assets. Alternatively, a risk weighted approach may be used. The Credit Union follows the percentage of total assets method.

As at December 31, 2017 the Credit Union’s total capital as a percent of assets was 5.92%. Therefore, the Credit Union has exceeded its minimum capital requirement at December 31, 2017.

The Credit Union's objectives when managing capital are to ensure the long term viability of the Credit Union and the security of member deposits by holding a level of capital deemed sufficient to protect against unanticipated losses, and to comply at all times with the capital requirements set out in the Act.

The Credit Union management ensures compliance with capital adequacy through the following: setting policies for capital management, monitoring and reporting; setting policies for related areas such as asset liability management; reporting to the Board of Directors or its committees regarding financial results and capital adequacy; reporting to the Credit Union Deposit Guarantee Corporation (“CUDGC”) on its capital adequacy; and setting budgets and reporting variances to those budgets.

Should the Credit Union not comply with its legislated capital adequacy requirements the following actions would result: the Chief Executive Officer would immediately notify the Board Chair, the Audit Committee Chair and CUDGC; the Board of Directors would be informed at their next scheduled meeting; an explanation and action plan would be presented and enacted; and the Credit Union may be subjected to intervention by the CUDGC as provided for in the Act.

## 12. FINANCIAL REVENUE - MEMBERS' LOANS & MORTGAGES

| | 2017 | 2016 |
|---|---|---|
| Personal loans | **$ 2,344,388** | $ 2,767,849 |
| Residential mortgages | **802,488** | 818,858 |
| RMOP | **1,482,675** | 1,464,961 |
| Commercial loans and mortgages | **228,392** | 199,420 |
| | **$ 4,857,943** | $ 5,251,088 |

## 13. INTEREST ON MEMBERS' DEPOSITS

| | 2017 | 2016 |
|---|---|---|
| Term deposit interest | **$ 262,170** | $ 300,202 |
| RRSP | **231,440** | 283,572 |
| Tax fee savings account - term deposit | **61,110** | 58,930 |
| Plan 24 | **63,704** | 54,140 |
| Special saver | **79,901** | 51,914 |
| RRIF | **12,394** | 17,286 |
| YC chequing | **35,858** | 32,634 |
| Tax-free savings account | **23,741** | 15,448 |
| Fat cat | **3,269** | 3,923 |
| Monthly savings plan | **1,405** | 1,358 |
| Head start | **853** | 957 |
| | **$ 775,845** | $ 820,364 |

## 14. INCOME TAXES

The provision for income taxes reported for the year ended December 31 differs from the amount computed by applying the Canadian statutory rate to income before income taxes for the following reasons:

| | 2017 | 2016 |
|---|---|---|
| Income before income taxes | **$ 564,066** | $ 375,336 |
| Increase (decrease) resulting from:` | | |
| Deductible dividends paid | **(153,530)** | (171,370) |
| Non-deductible expenses | **17,343** | 12,558 |
| Temporary differences | **23,191** | (18,640) |
| Taxable income | **$ 451,070** | $ 197,884 |
| Income taxes | **$ 60,894** | $ 26,715 |
| Income tax rate | **13.50 %** | 13.50 % |

## 15. RELATED PARTY TRANSACTIONS

At December 31, 2017 the aggregate amount of loans and mortgages outstanding to members of the Board of Directors and key management personnel totaled $829,940 (2016: $934,858) and the aggregate amount of deposits totaled $567,048 (2016: $547,159). These loans and mortgages have been advanced, and deposits receipted on the same terms and conditions as have been accorded to other members of the Credit Union.

No provision for impairment was necessary with respect to the loans.

The Credit Union's compensation, including the employers' portion of benefits, to key management personnel defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Credit Union, including directors and management was $570,072 (2016 $509,336). The directors also received reimbursement for the year ended December 31, 2017 of $29,923 (2016: $21,272) for their travel, meals and other out of pocket expenses.

## 16. FAIR VALUE OF FINANCIAL INSTRUMENTS

*Fair value*

The fair value of the Credit Union's financial instruments are calculated using the valuation methods and assumptions described below. The fair values do not reflect the value of assets that are not considered financial instruments such as prepaid expenses and property, plant and equipment assets.

