# Prospera Credit Union

Consolidated Financial Statements
**December 31, 2016**
(expressed in thousands of dollars)

February 21, 2017

## Independent Auditor's Report

**To the Members of**
**Prospera Credit Union**

We have audited the accompanying consolidated financial statements of Prospera Credit Union and its subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2016 and the consolidated statements of income and comprehensive income, changes in members' equity and cash flows for the year then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

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

**Auditor's responsibility**
Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

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

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

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**Opinion**
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Prospera Credit Union and its subsidiaries as at December 31, 2016 and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

**Chartered Professional Accountants**

# Prospera Credit Union

Consolidated Statement of Financial Position

**As at December 31, 2016**

(expressed in thousands of dollars)

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | 31,899 | 6,481 |
| Interest bearing deposits | 436,254 | 457,533 |
| Loans to members (note 5) | 2,665,176 | 2,323,937 |
| Other assets (note 9) | 5,998 | 3,444 |
| Derivative financial instruments (note 24) | 1,959 | 4,798 |
| Investments (note 7) | 96,345 | 70,923 |
| Property, premises and equipment (note 8) | 7,495 | 6,915 |
| Intangibles (note 10) | 1,695 | 2,296 |
| Retirement benefit asset (note 14) | 571 | 511 |
| Deferred income tax assets (note 20) | 2,642 | 2,459 |
| **TOTAL ASSETS** | 3,250,034 | 2,879,297 |
| **Liabilities** | | |
| Borrowings (note 11) | 411,532 | 293,109 |
| Member deposits (note 12) | 2,692,186 | 2,447,387 |
| Retirement benefit obligation (note 14) | 8,221 | 8,905 |
| Derivative financial instruments (note 24) | 896 | 989 |
| Other liabilities (note 15) | 5,174 | 4,643 |
| Income taxes payable | 287 | 344 |
| **TOTAL LIABILITIES** | 3,118,296 | 2,755,377 |
| **Members' Equity** | | |
| Capital and reserves attributable to members | | |
| Members' equity shares (note 13(c)) | 3,510 | 3,826 |
| Retained earnings | 133,511 | 124,490 |
| Other reserves | (5,283) | (4,396) |
| **TOTAL MEMBERS' EQUITY** | 131,738 | 123,920 |
| **TOTAL LIABILITIES AND MEMBERS' EQUITY** | 3,250,034 | 2,879,297 |

**Commitments and contingent liabilities** (notes 14 and 21)

**Approved by the Board of Directors**

Director

Director

The accompanying notes are an integral part of these consolidated financial statements.

# Prospera Credit Union

## Consolidated Statement of Income and Comprehensive Income

**For the year ended December 31, 2016**

(expressed in thousands of dollars)

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **Interest income** | | |
| Loans | 83,583 | 82,619 |
| Interest bearing deposits and investments | 11,197 | 13,505 |
| | 94,780 | 96,124 |
| **Interest expense** | | |
| Member deposits | 32,858 | 35,076 |
| Borrowings | 4,091 | 6,028 |
| | 36,949 | 41,104 |
| **Net interest income** (note 16) | 57,831 | 55,020 |
| **(Recovery of) provision for credit losses** (note 5) | (729) | 1,308 |
| **Net interest income after provision for credit losses** | 58,560 | 53,712 |
| **Other income** (note 17) | 12,729 | 13,504 |
| **Net interest income and other income** | 71,289 | 67,216 |
| **Non-interest expenses** | | |
| Salaries and employee benefits (note 18) | 34,426 | 33,538 |
| Occupancy | 7,300 | 7,194 |
| Other expenses (note 19) | 4,489 | 3,965 |
| Administration | 4,294 | 4,212 |
| Data processing | 2,930 | 2,710 |
| Communication and marketing | 2,548 | 2,343 |
| Depreciation and amortization | 2,428 | 2,360 |
| Clearing charges | 1,673 | 1,587 |
| | 60,088 | 57,909 |
| **Income before dividends on member deposit shares** | 11,201 | 9,307 |
| **Dividends on member deposit shares** | 71 | 174 |
| **Income before income taxes** | 11,130 | 9,133 |
| **Provision for (recovery of) income taxes** (note 20) | | |
| Current | 1,793 | 1,618 |
| Deferred | 220 | (213) |
| | 2,013 | 1,405 |
| **Net income for the year** | 9,117 | 7,728 |
| **Other comprehensive (loss) income for the year** | | |
| Changes related to defined benefit plans (note 14(e)) | (81) | 920 |
| Change in fair value of cash flow hedges (note 24) | (801) | 91 |
| Change in fair value of investments | (5) | (215) |
| | (887) | 796 |
| **Comprehensive income attributable to members** | 8,230 | 8,524 |

The accompanying notes are an integral part of these consolidated financial statements.

# Prospera Credit Union

Consolidated Statement of Changes in Members' Equity

**For the year ended December 31, 2016**

(expressed in thousands of dollars)

| | | | Other reserves | | | |
|---|---|---|---|---|---|---|
| | Members' equity shares $ | Retained earnings $ | Defined benefit plans[1] $ | Cash flow hedges and retained interest[2] $ | Investments[2] $ | Members' equity $ |
| **Balance - December 31, 2014** | 4,179 | 116,872 | (5,534) | 127 | 215 | 115,859 |
| Net income and other comprehensive income | - | 7,728 | 920 | 91 | (215) | 8,524 |
| Dividends on members' equity shares | - | (110) | - | - | - | (110) |
| Share redemptions | (353) | - | - | - | - | (353) |
| **Balance - December 31, 2015** | 3,826 | 124,490 | (4,614) | 218 | - | 123,920 |
| Net income and other comprehensive income | - | 9,117 | (81) | (801) | (5) | 8,230 |
| Dividends on members' equity shares | - | (96) | - | - | - | (96) |
| Share redemptions | (316) | - | - | - | - | (316) |
| **Balance - December 31, 2016** | 3,510 | 133,511 | (4,695) | (583) | (5) | 131,738 |

[1] Changes in other reserves related to defined benefit plans are not recyclable to net income.

[2] Changes in other reserves related to cash flow hedges, retained interest and investments are recyclable to net income.

The accompanying notes are an integral part of these consolidated financial statements.

# Prospera Credit Union

Consolidated Statement of Cash Flows

**For the year ended December 31, 2016**

(expressed in thousands of dollars)

| | 2016 $ | 2015 $ |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income for the year | 9,117 | 7,728 |
| Items not affecting cash | | |
| Net interest income | (57,831) | (55,020) |
| Depreciation and amortization | 2,428 | 2,360 |
| (Recovery of) provision for credit losses | (729) | 1,308 |
| Provision for income taxes | 1,793 | 1,618 |
| Deferred income taxes (recovery) | 220 | (213) |
| Net change in fair value of derivative financial instruments (note 24) | 1,735 | (1,801) |
| Net change in fair value of secured borrowings | (1,526) | 1,408 |
| Loss (gain) on sale of property, premises and equipment | 10 | (4) |
| | (44,783) | (42,616) |
| Net change in loans to members | (340,510) | (32,495) |
| Net change in member deposits | 247,448 | 163,185 |
| Interest received | 95,230 | 94,676 |
| Interest paid | (36,971) | (41,930) |
| Issuance of member deposit shares | 183 | 186 |
| Redemption of member deposit shares | (1,662) | (1,525) |
| Dividends paid | (1,170) | (488) |
| Change in other assets and retirement benefit asset | (2,614) | (565) |
| Net change in derivative financial instruments | (2,746) | 1,847 |
| Change in other liabilities and retirement benefit obligation | (423) | 264 |
| Income taxes paid | (1,880) | (780) |
| Other items | 2,333 | (203) |
| | (87,565) | 139,556 |
| **Cash flows from investing activities** | | |
| Investment in term deposits | (361,349) | (381,754) |
| Proceeds from maturity of term deposits | 382,628 | 195,587 |
| Purchase of investments | (218,176) | (102,893) |
| Proceeds from the sale and maturity of investments | 192,754 | 71,599 |
| Proceeds on disposal of property, premises, and equipment | - | 11 |
| Additions to property, premises, equipment and intangibles | (2,507) | (2,120) |
| | (6,650) | (219,570) |
| **Cash flows from financing activities** | | |
| Proceeds from borrowed funds | - | 44,996 |
| Proceeds from securitization transactions | 210,936 | 73,901 |
| Proceeds from securitization transactions (derecognized) | - | 20,030 |
| Repayments of borrowed funds | (44,999) | (43,642) |
| Repayments of secured borrowings | (45,988) | (10,591) |
| Redemption of members' equity shares | (316) | (353) |
| | 119,633 | 84,341 |
| **Increase in cash and cash equivalents** | 25,418 | 4,327 |
| **Cash and cash equivalents - Beginning of year** | 6,481 | 2,154 |
| **Cash and cash equivalents - End of year** | 31,899 | 6,481 |
| **Cash and cash equivalents consist of:** | | |
| Demand deposits and clearings with Central 1 | 30,550 | 6,481 |
| Term deposits with Central 1 with less than 90 days to maturity | 1,349 | - |
| | 31,899 | 6,481 |

The accompanying notes are an integral part of these consolidated financial statements.

(expressed in thousands of dollars)

## 1 General information

Prospera Credit Union (the “Credit Union”) is incorporated under the Credit Union Incorporation Act of British Columbia and its operations are subject to the Financial Institutions Act of British Columbia (the “FIA”). The Credit Union’s primary business activities include providing financial services to its members and the general public across British Columbia. It provides Personal Banking, Business Banking and Wealth Management services through a network of 16 branches, online and mobile banking, the Exchange ATM network and a contact centre.

The Credit Union is domiciled in Canada and its registered office is at #500 - 32071 S. Fraser Way, Abbotsford, British Columbia.

The consolidated financial statements have been approved for issue by the Board of Directors (the “Board”) on February 15, 2017.

## 2 Basis of presentation

a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) using applicable IFRS as well as the regulations of the FIA. The accounting policies applied in these consolidated financial statements are based upon IFRS effective for the year ended December 31, 2016, as issued and effective.

b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis, except for available-for-sale financial assets, financial assets and financial liabilities accounted for at fair value through profit or loss and all derivative financial instruments, which are measured at fair value.

c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is also the Credit Union’s functional currency. The figures shown in the consolidated financial statements are expressed in thousands of dollars, unless otherwise stated.

(expressed in thousands of dollars)

d) Use of estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

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 and in any future periods affected.

Information on significant areas of uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are described in note 4.

## 3 Summary of significant accounting policies

a) Consolidation

The Credit Union consolidates investees when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

The Credit Union consolidates the following investees in which it has control as wholly owned subsidiaries. Its wholly owned subsidiaries are Prospera Insurance Agencies Ltd., Prospera Technologies Inc., 413297 B.C. Ltd., and Prospera Holdings Ltd.

Intercompany balances, and income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements. Intercompany losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

b) Foreign currency translation

Transactions in foreign currencies are translated to the functional currency of the Credit Union at the exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between the 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 the foreign currency translated at the exchange rate at the end of the reporting period. Foreign currency differences arising on translation are recognized in the consolidated statement of income. Non-monetary items that are measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rates at the date when the fair value was determined.

(expressed in thousands of dollars)

c) Cash resources

Cash and cash equivalents include highly liquid balances with less than 90 days to maturity from the original date of issuance and include temporary clearing items. Interest bearing deposits include deposits with Central 1 Credit Union ("Central 1").

d) Financial assets and liabilities - categorization, measurement and recognition

i) Financial assets

Management determines the categorization of its financial assets at initial recognition. 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 ("FVTPL"), 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's financial assets are categorized as one of the following: financial assets at FVTPL, loans and receivables, financial assets available-for-sale ("AFS") and financial assets held-to-maturity ("HTM").

*Financial assets at FVTPL*

This category comprises financial assets classified as FVTPL and financial assets designated by the Credit Union as FVTPL upon initial recognition.

A financial asset is required to be classified as FVTPL if it is acquired principally for the purpose of selling it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivative financial instruments are also categorized as FVTPL unless they are designated and are effective as hedging instruments in a hedge accounting relationship. Gains and losses on assets classified as FVTPL are recorded in net income.

The Credit Union has not designated any assets as FVTPL. The Credit Union's financial assets classified as FVTPL consist of derivative financial instruments such as equity options and interest rate swaps related to securitized loans and index-linked deposit contracts.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

1) those that the Credit Union intends to sell immediately or in the short term, which are classified as FVTPL, and those that the Credit Union upon initial recognition designates as FVTPL;

2) those that the Credit Union upon initial recognition designates as AFS; or

(expressed in thousands of dollars)

3) those for which the holder may not recover substantially all of its initial investment, for reasons other than credit deterioration.

Loans and receivables are recorded at fair value on initial recognition and subsequently at amortized cost using the effective interest method.

The Credit Union's loans and receivables principally consist of cash and cash equivalents, loans to members, interest bearing deposits, and other assets.

*Financial assets available-for-sale*

AFS assets are those non-derivative financial assets that are designated as AFS or are not classified as FVTPL, not designated as FVTPL or do not qualify as loans and receivables. AFS assets are recorded at cost which includes direct and incremental transaction costs. Subsequently, they are carried at fair value, unless they do not have a quoted market price in an active market and fair value is not reliably determinable, in which case they are carried at cost.

Unrealized gains and losses arising from changes in the fair value of AFS financial assets are recognized directly in equity, until the financial asset is derecognized or impaired. As a result of the derecognition or impairment of an AFS asset, the cumulative gain or loss previously recognized in equity is recognized in the consolidated statement of income.

Interest income on AFS assets is calculated using the effective interest method and is recognized in the consolidated statement of income. Dividends on AFS equity instruments are recognized in the consolidated statement of income when the Credit Union's right to receive payment is established.

The Credit Union's AFS assets consist of Central 1 equity shares and other investments, included in investments.

*Financial assets held-to-maturity*

HTM assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Credit Union's management has the positive intention and ability to hold to maturity, other than:

1) those that the Credit Union upon initial recognition designates as FVTPL;

2) those that the Credit Union designates as AFS; and

3) those that meet the definition of loans and receivables.

These are initially recognized at fair value including direct and incremental transaction costs and measured subsequently at amortized cost, using the effective interest method. Interest on HTM assets is recognized in the consolidated statement of income.

(expressed in thousands of dollars)

The Credit Union's HTM assets consist of government backed securities, which are included in investments.

ii) Financial liabilities

Management determines the categorization of its financial liabilities at initial recognition. The Credit Union initially recognizes financial liabilities (including liabilities designated at FVTPL) on the trade date at which the Credit Union becomes a party to the contractual provisions of the instrument. Financial liabilities are categorized as FVTPL or financial liabilities at amortized cost. Financial liabilities are derecognized when extinguished.

*Financial liabilities at FVTPL*

Upon initial recognition, financial liabilities at FVTPL are classified or are designated by the Credit Union as FVTPL.

A financial liability is required to be classified as FVTPL if it is incurred principally for the purpose of repurchasing it in the near term or if it is part of a portfolio of identified financial liabilities that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivative liabilities are also categorized as FVTPL unless they are designated and are effective hedging instruments in a hedge accounting relationship. Gains and losses on FVTPL financial liabilities are recorded in net income.

The Credit Union's financial liabilities classified as FVTPL consist of derivative financial instruments, and certain secured borrowings have also been designated as FVTPL in order to reduce a reporting mismatch that would arise if such borrowings were recorded at amortized cost.

*Financial liabilities at amortized cost*

Financial liabilities that are not classified or designated as FVTPL fall into this category. Financial liabilities at amortized cost consist of amounts drawn on lines of credit, accounts payable, certain secured borrowings, and member deposits. These are measured at fair value on initial recognition and subsequently at amortized cost using the effective interest method.

iii) Fair value of financial instruments

The best evidence of fair value at initial recognition is prices quoted in an active market. Fair values of financial instruments quoted in active markets are determined by reference to closing bid prices at the reporting date. If there is no active market for a financial instrument, the Credit Union establishes fair value using an appropriate valuation technique. These techniques principally include the use of recent arm's length transactions for investments in unquoted securities, discounted cash flow analysis for derivatives, third-party option pricing models for index-linked option contracts and other valuation techniques commonly used by market participants.

(expressed in thousands of dollars)

Fair values reflect the credit risk of the instruments and include adjustments to take account of the credit risk of the Credit Union and the counterparty as relevant. Fair value estimates obtained from models are adjusted for other factors, such as liquidity risk or model uncertainties, to the extent that the Credit Union believes a third-party market participant would take them into account in pricing a transaction. Fair values determined by applying valuation techniques utilize independent observable market inputs to the maximum extent possible.

iv) Impairment of financial assets

The Credit Union assesses, at each statement of financial position date, whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are recorded only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and the loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Credit Union on non-market terms that the Credit Union would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, or other observable data relating to a group of assets such as conditions that correlate with defaults in the group.

*Financial assets classified as loans and receivables*

The Credit Union maintains an allowance for credit losses that, in management's estimation, is considered adequate to provide for credit-related losses. The allowance for credit losses consists of individual and collective allowances. The individual allowance is determined on the basis of specific loans that, in management's opinion, may not be fully collectible. The individual allowance is the amount required to reduce the carrying value of an impaired loan to its present value of estimated future cash flows discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment is the current effective interest rate determined under the contract at the time the loan becomes impaired.

For the purposes of a collective evaluation of impairment, the portfolio is grouped on the basis of similar characteristics. These characteristics are relevant to the estimation of future cash flows and historical loss experience which is adjusted on the basis of current observable data to reflect the effects of current conditions. Assets that are individually assessed for impairment and for which no individual allowances are recorded are included in a collective assessment of impairment.

(expressed in thousands of dollars)

The Credit Union adjusts its input to its collective allowance methodology on an ongoing basis, taking into account factors such as historical loss experience and adjusting for current observable data that did not impact the period which the historical loss experience was based on. Estimates of changes in future cash flows for groups of assets reflect and are directionally consistent with changes in related observable data from period to period (for example, mortgage delinquency, or other factors indicative of changes in the probability of losses by the Credit Union and in their magnitude).

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the consolidated statement of income in provision for credit losses.

Loans that were past due and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans.

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Credit Union, as and when more information becomes available, to reduce any differences between loss estimates and actual loss experience. When a loan is uncollectible, it is written off after the amount of the final loss has been determined.

*Assets classified as available-for-sale*

A significant or prolonged decline in the fair value of an AFS equity security below its cost is considered objective evidence in determining whether the asset is impaired. An AFS debt instrument may be identified as impaired due to circumstances which can include actual delinquency in contractual payment of principal or interest and/or significant events which indicate there is doubt as to the collectibility of the principal or contractual interest. For designated AFS assets, if any such evidence exists, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the consolidated statement of income, is reclassified from equity and recognized in the consolidated statement of income.

If, in a subsequent period, the fair value of a debt instrument classified as AFS increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income. Impairment losses recognized in the consolidated statement of income on equity instruments are not reversed.

(expressed in thousands of dollars)

*Assets classified as held-to-maturity*

A HTM debt instrument may be identified as impaired due to circumstances which can include actual delinquency in contractual payment of principal or interest and/or significant events which indicate there is doubt as to the collectibility of the principal or contractual interest. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the investment and recognized in the consolidated statement of income.

e) Property held for resale

In certain circumstances, the Credit Union may take possession of property held as collateral as a result of foreclosure on loans that are in default. Foreclosed properties where the Credit Union has taken possession are classified as assets held for sale and are measured at the lower of the carrying amount and the fair value less costs to sell.

The Credit Union does not, as a rule, occupy repossessed properties for its business use. These assets are normally sold in a manner that maximizes the benefit to the Credit Union, the member and the member's other creditors, and may involve the use of realtors.

No properties were held for resale as at the end of 2016 or 2015.

f) Derivatives and hedge accounting

Derivative financial instruments are financial contracts whose value changes in response to a change in a specified interest rate, exchange rate or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. Derivative contracts have no initial net investment or a net investment which would be smaller than a non-derivative contract and are settled at a future date.

Derivatives are initially recognized at fair value on the date a derivative contract is entered into. They are subsequently re-measured at their fair value and reported as assets where they have a positive fair value or as liabilities where they have a negative fair value.

Derivatives may also be embedded in other financial instruments and are treated as separate derivatives when:

i) their economic characteristics and risks are not closely related to those of the host contract;

ii) a separate instrument with the same terms would meet the definition of a derivative instrument; and

iii) the host contract is not designated as FVTPL or classified as FVTPL.

Changes in fair value on derivative financial instruments not qualifying for hedge accounting are recognized in the consolidated statement of income.

(expressed in thousands of dollars)

The Credit Union designates derivatives as either hedges of highly probable future cash flows attributable to a recognized asset or liability, or a forecasted transaction (cash flow hedge), or FVTPL derivatives in instances where the derivative does not qualify or has not been designated as a hedge in a hedge accounting relationship. The Credit Union periodically uses derivatives for economic hedging purposes to mitigate an identified financial risk.

g) Cash flow hedges

The Credit Union uses hedge accounting for derivatives designated as cash flow hedges provided certain criteria are met. The Credit Union documents the relationship, at its inception, between hedged items and hedging instruments, as well as identifying the risk being hedged and its risk management objective and strategy for undertaking various hedge transactions. The Credit Union also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the cash flows attributable to the hedged risk.