The estimated fair value amounts are designed to approximate amounts at which instruments could be exchanged in a current transaction between willing parties who are under no compulsion to act. Fair values are based on estimates using present value and other valuation techniques, which are significantly affected by the assumptions used concerning the amount and timing of estimated future cash flows and discount rates which reflect varying degrees of risk. Because of the estimation process and the need to use judgment, the aggregate fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instruments.

*Fair value hierarchy*

Financial instruments recorded at fair value on the Statement of Financial Position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;

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

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

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

The fair values of cash and cash equivalents, certain other assets and certain other liabilities are assumed to approximate their carrying values, due to their short-term nature.

*(continues)*

## 16. FAIR VALUE OF FINANCIAL INSTRUMENTS *(continued)*

The estimated fair value of fixed rate loans, fixed rate deposits and liabilities qualifying as regulatory capital is determined by discounting the expected future cash flows of these loans, deposits and capital accounts at current market rates for products with similar terms and credit risks.

The fair value of investments is based on quoted market values where available. (See Note 5)

Investments in credit union related entities such as Atlantic Central, League Data Limited. and League Savings and Mortgage are not traded in an active market. As the fair value cannot be reliably measured, these investments are carried at cost, less any identified impairment losses. The Credit Union has not recorded any impairment losses on these investments.

There has been no significant transfer of amounts between Level 1, Level 2 and Level 3 financial instruments for the years ended December 31, 2017 and 2016.

Additionally, there are no financial instruments classified in Level 3.

## 17. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

The Credit Union is exposed to the following risks as a result of holding financial instruments: credit risk, liquidity risk and market risk. The following is a description of these risks and how the Credit Union manages its exposure to these risks.

*Credit risk*

The business of the Credit Union necessitates the management of credit risk. Credit risk is the potential for loss due to the failure of a borrower to meet its contractual obligations.

The Board of Directors of the Credit Union oversees the risk management process. Senior management coordinates policy setting on risk management issues, assesses the risk exposure of the Credit Union and reviews the effectiveness of internal control processes.

The Credit Union uses a disciplined lending approach with standard underwriting parameters for each category of loans. These parameters are used to assist the Credit Union in implementing a prudent and effective process to assess the borrower's ability to repay.

The Credit Union's credit risk is primarily attributable to its loans and mortgages receivable. The amounts disclosed on the Statement of Financial Position are net of the allowance for impaired loans, estimated by management of the Credit Union based on previous experience and its assessment of the current economic environment.

The Credit Union mitigates credit risk by obtaining quality collateral. The Credit Union considers collateral to be of good quality if it can determine the legal validity and market value on an on-going basis. The Credit Union’s internal policy provides additional information regarding the appropriate collateral based on the category of loan. Types of collateral generally obtained by the Credit Union are, but are not limited to, the following: member’s personal property such as vehicles; cash and marketable securities; mortgage charges; fixed, floating or specific general security agreements and personal guarantees.

In addition, the Credit Union monitors its loan concentration to ensure that it is in compliance with its policies.

*(continues)*

## 17. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS *(continued)*

*Liquidity risk*

The business of the Credit Union necessitates the management of liquidity risk. Liquidity risk is the risk of being unable to meet financial commitments, under all circumstances, without having to raise funds at unreasonable prices or sell assets on a forced basis.

The Credit Union's objective is to implement a policy that addresses limits on the sources, quality and amount of the assets to meet normal operational and regulatory requirements and provide contingency funding for significant deposit withdrawals.

The Board is ultimately responsible for the liquidity risk management policy. Management reports regularly to the Board, the Credit Union's compliance with the policy and regulatory requirements; concentration of large deposits of single/connected depositors as a percentage of total deposits; and reports borrowings for liquidity purposes, the level of borrowings and the liquidity less borrowings in relation to the statutory minimum.