The effective portion of changes in the fair value of a derivative that is designated and qualifies as a cash flow hedge is recognized in the consolidated statement of changes in members' equity. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of income. Amounts accumulated in equity are reclassified to the consolidated statement of income in the periods when the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, hedge accounting ceases and any cumulative gain or loss existing in equity at that time remains in equity and is recognized when the hedged forecast transaction is ultimately recognized in the consolidated statement of income. However, when a forecast transaction is no longer expected to occur, or when the hedged item expires or is sold, the cumulative gain or loss that was deferred in equity is immediately transferred to the consolidated statement of income.

h) Derecognition of financial instruments

Financial assets are derecognized when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred. If the Credit Union has neither transferred nor retained substantially all the risks and rewards of the transferred financial asset, it assesses whether it has retained control over the transferred asset. If control has been retained, the Credit Union continues to recognize the transferred asset to the extent of its continuing involvement. If control has not been retained, the Credit Union derecognizes the transferred asset.

Financial liabilities are derecognized when they have been redeemed or otherwise extinguished.

The Credit Union, through securitizations, periodically transfers loans to independent third parties. Where the Credit Union's securitizations and other transfers of receivables do not result in a transfer of contractual cash flows of the receivables or an assumption of an obligation to pay the cash flows of the receivable to a transferee, the Credit Union does not derecognize the transferred receivables and instead records a secured borrowing with respect to any consideration received.

(expressed in thousands of dollars)

For whole loan sales that result in a transfer of contractual cash flow, the Credit Union derecognizes the assets sold. The Credit Union accounts for gains or losses in the consolidated statement of income. The amount of the gain or loss is based on the carrying value of the loans sold.

i) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognized amounts with the same counterparty and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

j) Interest income and expenses

Interest income or expense for all interest bearing financial instruments is recognized within interest income or interest expense in the consolidated 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 (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Credit Union estimates future cash flows considering all contractual terms of the financial instrument but does not consider future credit losses.

The calculation of the effective interest method includes all fees and costs paid or received between parties to the contract 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. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Interest income and expenses presented in the consolidated statement of income include:

i) interest on financial assets and financial liabilities measured at amortized cost, calculated on an effective interest basis;

ii) interest on AFS investment securities calculated on an effective interest basis;

iii) the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period that the hedged cash flows affect interest income/expense;

iv) fair value changes in qualifying derivatives, including hedge ineffectiveness; and

v) gains or losses on derivative financial instruments that do not qualify for hedge accounting.

(expressed in thousands of dollars)

k) Fee and commission income

The accounting treatment for loan fees varies depending on the transaction. Fees that are considered to be adjustments to loan yield are recognized using the effective interest method. The effective interest method capitalizes fees and transaction costs on the consolidated statement of financial position and amortizes them to interest income over the expected life of the related loan. Mortgage prepayment fees are recognized in interest income when received, unless they relate to a minor modification to the terms of the mortgage, in which case the fees are recognized over the expected remaining term of the original mortgage using the effective interest method. Loan origination, restructuring and renegotiation fees for loans are recorded as interest income over the expected term of the loan using the effective interest method. Commitment fees are recorded in interest income over the expected term of the loan, unless the loan commitment is not expected to be used, in which case they are recorded to other income. Loan discharge and administration fees are recorded directly to other income when the loan transaction is complete.

Loan fees that are recognized using the effective interest method are included with loan balances on the consolidated statement of financial position.

Service charges and foreign exchange transaction fees are recognized on an accrual basis when the service is performed.

Commission income is earned on the sale of insurance policies and is recognized as at the related insurance policy's effective date. The Credit Union may receive additional commissions from insurance companies, which are recorded at the earlier of the period in which amounts can be reliably measured or the period in which the amounts are received.

Investment management fees, mutual fund fees and financial planning fees are recorded at the date of sale on an accrual basis or upon performance of services.

l) Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(expressed in thousands of dollars)

m) Property, premises and equipment

i) Recognition and measurement

All premises and equipment used by the Credit Union are measured at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

ii) Subsequent costs

Subsequent expenditures are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Credit Union and the cost of the item can be reliably measured.

All repair and maintenance costs are charged to the consolidated statement of income during the financial period in which they are incurred.

iii) Depreciation

Land is carried at cost and is not depreciated. Asset classes are further categorized for depreciation where significant differences in the estimated useful life of the various components of individually significant assets are identified. Depreciation is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

| | |
|---|---|
| Buildings and betterments | 7 to 30 years |
| Leasehold improvements | 3 to 10 years |
| Computer equipment | 3 to 10 years |
| Office furniture | 3 to 7 years |
| Equipment | 3 to 7 years |

The residual values and useful lives of premises and equipment are reviewed, and adjusted if appropriate, at each statement of financial position date. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount and are included in the consolidated statement of income.

(expressed in thousands of dollars)

n) Intangibles

Computer software is capitalized when the future economic benefit is expected to exceed a period of one year. Otherwise, software costs are expensed when incurred. Capitalized software costs are initially recognized at cost and amortized using the straight-line method over the expected useful life. The expected useful life ranges from 3 to 10 years.

o) Leased assets

In accordance with International Accounting Standards ("IAS") 17, *Leases*, the economic ownership of a leased asset is transferred to the lessee if the lessee bears substantially all the risks and rewards related to the ownership of the leased asset. In some cases, the lease transaction is not always conclusive, and management uses judgment in determining whether the lease is a finance lease arrangement that transfers substantially all the risks and rewards incidental to ownership. If this determination is positive, the related asset is then recognized by the lessee at the inception of the lease at an amount equal to the lower of its fair value and the present value of the minimum lease payments. A corresponding amount is recognized as a finance lease liability.

All of the Credit Union's lease agreements are classified as operating leases. Payments on operating lease agreements are recognized as an expense on a straight-line basis over the lease term. Associated costs such as maintenance and insurance are expensed as incurred.

p) Income tax

Income tax expense comprises current and deferred taxes. Current and deferred taxes are recognized in the consolidated statement of income except to the extent that they relate to items recognized directly in members' equity or in other comprehensive income.

i) Current income tax

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

(expressed in thousands of dollars)

ii) Deferred income tax

Deferred tax is recognized with respect to temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current tax 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.

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

q) Employee benefits

The Credit Union operates various pension plans. The plans are generally funded through contributions to trustee-administered funds determined by periodic actuarial calculations. The Credit Union has both defined benefit and defined contribution plans.

i) Defined benefit pension plans

A defined benefit pension plan typically defines an amount of a pension benefit that an employee will receive on retirement, usually dependent upon one or more factors, such as age, years of service and compensation. The actuarial and investment risks of a defined benefit plan are typically primarily the responsibility of the sponsor of the plan.

The Credit Union uses the projected unit credit method to determine the present value of its defined benefit pension obligations and the related current service cost and, where applicable, past service cost. The defined benefit obligation is calculated on an annual basis by the appointed independent actuary to the respective defined benefit plans. This requires the Credit Union to determine the benefit attributable to the current and prior periods and to make estimates about demographic and financial variables that will affect the ultimate cost of the benefit. The present value of the defined benefit obligation of the respective plan is determined by discounting the estimated future cash flow outflows using interest rates of high quality corporate bonds that are denominated in Canadian dollars and that have terms to maturity approximating the terms of the respective related defined benefit plan liability.

For funded plans, the Credit Union recognizes the fair value of the plan assets in accordance with the requirements of IFRS 13 for fair value measurements. Financial instruments such as quoted equities are valued using closing prices.

(expressed in thousands of dollars)

The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus on an individual plan basis. If a plan surplus exists, the fair value of the plan assets recognized on the Credit Union's consolidated statement of financial position is limited to the amount from which the Credit Union can derive a future economic benefit.

The Credit Union recognizes the service cost of the respective plans in salaries and employee benefits. The service cost principally comprises the current service cost representing the increase in the present value of the defined benefit obligation from employee service in the current period and the past service cost representing the changes in the present value of the defined benefit obligation from a plan amendment or curtailment.

The Credit Union recognizes the net interest on the defined benefit liability (asset) directly in the consolidated statement of income.

Re-measurements of the defined benefit asset (obligation) are recognized immediately in other comprehensive income and are transferred into other reserves within the consolidated statement of changes in members' equity. Re-measurements principally consist of actuarial gains and losses, the return on plan assets excluding amounts incorporated into the net interest on the net defined benefit asset (obligation) and any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit asset (obligation).

ii) Post-employment health care benefits

The Credit Union operates a post-employment health care benefit plan. The method of accounting, assumptions and the frequency of valuations are similar to those used for defined benefit pension plans.

iii) Defined contribution pension plans

For defined contribution plans, the Credit Union pays a specified flat rate for employer contributions. The Credit Union has no further payment obligations once the contributions have been paid. The contributions are recognized as an employee benefit expense on an accrual basis in the periods during which services are rendered by employees.

(expressed in thousands of dollars)

iv) Participation in multi-employer pension plan

The Credit Union provides defined retirement benefits to certain employees through a multi-employer plan administered by Central 1. There are two divisions within this multi-employer plan, a 1.75% division and a 1.20% division. The Credit Union is the only remaining participant in the 1.20% division of the plan, whereas a number of member credit unions continue to participate in the 1.75% division of the plan. Within these consolidated financial statements, the Credit Union accounts for the 1.75% division of the plan as a defined contribution pension plan, and the 1.20% division of the plan as a defined benefit pension plan.

Each member credit union of the 1.75% division of the multi-employer plan is exposed to the actuarial risks of the other employers with the result that, in the Credit Union's opinion, there is no reasonable way to allocate any defined benefit obligations. As this is a multi-employer plan, the assets and liabilities are pooled and assets are not tracked separately by participating employer. Although the actuaries may be able to determine a breakdown of the current liabilities based on each employer's individual demographic profile and allocate a proportionate share of the assets based on the solvency ratio of the entire plan, the plan does not track accumulated contributions and investment earnings for each employer. As this is a multi-employer plan, the plan exposes individual participating employers to the common actuarial risks of all of the defined benefit plan members within the 1.75% division. As a result, the Credit Union is not able to determine the extent to which it may be liable to the plan for other member entities' obligations under the terms and conditions of the plan. There is also no indication of the level of participation in the plan by the Credit Union compared with other participating entities. Accordingly, the Credit Union's participation in the 1.75% division of the plan is accounted for as a defined contribution plan with contributions recorded on an accrual basis. The Credit Union has provided additional disclosure on the overall funding status of the multi-employer plan and future contribution levels in note 14(h).

r) Related parties

A related party is a person or an entity that is related to the Credit Union.

i) A person or a close member of that person's family is related to the Credit Union if that person:

1) has control or joint control over the Credit Union, with the power to govern the Credit Union's financial and operating policies;

2) has significant influence over the Credit Union, participating in financial or operating policy decisions, but not control over these policies; or

3) is a member of the key management personnel of the Credit Union. Key management personnel, consistent with the definition under IAS 24, *Related Party Disclosures*, are persons having authority and responsibility for planning, directing and controlling the activities of the Credit Union, directly or indirectly. Key management personnel for the Credit Union are comprised of the Board and executive management.

(expressed in thousands of dollars)

An entity is related to the Credit Union if any of the following conditions apply:

1) the entity and the Credit Union are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);

2) one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group, of which the other entity is a member);

3) both entities are joint ventures of the same third party;

4) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;

5) the entity is a post-employment benefit plan for the benefit of employees of either the Credit Union or an entity related to the Credit Union;

6) the entity is controlled or jointly controlled by a person identified in (i) above; or

7) a person identified in (i)(1) above has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

s) 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, where appropriate, the risks specific to the liability.

A provision for onerous contracts is recognized when the expected benefits to be derived by the Credit Union from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Credit Union recognizes any impairment loss on the assets associated with the contract.

(expressed in thousands of dollars)

t) Equity and non-equity shares

Upon opening an account at the Credit Union, new members are required to purchase a minimum of 25 Class A Membership equity shares (junior members - five shares). Class A Membership equity shares are redeemable on demand by the member. Periodically, members may purchase Class F, G, H or I Preferred shares, as authorized by the Board, which are redeemable at the end of the time periods stated for that particular class of share. Accordingly, these classes of shares are recorded as member deposit shares.

Class A Membership, Class C Investment, Class D Insured, Class E Equity, and Preferred shares of the Credit Union are not subject to guarantee by the Credit Union Deposit Insurance Corporation of British Columbia ("CUDIC"). No Class H or I Preferred shares are issued. Dividends may be declared annually on Class A Membership, Class C Investment, Class E Equity and Preferred shares at the discretion of the Board.

Members, periodically, as authorized by the Board, are permitted to purchase Class C Investment and Class E Equity shares. Redemption of Class C Investment and Class E Equity shares is subject to certain conditions and approval of the Board. Accordingly, they are recorded as members' equity.

During the year ended December 31, 2016 all Class E, F, and G Shares were redeemed or matured.

u) Current year changes in accounting policies

Annual Improvements 2012-2014

The IASB issued Annual Improvements to IFRS 2012-2014 cycle on September 25, 2014. The amendments affect IFRS 5, IFRS 7, IAS 19 and IAS 34 and apply for annual periods beginning on or after January 1, 2016. The Credit Union has determined that the amendments to IFRS 5, IAS 19, and IAS 34 are not applicable; however, amendments to IFRS 7 are applicable as follows:

i) IFRS 7 - Financial instruments: Disclosure

Servicing contracts: If an entity transfers a financial asset to a third party under conditions which allow the transferor to derecognise the asset, IFRS 7 requires disclosure of all types of continuing involvement that the entity might still have in the transferred assets. IFRS 7 provides guidance on what is meant by continuing involvement and guidance to help management determine whether the terms of an arrangement to service a financial asset which has been transferred constitute continuing involvement. The amendment is prospective with an option to apply retrospectively. A consequential amendment to IFRS 1 is included to give the same relief to first-time adopters.

As a result of the above, the Credit Union has provided additional disclosures on servicing contracts and continuing involvement in note 6.

There were no other current year changes in accounting policies that had a significant effect on the Credit Union's consolidated financial statements.

(expressed in thousands of dollars)

v) Standards and interpretations issued but not yet effective

A number of standards and interpretations, and amendments thereto, have been issued by the IASB that are not effective for these consolidated financial statements. The Credit Union has not adopted any standards that are not yet effective but are eligible for early adoption. Those expected to have an effect on the Credit Union's consolidated financial statements are discussed below:

i) IFRS 9 - Financial Instruments

IFRS 9 was issued in 2009 and addresses classification and measurement of financial assets and financial liabilities. The final version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains three primary measurement categories for financial assets: amortized cost, fair value through other comprehensive income and fair value through profit or loss. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option to recognize changes in fair value with no recycling of gains or loss to the income statement.

IFRS 9 requires credit losses to be recognized on a single, forward looking expected loss impairment model rather than using an incurred loss model. At initial recognition, an allowance of a 12-month Expected Credit Loss (ECL) will be required for defaults that may occur within the next 12 months. If these assets experience a significant change in credit risk, an increase in the allowance to a lifetime ECL is required, which is meant to recognize expected loss over the remaining life of the financial instrument. The determination of whether or not a significant change in credit risk has occurred will incorporate all currently available information as well as any forecasts of future economic conditions or events and is conducted at each reporting period. As a result, management expects that the provision impairment charge will be more volatile and may be higher than was previously recorded under IAS 39.

For financial liabilities, there were no changes to classification and measurement except for the recognition of changes in credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss.

IFRS 9 also relaxes the requirements for hedge effectiveness by replacing the current effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually uses for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39.

The standard is effective for accounting periods beginning on or after January 1, 2018. Amendments to IFRS 7, *Financial Instruments - Disclosure*, will also be effective on adoption of IFRS 9. The Credit Union continues to assess the full impact of IFRS 9.

(expressed in thousands of dollars)

ii) IFRS 15 - Revenue from Contracts with Customers

In September 2015, the IASB issued an amendment to IRFS 15, *Revenue from Contracts with Customers*, to defer the effective date by one year to 2018. A further amendment was issued in April 2016 to clarify guidance on identifying performance obligations, licenses of intellectual property and principal versus agent, and to provide additional practical expedients on transition. IFRS 15 deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18, *Revenue,* and IAS 11, *Construction Contracts,* and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2018 and earlier application is permitted. The Credit Union is in the process of assessing the impact of IFRS 15.

iii) IFRS 16 - Leases

IFRS 16 was issued in January 2016 and replaces current guidance in IAS 17. Under IAS 17, lessees are required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 requires lessees to recognize a lease liability reflecting future lease payments and a 'right-of-use asset' for virtually all contracts. For lessors the accounting stays almost the same as IAS 17. The standard is effective for accounting periods beginning on or after January 1, 2019. The Credit Union is in the process of assessing the impact of IFRS 16.

iv) IAS 12 - Income Taxes

In January 2016, the IASB issued amendments to clarify the requirements for recognising deferred tax assets on unrealised losses. The amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. They also clarify certain other aspects of accounting for deferred tax assets. The amendments are effective from January 1, 2017, and early adoption is permitted. The Credit Union is in the process of assessing the impact of such amendments to IAS 12.

v) IAS 7 - Statements of Cash Flows

In January 2016, the IASB also issued an amendment to IAS 7 introducing an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. This amendment is part of the IASB's disclosure initiative, which continues to explore how financial statement disclosures can be improved, and is issued at response to requests from investors for information that helps them better understand changes in an entity's debt. The amendments are effective from January 1, 2017, and early adoption is permitted. The Credit Union is in the process of assessing the impact of such amendments to IAS 7.

(expressed in thousands of dollars)

## 4 Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Credit Union's accounting policies. Change in assumptions may have a significant impact on the consolidated financial statements in the period the assumptions changed. The principal areas involving a higher degree of judgment or complexity and/or areas which require significant estimates are described below:

a) Allowance for credit losses on loans to members

The Credit Union regularly reviews its loan portfolio for impairment. In determining whether an impairment loss should be recorded in the consolidated statement of income, the Credit Union makes judgments as to whether there is any observable data indicating an impairment trigger followed by a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified within that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of members in a group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows.

Management also uses estimates for the consideration of key variables within the loan loss allowance methodology, including the probabilities of future member defaults considering historic trends, the estimated loss identification period between impairment occurring and losses being identified and evidenced by the establishment of an appropriate allowance, and also the incorporation of a qualitative adjustment for management's judgement as to whether current economic conditions that exist at the reporting date (but which are not present in the data sets used to establish the various metrics underlying the loan loss) could cause the actual level of inherent losses to be greater or less than those suggested by historic experience.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed annually to reduce any difference between loss estimates and actual loss experience. Were the net present value of estimated cash flows to differ by +/-1%, the impairment loss is estimated to be $52 (2015 - $86) higher or lower. The Credit Union has disclosed the allowance for credit losses on loans to members in note 5.

b) Fair values of financial instruments

The fair values of financial instruments where no active market exists or where quoted prices are not otherwise available are determined using specific valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or by using models. Where market observable inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by management. To the extent practicable, models make maximum of market observable data; however, areas such as credit risk (both the Credit Union's credit risk and counterparty risk) and correlations require management to make estimates. The Credit Union has disclosed the fair values of financials instruments in note 25.

(expressed in thousands of dollars)

c) Securitizations and derecognition of transferred financial instruments

The Credit Union transfers residential mortgages to an independent third party either directly or through an initial transfer to intermediary financial institutions that are eligible, authorized transferors approved by the third party.

Depending on the contractual arrangements, the Credit Union may not derecognize the securitized residential mortgages and may instead recognize a secured borrowing; may recognize only a portion of the assets up to the Credit Union's remaining involvement in those assets; or may derecognize the assets and recognize, as separate assets or liabilities, any rights and obligations constituted or retained in the transfer. In assessing the derecognition criteria, management is often required to make judgments as to the extent to which cash flows are transferred and any continuing exposure to risks and rewards of the transferred receivables. The Credit Union has provided additional disclosures concerning the accounting treatment for securitization transactions during the year in note 6.

d) Retirement benefits

The present value of retirement benefit obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. Any changes in these assumptions will impact the carrying amount of pension obligations.

One of the assumptions used in determining the net cost for retirement benefit plans is the discount rate. The Credit Union determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Credit Union considers the 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. Other key assumptions for pension obligations are based in part on current market conditions. The Credit Union has provided additional disclosures concerning the accounting treatment of retirement benefits during the year in note 14.

e) Income taxes

The Credit Union computes an effective tax rate which includes an evaluation of the current and future availability of the credit union deduction under the Canadian Income Tax Act and the small business income tax rate under the British Columbia Income Tax Act. The credit union deduction and the BC small business income tax rate apply to credit unions on taxable income of the credit union until such time as 4/3 of 5% of the amounts owing to members (including deposits, members' shares and other borrowings) (the "maximum cumulative reserve") exceeds the cumulative taxable income that was previously subject to the credit union deduction (the "preferred rate amount") of the credit union. An estimate of future deposit, member borrowing, share and income growth is based on the modeling of the Credit Union's business plan, inclusive of economic indicators, and provides the basis in determining the availability of the credit union deduction and the credit union small business income tax rate.

(expressed in thousands of dollars)

In 2013, the Canadian Income Tax Act was amended to phase out the credit union deduction available to credit unions over five years. The preferential treatment will be reduced to 80% for 2016, 60% for 2017, 40% for 2018, 20% for 2019 and 0% for 2020 and later years.

The credit union deduction and the BC small business income tax rate are taken into account to determine the effective tax rate used in computing the income tax provision. However, the actual amounts of income tax expense do not become known until the filing with and assessment of the income tax return by the relevant tax authorities, which occurs subsequent to the issuance of the consolidated financial statements. To the extent that estimates differ from the final tax returns, net income would be affected in the subsequent year.

The Credit Union periodically assesses its liabilities and contingencies related to income taxes for all years open to audit based on the latest information available. For matters where it is probable that an adjustment will be made, the Credit Union records its best estimate of the tax liability including the related interest and penalties in the current tax provision. The Credit Union has disclosed the accounting treatment for income tax for the year in note 20.