The Act requires credit unions to maintain investments equal to a minimum of 6% of liabilities for adequate liquidity. Assets held by the Credit Union for such purposes are investments and demand deposits held with Atlantic Central in the amount of $8,856,277. (December 31, 2016: $21,862,612) 6% of liabilities total $8,707,030 with excess liquidity being $149,247.

Contractual maturities of financial liabilities are shown under interest rate risk.

*Market risk*

Market risk is the risk of loss that may arise from change in market factors such as interest rates and foreign exchange rates. The Credit Union is exposed to this market risk in its investing and asset/liability management activities.

Senior management is responsible for managing market risk in accordance with the Credit Union's Asset and Liability Management and Investment policy set by the Board. Senior management reports regularly to the Board its compliance with the policy and regulatory requirements; dollar volume and yields of all investments; and the particulars of all investment transactions entered into by the Credit Union. All exceptions noted are to be reported to the Board.

The Board is responsible for monitoring significant variances and ensuring that corrective measures are implemented.

*Interest rate risk*

The Credit Union's major source of income is financial margin, the difference between interest earned on investments and member loans and interest paid on member deposits. Interest rate risk refers to the potential impact of changes in interest rates on the Credit Union's earnings when maturities of its financial liabilities are not matched with the maturities of its financial assets or which are priced on a different basis. It is the policy of the Credit Union to keep exposure to interest rate fluctuations within limits set by the Board of Directors.

The following schedule shows the Credit Union's sensitivity to interest rate changes. A significant amount of loans and deposits can be settled before maturity and a penalty may apply, but no adjustment has been made for payments that may occur prior to maturity. Amounts that are not interest sensitive have been grouped together regardless of maturity.

The table below summarizes the carrying amounts of financial instruments exposed to interest rate risk by maturity dates:

*(continues)*

## 17. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS *(continued)*

| | Assets | Liabilities | Asset/ Liability Gap |
|---|---|---|---|
| | $ | $ | $ |
| Variable | 11,010 | 75,717 | - 64,707 |
| 3 months | 12,916 | 12,134 | 782 |
| 6 months | 10,144 | 4,658 | 5,486 |
| 9 months | 11,731 | 2,840 | 8,891 |
| 12 months | 17,226 | 4,932 | 12,294 |
| 1-5 years | 82,419 | 14,813 | 67,606 |
| > 5 years | 2,146 | | 2,146 |
| Not interest sensitive | 8,174 | 40,672 | - 32,498 |
| | 155,766 | 155,766 | - |

*Interest rate risk sensitivity*

Interest rate risk refers to the potential impact of changes in interest rates on the Credit Union's earnings when maturities of its financial liabilities are not matched with the maturities of its financial assets or are priced on a different basis. It is the policy of the Credit Union to keep exposure to interest rate fluctuations within limits set by the Board and Regulations.

At December 31, 2017, if interest rates at that date had been 100 basis points lower with all other variables held constant, net income before income tax for the year would have been $171,000 lower. If interest rates had been 100 basis points higher, with all other variables held constant, net income before income tax would have been $168,000 higher.

*Foreign currency exchange risk*

Foreign currency exchange risk refers to the potential impact of changes in foreign exchange rates on the Credit Union's earnings when balances of its foreign currency liabilities are not matched with the balances of its foreign currency assets. It is the policy of the Credit Union to mitigate exposure to foreign exchange rate fluctuations by matching its foreign currency liabilities to its foreign currency assets. The Credit Union does not hold foreign investments beyond cash required to meet daily operational requirements.

## 18. COMMITMENTS

In the normal course of business, the Credit Union enters into various credit commitments to meet the requirements of its members. These commitments include lines of credit available on a revolving basis. These credit arrangements are subject to the Credit Union's normal credit standards and collateral may be obtained where appropriate. The contract amounts set out below represent the maximum future cash requirements should the contracts be fully drawn. However, many of these arrangements will expire or terminate without being fully drawn. At December 31, 2017, the unused authorized lines of credit totalled $7,408,957 (2016: $6,842,429)

## 19. COMPARATIVE FIGURES

Some of the comparative figures have been reclassified to conform to the current year's presentation.