## 5 Loans to members

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Personal Banking | | |
| Residential mortgages (note 6) | 1,589,258 | 1,394,872 |
| Loans | 383,120 | 357,569 |
| Business Banking mortgages and loans | 690,469 | 570,309 |
| Net deferred transaction fees and related costs | 2,791 | 2,875 |
| Accrued interest | 3,584 | 3,358 |
| | 2,669,222 | 2,328,983 |
| Less: Allowance for credit losses | (4,046) | (5,046) |
| | 2,665,176 | 2,323,937 |
| Current | 1,043,610 | 957,549 |
| Non-current | 1,621,566 | 1,366,388 |

(expressed in thousands of dollars)

**Reconciliation of allowance for credit losses**

| | 2016 | | | 2015 |
|---|---|---|---|---|
| | Personal Banking mortgages and loans $ | Business Banking mortgages and loans $ | Total $ | Total $ |
| Balance - Beginning of year | 1,590 | 3,456 | 5,046 | 5,259 |
| Loan write-offs | (369) | (232) | (601) | (1,713) |
| (Recovery of) provision for credit losses | (54) | (345) | (399) | 1,500 |
| Balance - End of year | 1,167 | 2,879 | 4,046 | 5,046 |
| Individual allowance | 90 | 647 | 737 | 1,293 |
| Collective allowance | 1,077 | 2,232 | 3,309 | 3,753 |
| Total allowance for credit losses | 1,167 | 2,879 | 4,046 | 5,046 |

During the year, the Credit Union recorded recoveries of $330 (2015 - $192) on loans that have been previously written off. Such recoveries are included within provision for credit losses in the consolidated statement of income. The Credit Union also holds $6,577 (2015 - $6,189) in an account that is separate from the total allowance from credit losses presented above. This amount is a specific reserve and acts as a provision for its purchased loans.

**Loans to members individually impaired**

A loan is considered impaired when a counterparty has not made a payment by the contractual due date and an individual allowance for credit has been established. The following table presents the carrying value of loans that are individually impaired:

| | 2016 $ | 2015 $ |
|---|---|---|
| Personal Banking | | |
| Residential mortgages | - | 1,968 |
| Loans | 68 | 143 |
| Business Banking mortgages and loans | 1,179 | 2,007 |
| | 1,247 | 4,118 |

Included in the above is $132 (2015 - $161) of accrued interest receivable.

(expressed in thousands of dollars)

### Loans past due but not impaired

A loan is considered past due when a counterparty has not made a payment by the contractual due date. The following table presents the carrying value of loans that are past due but not classified as impaired because they are either:

i) less than 90 days past due and there is no information that an impairment event has occurred; or

ii) fully secured and collection efforts are reasonably expected to result in repayment.

Loans that are past due but not impaired are as follows:

| | 2016 | | | | 2015 |
|---|---|---|---|---|---|
| | 1-29 days $ | 30-89 days $ | 90 days and greater $ | Total $ | Total $ |
| Personal Banking | | | | | |
| Residential mortgages | 11,415 | 829 | 708 | 12,952 | 11,888 |
| Loans | 258 | 48 | - | 306 | 515 |
| Business Banking mortgages and loans | 1,561 | 166 | 277 | 2,004 | 3,095 |
| | 13,234 | 1,043 | 985 | 15,262 | 15,498 |

The fair value of the collateral held by the Credit Union as security for individually impaired and past due loans was $29,715 (2015 - $32,436). The Credit Union has estimated the fair value of collateral based on an updated assessment of the security appraisals undertaken at the original funding assessment or management's knowledge of the fair value of security.

The principal collateral and other credit enhancements the Credit Union holds as security for loans include:

i) insurance and mortgages over residential lots and properties;

ii) recourse to business assets such as real estate, equipment, inventory and accounts receivable;

iii) recourse to the Business Banking real estate properties being financed; and

iv) recourse to liquid assets, guarantees and securities.

Valuations of collateral are updated periodically depending on the nature of the collateral. The Credit Union has policies in place to monitor the existence of undesirable concentration in the collateral supporting its credit exposure.

(expressed in thousands of dollars)

## 6 Loan securitizations and other transfers

### Transferred financial assets that are not derecognized in their entirety

The Credit Union securitizes insured residential mortgages by participating in the National Housing Authority ("NHA") Canada Mortgage Bond ("CMB") and Mortgage-Backed Securities ("MBS") programs. Through the programs, the Credit Union issues securities backed by residential mortgages that are insured against borrower's default. Once the mortgages are securitized, the Credit Union assigns underlying mortgages and/or related securities to Canada Mortgage and Housing Corporation ("CMHC").

During the year, the Credit Union entered into transfer agreements which were reviewed in order to determine whether the transfers of financial assets should result in all or a portion of the transferred mortgages being derecognized from its consolidated statement of financial position. The derecognition requirements include an assessment of whether the Credit Union's rights to contractual cash flows have expired or have been transferred or whether an obligation has been undertaken by the Credit Union to pay the cash flows collected on the underlying transferred assets over to a third party. The derecognition standards also include an assessment of whether substantially all the risks and rewards of ownership have been transferred.

The Credit Union has determined that an amount of $210,936 (2015 - $74,011) raised from securitization transactions during the year should be accounted for as a secured borrowing as the Credit Union did not transfer substantially all of the risks and rewards of ownership, principally because it did not transfer prepayment, interest and credit risk of the mortgages in the securitization. At December 31, 2016, the Credit Union had $331,660 (2015 - $194,149) of residential mortgages which had been securitized and included on the consolidated statement of financial position as the securitization transactions did not meet the requirements for derecognition. The total carrying amount of the original loans securitized as at December 31, 2016 was $451,217 (2015 - $261,105) at the point of initial securitization. These loans are held as security for the secured borrowings (note 11). As a result of the transactions, the Credit Union receives the net differential between the monthly interest receipts of the mortgages and the interest expense on the borrowings. The exposure to variability of future interest income and expense has been incorporated into the Credit Union's interest rate sensitivity calculations in note 22.

(expressed in thousands of dollars)

The following table shows the carrying amounts of assets and liabilities relating to securitization transactions which have not been derecognized:

| | Loans and receivables | |
|---|---|---|
| | **2016** **$** | **2015** **$** |
| Carrying amount of assets | 404,352 | 240,230 |
| Carrying amount of associated liabilities | (411,532) | (248,113) |
| Carrying amount of derivatives | 1,722 | 3,653 |
| **For those liabilities that have recourse only to the transferred assets:** | | |
| Fair value of assets | 411,336 | 247,017 |
| Fair value of associated liabilities | (411,532) | (248,113) |
| Fair value of associated derivatives | 1,722 | 3,653 |
| **Net position** | (3,932) | (1,673) |

### Transferred financial assets that are derecognized

During 2015, the Credit Union entered into a whole loan sale agreement with Central 1 to sell a pool of $19,772 CMHC insured mortgages. The Credit Union received proceeds of $20,030 and recognized a net gain of $258 (note 17) in the consolidated statement of income. The Credit Union transferred all rights and obligations to the interest and principal from these mortgages and retains no prepayment, credit and interest rate risk. The Credit Union continues to service these mortgages and remit any associated net cash flow to Central 1. There were no whole loan sales during 2016. The Credit Union received $69 (2015 - $77) in servicing revenues that was recorded in Other Income. Cumulatively, as of December 31, 2016 the Credit Union has received $171 in servicing revenues from the continuing involvement in these assets (2015 - $131). The Credit Union has determined that its maximum exposure to loss from its continuing involvement in these loans would be the lost servicing revenue of $78 (2015 - $141). The following table describes the mortgages to be collected by the Credit Union on behalf of Central 1:

**2016**

| | Maturity of continuing involvement | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Total** **$** | **Within 3 months** **$** | **3-6 months** **$** | **6 months - 1 year** **$** | **1-3 years** **$** | **3-5 years** **$** | **More than 5 years** **$** |
| **Type of continuing involvement** | | | | | | | |
| Securitized loans | 25,269 | - | - | 9,594 | 15,675 | - | - |

(expressed in thousands of dollars)

**2015**

| | | | | | | | Maturity of continuing involvement |
|---|---|---|---|---|---|---|---|
| | Total $ | Within 3 months $ | 3-6 months $ | 6 months - 1 year $ | 1-3 years $ | 3-5 years $ | More than 5 years $ |
| **Type of continuing involvement** | | | | | | | |
| Securitized loans | 30,204 | - | - | - | 12,794 | 17,410 | - |

## 7 Investments

(expressed in thousands of dollars except for number of shares and value per share)

| | 2016 $ | 2015 $ |
|---|---|---|
| Central 1 equity shares and accrued dividends | 11,603 | 10,423 |
| Government backed securities | 2,505 | 12,850 |
| Government backed securities - reinvestment account (note 11) | 72,692 | 46,081 |
| Other investments | 9,545 | 1,569 |
| | 96,345 | 70,923 |
| Current portion | 65,237 | 23,112 |
| Non-current portion | 31,108 | 47,811 |

Included in Central 1 equity shares and accrued dividends are 88,587 Class E Central 1 shares issued with a par value of $0.01 each, redeemable at $100 each at the option of Central 1. There is no separately quoted market value for these shares and the fair value cannot be reasonably determined. The timing of redemption of these shares cannot be determined; therefore the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed. As a result, the Class E shares are recorded at cost.

(expressed in thousands of dollars)

## 8 Property, premises and equipment

| | Office equipment $ | Office furniture $ | Leasehold improvements $ | Land and buildings $ | Automotive equipment $ | Total $ |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| As at December 31, 2014 | 11,973 | 1,691 | 10,547 | 1,484 | 32 | 25,727 |
| Additions | 1,651 | 38 | 278 | 8 | 40 | 2,015 |
| Disposals | (1,489) | (2) | - | - | (32) | (1,523) |
| As at December 31, 2015 | 12,135 | 1,727 | 10,825 | 1,492 | 40 | 26,219 |
| Additions | 2,042 | 21 | 400 | 9 | - | 2,472 |
| Disposals | (1,593) | (4) | (91) | (90) | - | (1,778) |
| As at December 31, 2016 | 12,584 | 1,744 | 11,134 | 1,411 | 40 | 26,913 |
| **Depreciation and impairment** | | | | | | |
| As at December 31, 2014 | 9,802 | 1,507 | 7,741 | 6 | 32 | 19,088 |
| Disposals | (1,483) | (2) | - | - | (32) | (1,517) |
| Depreciation charge for the year | 885 | 35 | 768 | 43 | 2 | 1,733 |
| As at December 31, 2015 | 9,204 | 1,540 | 8,509 | 49 | 2 | 19,304 |
| Disposals | (1,585) | (4) | (89) | - | - | (1,678) |
| Depreciation charge for the year | 1,071 | 39 | 635 | 43 | 4 | 1,792 |
| As at December 31, 2016 | 8,690 | 1,575 | 9,055 | 92 | 6 | 19,418 |
| **Carrying amounts** | | | | | | |
| As at December 31, 2015 | 2,931 | 187 | 2,316 | 1,443 | 38 | 6,915 |
| As at December 31, 2016 | 3,894 | 169 | 2,079 | 1,319 | 34 | 7,495 |

## 9 Other assets

| | 2016 $ | 2015 $ |
|---|---|---|
| Prepaid expenses | 3,986 | 2,345 |
| Accounts receivable | 2,012 | 1,099 |
| | 5,998 | 3,444 |
| Current portion | 3,407 | 2,011 |
| Non-current portion | 2,591 | 1,433 |

(expressed in thousands of dollars)

## 10 Intangibles

| | Software $ |
|---|---|
| **Cost** | |
| As at December 31, 2014 | 9,977 |
| Additions | 105 |
| Disposals | (31) |
| As at December 31, 2015 | 10,051 |
| Additions | 35 |
| Disposals | (3) |
| As at December 31, 2016 | 10,083 |
| **Amortization** | |
| As at December 31, 2014 | 7,159 |
| Disposals | (31) |
| Amortization charge for the year | 627 |
| As at December 31, 2015 | 7,755 |
| Disposals | (3) |
| Amortization charge for the year | 636 |
| As at December 31, 2016 | 8,388 |
| **Carrying amounts** | |
| As at December 31, 2015 | 2,296 |
| As at December 31, 2016 | 1,695 |

Remaining amortization of the carrying amounts as at December 31, 2016 is as follows:

| | $ |
|---|---|
| Within 1 year | 586 |
| 1 - 5 years | 1,109 |
| After 5 years | - |
| | 1,695 |

## 11 Borrowings

| | 2016 $ | 2015 $ |
|---|---|---|
| Lines of credit | - | 44,996 |
| Secured borrowings (note 6) | | |
| At amortized cost | 270,446 | 72,377 |
| At fair value | 141,086 | 175,736 |
| | 411,532 | 293,109 |

(expressed in thousands of dollars)

| Maturity date | Weighted average interest rate % | 2016 $ | 2015 $ |
|---|---|---|---|
| Due in 2016 | 1.74 | - | 70,086 |
| Due in 2017 | 1.88 | 46,590 | 50,207 |
| Due in 2018 | 1.68 | 46,613 | 42,284 |
| Due in 2019 | 1.79 | 75,450 | 85,690 |
| Due in 2020 | 1.20 | 41,837 | 41,837 |
| Due in 2021 | 1.29 | 199,574 | - |
| Fair value adjustment | | 1,468 | 3,005 |
| | | 411,532 | 293,109 |
| Current | | 46,590 | 70,086 |
| Non-current | | 364,942 | 223,023 |

As of December 31, 2016, the Credit Union has two approved lines of credit totalling $180,497 (2015 - $156,724).

Security provided as collateral for the line of credit facilities comprises a general assignment of loans to members, accounts receivable, and a demand debenture in favour of Central 1.

The secured borrowings arise from securitization transactions and are secured by specific pools of loans to members of $331,660 (2015 - $194,149) and government backed securities of $72,692 (2015 - $46,081) (notes 6 and 7).

## 12 Member deposits

| | 2016 $ | 2015 $ |
|---|---|---|
| Term deposits | 1,455,248 | 1,334,010 |
| Demand deposits | 807,998 | 690,530 |
| Registered savings plans | 411,037 | 402,509 |
| Member deposit shares (note 13(b)) | 4,007 | 6,440 |
| Deferred transaction costs | (163) | (183) |
| Accrued interest | 14,059 | 14,081 |
| | 2,692,186 | 2,447,387 |
| Current | 2,146,558 | 1,874,944 |
| Non-current | 545,628 | 572,443 |

(expressed in thousands of dollars)

## 13 Member deposit and members' equity shares

a) Authorized shares
(expressed in thousands of dollars except for value per share)

Unlimited number of shares with a par value and redemption value of $1 each:

Class A Membership voting equity shares
Class B Patronage voting equity shares
Class C Investment non-voting equity shares
Class D Non-equity shares

Unlimited Class E Equity voting, non-redeemable, non-cumulative shares with a par value of $1 each

Unlimited Class F, G, H and I Preferred shares. Each class of Preferred share is issuable in Series (Series 1, 2 or 3). Each Series of each class can be offered in 3-, 5-, 7- or 10-year terms. Each class of Preferred share is redeemable at the end of its term, non-voting and entitled to cumulative dividends at a rate set when issued.

b) Issued shares classified as member deposits (note 12) consist of the following:
(expressed in thousands of dollars except for number of shares)

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| 3,971,592 (2015 - 4,070,902) Class A Membership equity shares | 3,972 | 4,071 |
| 34,715 (2015 - 35,551) Class D Non-equity shares | 35 | 36 |
| Nil (2015 - 1,380,085) Class F, Series 1-3, and Class G, Series 1, 3-to-10 year Preferred shares; the shares have cumulative dividends of 5.07% to 7.00% | - | 1,380 |
| Accrued dividends on Preferred shares | - | 953 |
| | 4,007 | 6,440 |

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Class A Membership equity shares issued in the year | 183 | 186 |
| Class A Membership equity shares redeemed in the year | (282) | (365) |
| Net redemptions in the year | (99) | (179) |

The changes in Class D Non-equity shares and Class F and G Preferred shares relate to redemptions only as no shares were issued during the year ended December 31, 2016. All Class F and G Preferred shares reached maturity in 2016 and have now been fully redeemed.

(expressed in thousands of dollars)

The Class F, Series 1-3, and Class G, Series 1, 3-to-10 year Preferred shares were subject to redemption as follows:

| | 2016 $ | 2015 $ |
|---|---|---|
| 2015 | - | - |
| 2016 | - | 2,333 |
| Less: Accrued dividends | - | (953) |
| | - | 1,380 |

c) Issued shares classified as members' equity consist of the following: (expressed in thousands of dollars except for number of shares)

| | 2016 $ | 2015 $ |
|---|---|---|
| 3,509,689 (2015 - 3,602,977) Class C Investment equity shares | 3,510 | 3,603 |
| Nil (2015 - 223,000) Class E Equity shares | - | 223 |
| | 3,510 | 3,826 |

The changes in Class C Investment equity shares and Class E Equity shares relate to redemptions only as no shares were issued during the year (2015 - nil). All Class E Equity shares were fully paid out in 2016.

## 14 Pension and other retirement benefits

The Credit Union provides pension benefits to employees through defined contribution, defined benefit, supplemental retirement and multi-employer defined benefit plans. Other post-retirement benefits including health care, dental benefits or cash alternatives are provided to eligible Credit Union employees upon or after retirement.

The defined benefit plans are registered in the province of British Columbia and governed by provincial regulations and practices. They are administered by a Board of Trustees.

(expressed in thousands of dollars)

The Credit Union operates four defined benefit plans in Canada, two of which are funded plans and two are unfunded plans. The risk characteristics and assumptions are similar for all defined benefit plans. The Credit Union funds the defined benefit plans and multi-employer defined benefit plans based on actuarially prescribed amounts. The unfunded supplemental retirement and non-pension post-retirement benefits are paid by the Credit Union at the time of entitlement. The weighted average duration of the defined benefit obligation is as follows:

| | 2016 | | | 2015 |
|---|---|---|---|---|
| | **Funded plans** | **Unfunded plans** | | |
| Weighted average duration | 19 years | 8 years | 18 years | 17 years |

The unfunded portion of the defined benefit obligation is $2,456 (2015 - $3,578). The accrued benefit obligation for the supplemental retirement plan is secured by an irrevocable letter of credit issued by the Credit Union in the amount of $1,369 (2015 - $2,730).

a) Retirement benefit obligation

| | 2016 | | | 2015 |
|---|---|---|---|---|
| | **Funded plans $** | **Unfunded plans $** | **Total $** | **Total $** |
| Defined benefit obligation | (27,078) | (2,512) | (29,590) | (28,994) |
| Fair value of plan assets | 21,884 | 56 | 21,940 | 20,600 |
| Net retirement benefit obligation | (5,194) | (2,456) | (7,650) | (8,394) |
| Retirement benefit asset recognized on the consolidated statement of financial position | 571 | - | 571 | 511 |
| Retirement benefit obligation recognized on the consolidated statement of financial position | (5,765) | (2,456) | (8,221) | (8,905) |
| Net retirement benefit obligation | (5,194) | (2,456) | (7,650) | (8,394) |
| Current portion | (625) | (322) | (947) | (1,185) |
| Non-current portion | (4,569) | (2,134) | (6,703) | (7,209) |

(expressed in thousands of dollars)

The movement in the defined benefit obligation is as follows:

| | 2016 | | | 2015 |
|---|---|---|---|---|
| | Funded plans $ | Unfunded plans $ | Total $ | Total $ |
| Defined benefit obligation at January 1 | 25,369 | 3,625 | 28,994 | 28,303 |
| Current service cost (net of employee contributions) | 745 | 25 | 770 | 855 |
| Interest cost | 1,032 | 119 | 1,151 | 1,147 |
| Re-measurements - experience | 579 | 47 | 626 | (314) |
| Re-measurements - financial | - | 2 | 2 | (8) |
| Benefit payments | (647) | (1,356) | (2,003) | (989) |
| | - | 50 | 50 | - |
| Defined benefit obligation at December 31 | 27,078 | 2,512 | 29,590 | 28,994 |

b) Fair value of plan assets

i) Movement in the fair value of plan assets is as follows:

| | 2016 | | | 2015 |
|---|---|---|---|---|
| | Funded plans $ | Unfunded plans $ | Total $ | Total $ |
| Fair value of plan assets at January 1 | 20,552 | 48 | 20,600 | 18,912 |
| Interest income | 825 | - | 825 | 761 |
| Administration expenses | (78) | - | (78) | (62) |
| Re-measurements - financial | 347 | - | 347 | 604 |
| Employer contributions | 885 | 1,364 | 2,249 | 1,374 |
| Benefit payments | (647) | (1,356) | (2,003) | (989) |
| Fair value of plan assets at December 31 | 21,884 | 56 | 21,940 | 20,600 |

(expressed in thousands of dollars)

ii) Funded plan assets comprise the following:

| | Funded defined benefit plans | |
|---|---|---|
| | **2016** **%** | **2015** **%** |
| **Asset category** | | |
| Equity securities | 46 | 48 |
| Debt instruments | 29 | 29 |
| Real estate | 14 | 12 |
| Other assets | 11 | 11 |
| | 100 | 100 |

In the table above, all equity securities and bonds have quoted prices in active markets. The accrued benefit obligation and plan assets of all four defined benefit plans were actuarially measured for accounting purposes as of December 31, 2016. The effective date of the last actuarial valuation reports for funding purposes was December 31, 2015 and the effective date of the next required actuarial valuation report for funding purposes will be December 31, 2018.

The December 31, 2015 actuarial valuations, indicated, for the funded plans, a going concern unfunded liability of $788 and a solvency deficiency of $4,191. This deficit is targeted to be financed over time through increased contributions. The pension regulator has determined the period during which the solvency deficit must be funded. As approved by the regulator, the plan solvency deficit is expected to be funded by December 2025. The Credit Union paid $885 (2015 - $1,049) for employer contributions to the funded plans in fiscal year 2016. As a result of the valuation, the employer contribution rates were determined to be a flat dollar amount of $600 per annum effective January 1, 2017 rather than a percentage of payroll.

The investment policy relative to the majority of the funded plan assets reflects the Trustees' belief that the asset mix strategy should contain a combination of return enhancing and liability/duration matching investments to achieve the plan's investment return objectives and to protect the plan from significant fluctuations in the plan's solvency ratio.

The Trustees of the plan believe that the asset mix strategy should contain a combination of return enhancing and liability/duration matching investments to achieve the plan's investment return objectives and to protect the Plan from significant fluctuations in the plan's solvency ratio. The duration matching investments includes investments in long bonds while the return enhancing investments includes a diversification of investments in equities, real estate, and hedge funds.

(expressed in thousands of dollars)

The expected return on plan assets is determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the date of the consolidated statement of financial position. Expected returns on equity and property investments reflect long-term rates of return experienced in the respective markets. The actual return on plan assets for the year ended December 31, 2016 was $1,172 (2015 - $1,365).

c) Future contributions and benefit payments

The expected contributions and benefit payments for the year ending December 31, 2017 are as follows:

| | **$** |
|---|---|
| Employer contributions | 889 |
| Employee benefits | (625) |

d) The amounts recognized in the consolidated statement of income were as follows:

| | **2016 $** | **2015 $** |
|---|---|---|
| Current service cost (net of employee contributions) | 770 | 855 |
| Interest cost | 1,151 | 1,147 |
| Administration costs | 78 | 62 |
| Past service cost | 50 | - |
| Interest income | (825) | (761) |
| Total included in employee benefits expense (note 18) | 1,224 | 1,303 |

e) The amounts recognized in other comprehensive (loss) income were as follows:

| | **2016 $** | **2015 $** |
|---|---|---|
| Re-measurements in the year | (281) | 926 |
| Income tax recovery (expense) | 200 | (6) |
| Other comprehensive (loss) income related to defined benefit plans for the year | (81) | 920 |

f) The principal actuarial assumptions used, consistent for all defined benefit plans of the Credit Union, were as follows:

| | **2016 %** | **2015 %** |
|---|---|---|
| Discount rate | 4.00 | 4.00 |
| Inflation rate | 2.00 | 2.00 |
| Future salary increases | 3.00 | 3.00 |

(expressed in thousands of dollars)

The principal health care cost assumptions used in the post-retirement defined benefit plan were as follows:

| | 2016 % | 2015 % |
|---|---|---|
| Health care cost | | |
| Extended health | 8.00 | 8.00 |
| MSP | 4.00 | 4.00 |
| Dental | 3.00 | 3.00 |

For plans or portion of plans where indexing is used, future pension increase assumptions are based on 50% of the inflation rate.

Actuarial assumptions are management's best estimate assumptions. Assumptions regarding future mortality are set based on actuarial advice in accordance with published statistics and experience. Mortality assumptions, consistently for all defined benefit plans of the Credit Union, are based on the 2014 Canadian Pensioners' Mortality ("CPM") Table with 105% pension size adjustment factors and generational mortality improvements in accordance with the CPM Improvement Scale B. The projection factors are in accordance with the published table Scale AA where annual improvements range from 0.4% to 2% for males and 0.3% to 1.8% for females.

The tables translate the average post-retirement life expectancy of males to 22 years (2015 - 22 years) and females to 24 years (2015 - 24 years) for a pensioner retiring at age 65.

The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions presented below was performed by changing each assumption individually. If an actual change occurs, it is likely that some of these assumptions are correlated, which could change the combined impact.

| | 2016 % | 2015 % |
|---|---|---|
| Discount rate | | |
| Impact of: 1% increase | (4,414) | (4,349) |
| 1% decrease | 5,673 | 5,603 |
| Inflation rate | | |
| Impact of: 1% increase | 1,305 | 1,360 |
| 1% decrease | (1,196) | (1,245) |
| Future salary increases | | |
| Impact of: 1% increase | 1,047 | 1,308 |
| 1% decrease | (937) | (1,197) |
| Medical/dental trends | | |
| Impact of: 1% increase | 119 | 113 |
| 1% decrease | (104) | (99) |

(expressed in thousands of dollars)

g) Through its defined benefit plans, the Credit Union is exposed to a number of risks, the most significant of which are detailed below:

i) Investment risk

The defined benefit obligation is calculated with a discount rate. If the return on assets is lower than the discount rate, it will create a deficit.

ii) Interest rate risk

A variation in bond rates will affect the value of the defined benefit obligation.

iii) Longevity risk

A greater increase in life expectancy than the one predicted by the mortality table used will increase the defined benefit obligation.

iv) Inflation risk

The defined benefit obligation is calculated taking into account an increase in the level of salary and future cost of living adjustments. If actual inflation is greater than expected, that would result in an increase in the defined benefit obligation.

(expressed in thousands of dollars)

h) Participation in multi-employer plan

The Credit Union participates in a plan for certain eligible employees which is administered by Central 1.

The Credit Union is one of several employers that participate in the BC Credit Union Employees' Pension Plan (the "Plan"). The Plan is a multi-employer contributory defined benefit pension plan governed by a 12-member Board of Trustees. The Board of Trustees is responsible for overseeing the management of the Plan, including investment of the assets and administration of the benefits. The Plan, as at December 31, 2015, had about 3,200 active employees and approximately 760 retired plan members. Total plan assets at December 31, 2016 are estimated at $615,000 (2015 - $552,000). Every three years, an actuarial valuation is performed to assess the financial position of the Plan and the adequacy of the funding level. The most recent actuarial valuation, which was conducted as at December 31, 2015, indicated a going concern unfunded liability of $25,078 and a solvency deficiency of $123,032. The deficit is targeted to be financed over time through increased contributions, collectively, from the participating employers. The pension regulator has determined the period during which the solvency deficit must be funded. As approved by the regulator, the plan solvency deficit is expected to be funded by December 2025. The Credit Union paid $2,323 (2015 - $2,238) for employer contributions to the Plan in fiscal year 2016. Retirement benefits for the Plan are paid by the Credit Union monthly. As a result of the valuation, the contribution rates were determined to be 14.8% per annum for employer contributions based on the pensionable earnings of the respective participating employees and 2% to 10% per annum, depending on the planholder's age, for employee contributions effective January 1, 2017. The contributions continue to be expensed as invoiced by the Plan. The next actuarial valuation is scheduled for December 31, 2018.

## 15 Other liabilities

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Accounts payable and accruals | 5,124 | 4,582 |
| Deferred revenue | 50 | 61 |
| | 5,174 | 4,643 |
| Current | 4,836 | 4,275 |
| Non-current | 338 | 368 |

(expressed in thousands of dollars)

## 16 Net interest income

| | 2016 $ | 2015 $ |
|---|---|---|
| Interest income | | |
| Cash and cash equivalents | 40 | 73 |
| Interest bearing deposits | 9,977 | 9,153 |
| Financial assets | | |
| Cash flow hedges | 47 | 177 |
| Fair value through profit or loss | 91 | 3,632 |
| Available for sale investments | 194 | - |
| Held-to-maturity investments | 848 | 470 |
| Loans to members | 83,583 | 82,619 |
| | 94,780 | 96,124 |
| Interest expense | | |
| Member deposits | 32,858 | 35,076 |
| Borrowings | | |
| Lines of credit | 701 | 502 |
| Secured borrowings | 3,390 | 5,526 |
| | 36,949 | 41,104 |
| Net interest income | 57,831 | 55,020 |

## 17 Other income

| | 2016 $ | 2015 $ |
|---|---|---|
| Investment management | 5,498 | 5,387 |
| Service charges | 4,730 | 4,740 |
| Insurance commissions | 1,036 | 1,097 |
| Loan fees | 752 | 639 |
| Foreign exchange | 496 | 724 |
| Net gain on sale of investments | 132 | 560 |
| Net gain on securitization transactions (note 6) | - | 258 |
| Other | 85 | 95 |
| Gain on sale of property, premises, equipment and intangibles | - | 4 |
| | 12,729 | 13,504 |

(expressed in thousands of dollars)

## 18 Salaries and employee benefits

| | 2016 $ | 2015 $ |
|---|---|---|
| Salaries | 27,584 | 26,861 |
| Benefits | | |
| Other | 3,179 | 3,018 |
| Post-employment defined benefit plans | 59 | 76 |
| Pension costs | | |
| Defined contribution plans including multi-employer plan | 2,439 | 2,356 |
| Defined benefit plans | 1,165 | 1,227 |
| | 34,426 | 33,538 |

## 19 Other expenses

| | 2016 $ | 2015 $ |
|---|---|---|
| Deposit insurance fees | 2,138 | 1,824 |
| Professional services | 903 | 707 |
| Loan administration fees | 586 | 537 |
| Other | 471 | 523 |
| Central 1 dues | 381 | 374 |
| Loss on sale of property, premises and equipment | 10 | - |
| | 4,489 | 3,965 |

## 20 Income taxes

| | 2016 $ | 2015 $ |
|---|---|---|
| Current tax expense | 1,793 | 1,618 |
| Deferred tax expense (recovery) | 220 | (213) |
| | 2,013 | 1,405 |

(expressed in thousands of dollars)

Reconciliation of effective tax rate

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate. The income tax expense differs from the amount that would be computed by applying the combined federal and provincial statutory income tax rate of 26.00% (2015 - of 26.00%) to income before income taxes. The reasons for the differences are as follows:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Computed tax expense | 2,894 | 2,338 |
| (Decrease) increase resulting from | | |
| Preferred rate amount deduction for credit unions | (846) | (910) |
| Non-taxable items | 7 | 118 |
| Effect of tax rate changes on deferred income tax asset | (9) | (114) |
| Other | (33) | (27) |
| | 2,013 | 1,405 |

The effective tax rate for the Credit Union net of the credit union deduction was 18.4% (2015 - 15.9%). The overall tax rate was 18.1% (2015 - 15.4%). The rates reflect adjustments to the prior year tax return and provision adjustments due to more accurate information available at the time of filing the return.

Deferred income tax assets and liabilities are as follows:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Deferred income tax assets | | |
| To be recovered within 12 months | 3,204 | 3,345 |
| To be recovered after more than 12 months | 642 | 543 |
| | 3,846 | 3,888 |
| Deferred income tax liabilities | | |
| To be settled within 12 months | 773 | 842 |
| To be settled after more than 12 months | 431 | 587 |
| | 1,204 | 1,429 |
| Net deferred income tax assets | 2,642 | 2,459 |

(expressed in thousands of dollars)

The movement in deferred tax assets and liabilities is as follows:

| | December 31, 2015 $ | Recognized in profit or loss $ | Recognized in other comprehensive income $ | December 31, 2016 $ |
|---|---|---|---|---|
| Deferred income tax assets | | | | |
| Provision for credit losses | 715 | (23) | - | 692 |
| Deferred revenue | 203 | 208 | - | 411 |
| Retirement benefit obligation and severance accruals | 1,671 | (175) | 200 | 1,696 |
| Property, premises, equipment and software intangibles - differences between carrying amounts and undepreciated capital cost | 638 | (15) | - | 623 |
| Loss carry-forwards | 76 | 3 | - | 79 |
| Other | 585 | (240) | - | 345 |
| | 3,888 | (242) | 200 | 3,846 |
| Deferred income tax liabilities | | | | |
| Prepaid loan expenses | 765 | 263 | - | 1,028 |
| Other | 664 | (285) | (203) | 176 |
| | 1,429 | (22) | (203) | 1,204 |
| Net deferred income tax assets | 2,459 | (220) | 403 | 2,642 |

| | December 31, 2014 $ | Recognized in profit or loss $ | Recognized in other comprehensive income $ | December 31, 2015 $ |
|---|---|---|---|---|
| Deferred income tax assets | | | | |
| Provision for credit losses | 580 | 135 | - | 715 |
| Deferred revenue | 148 | 55 | - | 203 |
| Retirement benefit obligation and severance accruals | 1,648 | 29 | (6) | 1,671 |
| Property, premises, equipment and software intangibles - differences between carrying amounts and undepreciated capital cost | 562 | 76 | - | 638 |
| Loss carry-forwards | 68 | 8 | - | 76 |
| Other | 281 | 304 | - | 585 |
| | 3,287 | 607 | (6) | 3,888 |
| Deferred income tax liabilities | | | | |
| Prepaid loan expenses | 742 | 23 | - | 765 |
| Other | 315 | 371 | (22) | 664 |
| | 1,057 | 394 | (22) | 1,429 |
| Net deferred income tax assets | 2,230 | 213 | 16 | 2,459 |

(expressed in thousands of dollars)

## 21 Commitments and contingent liabilities

### Commitments

*Leases*

The Credit Union's premises are leased for varying terms and the majority of the leases are renewable at the end of the lease period at market rate. Lease payments included in occupancy expense amounted to $5,702 (2015 - $5,526). Future minimum lease commitments under non-cancellable operating leases are as follows:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Due in < 1 year | 5,575 | 5,814 |
| Due in 2-5 years | 15,504 | 18,258 |
| Due in > 5 years | 5,453 | 7,802 |
| | 26,532 | 31,874 |

The Credit Union has entered into non-cancellable sublease agreements of three premises leased by the Credit Union. The Credit Union expects to receive the following minimum sublease payments under these non-cancellable sublease arrangements:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Due in < 1 year | 50 | 48 |
| Due in 2-5 years | 91 | 141 |
| Due in > 5 years | - | - |
| | 141 | 189 |

*Letters of credit and other guarantees*

In the normal course of business, the Credit Union has outstanding letters of credit issued on behalf of members totalling $16,158 (2015 - $11,590), which are secured by member term deposits or property mortgages.

*Undrawn loan commitments to members*

Refer to note 22.

### Contingent liabilities

In the course of its business, various claims and legal proceedings may arise against the Credit Union. The Credit Union defends itself where appropriate and is currently of the opinion that it is likely to prevail; accordingly, no provision has been made in these consolidated financial statements.

(expressed in thousands of dollars)

## 22 Risk management

The Credit Union's risk management framework is designed to ensure that the outcomes of risk-taking activities are consistent with its strategies and risk appetite, and that there is an appropriate balance between risk and reward in order to maximize Credit Union returns. Risk management is carried out by a number of delegated committees reporting to the Board. The Board has overall responsibility for the establishment and oversight of the Credit Union's risk management framework. In addition, the Credit Union maintains an internal audit function, which is responsible for independent review of risk management and the Credit Union's control environment.

The risk management framework is subject to constant evaluation to ensure that it meets the challenges and requirements of the markets in which the Credit Union operates, including regulatory standards and industry best practices.

The Credit Union's risk management framework is applied on an enterprise wide basis and consists of three key elements:

a) Risk governance - a set of tools, policies and processes that the Credit Union has in place to identify, measure and manage its risks;

b) Risk appetite - outlines the amount and type of risk the Credit Union is willing to accept in order to pursue its strategic plan, providing an overview of the Credit Union's tolerance for risk which defines the boundaries within which risk-based decision-making can occur;

c) Risk management techniques - as guided by the Credit Union's risk appetite framework are integrated with the Credit Union's strategies and business planning process and include the following:

   i) Strategies, policies and limits

   ii) Guidelines, process and standards

   iii) Measurement, monitoring and reporting

Financial instruments comprise the majority of the Credit Union's assets and liabilities. The Credit Union accepts deposits from members at both fixed and floating rates for various periods and seeks to earn an interest rate margin by investing these funds in high quality financial instruments - principally mortgages. The primary types of financial risks that arise from these activities are credit, liquidity and market risk in the form of interest rate risk.

a) Credit risk

   Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to honour its financial and contractual obligations to the Credit Union. Credit risk arises in the Credit Union's direct lending operations, funding and investment activities where counterparties have repayment or other obligations to the Credit Union.

(expressed in thousands of dollars)

i) Management of credit risk

The effective management of credit risk requires the establishment of an appropriate credit risk culture. Key credit risk policies and credit risk management strategies are important elements used to create this culture. The Board of Directors, both directly and through executive and board committees, reviews and approves the Credit Union's credit risk strategy and credit risk policy on an annual basis. The objectives of the credit risk strategy are to ensure that:

1) Target markets and product offerings are well defined at both the organizational and lines of business levels;

2) The risk parameters for new underwritings and for the portfolios as a whole are clearly specified; and

3) Transactions, including origination, syndication, loan sales and hedging, are managed in a manner that is consistent with the Credit Union's risk appetite.

The credit risk policy articulates the credit risk management framework, including:

1) Key credit risk management principles;

2) Delegation of authority;

3) The credit risk management program;

4) Aggregate limits, beyond which credit applications must be escalated to the Board for approval; and

5) Single name/aggregation exposures, beyond which exposures must be reported to the Board.

Management develops the credit risk management framework and policies that detail, among other things, the credit risk rating systems and associated parameter estimates; the delegation of authority for granting credit; the calculation of the allowance for credit losses; and the authorization of write-offs.

The Credit Union regularly reviews the various segments of the credit portfolio on an enterprise-wide basis to assess the impact of economic trends or specific events on the performance of the portfolio, and to determine whether corrective action is required. These reviews include the examination of the risk factors for particular products and industries. The results of these reviews are reported to the senior management and, when significant, to the Board.

(expressed in thousands of dollars)

Concentration of loans is managed by the implementation of sectoral and member specific limits as well as the periodic use of syndications with other financial institutions to limit the potential exposure to any one member.

ii) Credit risk exposure

The following table represents the maximum exposure to credit risk before taking into consideration any collateral. For financial assets recognized on the consolidated statement of financial position, the exposure to credit risk is their stated carrying amount. For loan commitments, the maximum exposure is the full amount of the committed facility including drawn and undrawn balances.

| | 2016 | | | 2015 |
|---|---|---|---|---|
| **Credit risk exposure** | **Outstanding $** | **Undrawn commitments $** | **Total exposure $** | **Total exposure $** |
| Cash and cash equivalents | 31,899 | - | 31,899 | 6,481 |
| Interest bearing deposits | 436,254 | - | 436,254 | 457,533 |
| Personal Banking | | | | |
| Mortgages | 1,590,508 | 81,840 | 1,672,348 | 1,444,840 |
| Loans | 200,781 | 507 | 201,288 | 178,206 |
| Line of credit and overdraft | 181,089 | 267,042 | 448,131 | 396,877 |
| Business Banking | | | | |
| Mortgages | 633,987 | 75,969 | 709,956 | 541,963 |
| Loans | 29,704 | 30 | 29,734 | 48,624 |
| Line of credit and overdraft | 26,778 | 55,158 | 81,936 | 81,365 |
| Accrued interest on loans | 3,584 | - | 3,584 | 3,358 |
| Derivative financial instruments | 1,959 | - | 1,959 | 4,798 |
| Investments | 96,345 | - | 96,345 | 70,923 |
| Accounts receivable | 2,012 | - | 2,012 | 1,099 |
| Total exposure | 3,234,900 | 480,546 | 3,715,446 | 3,236,067 |

The classes of financial instruments to which the Credit Union is most exposed are loans to members, cash resources and derivatives. The Credit Union often takes collateral as security in common with other lending institutions.

For the Personal Banking loan portfolio (residential and consumer loans), the Credit Union's underwriting methodologies and risk modelling are member based rather than product based. As such, the Credit Union reviews the member's capacity to repay the loan rather than relying exclusively on collateral; although, it is an important mitigant of establishing credit risk. Decisions on consumer loans are based on an overall assessment of credit risk utilizing a scoring model that takes into account factors such as Beacon scores and debt levels relative to income.

Personal Banking mortgages which represent the largest potential exposure are supported by collateral in the form of residential property which is often also used as security for Personal Banking loans.

(expressed in thousands of dollars)

The credit quality of the Business Banking loan portfolio for those loans that are neither past due nor impaired can be assessed by reference to the Credit Union's internal rating system. The Credit Union assesses the quality of Business Banking loans using an internal rating tool taking into consideration a number of factors, such as the security, the borrower's management performance, current and projected financial results and industry statistics related to the borrower's industry, and utilizes the experience and judgment of the Credit department. Business Banking loans are divided into segments based on the following rating system and are regularly reviewed and updated as appropriate.

The following table represents the Business Banking loan portfolio for those loans that are neither past due nor impaired.

| **Risk rating** | | **2016** **$** | **2015** **$** |
|---|---|---|---|
| 1 - 2 | Excellent to very good | 46,323 | 31,181 |
| 3 | Satisfactory | 637,293 | 528,844 |
| 4 - 5 | Less than satisfactory to poor | 4,019 | 5,454 |
| | | 687,635 | 565,479 |

b) Liquidity risk

Liquidity risk is the risk that the Credit Union is unable to meet its financial obligations in a timely manner as they fall due. The Credit Union will at all times maintain statutory liquidity levels with Central 1 as required by regulations. Included in cash and cash equivalents and interest bearing deposits are the minimum liquidity threshold cash resources of $248,098 (2015 - $219,207).

Accordingly, the Credit Union has policies and procedures in place to manage its liquidity position to comply with both regulatory requirements and sound business practices.

i) Management of liquidity risk

Effective liquidity risk management is essential in order ensure that the Credit Union maintains sufficient liquidity to meet its liabilities when due, to manage the cost of funds, and to enable the lines of business to continue to generate revenue, even under adverse circumstances.

Liquidity risk is managed within and on both an operational and strategic level on a total Credit Union basis and is approved by the Board of Directors. The desired liquidity level above the statutory requirement is determined by taking into account the balance between the cost of liquidity and the yield achieved. Contingency liquidity is managed by having a plan in place that can be invoked very quickly, as well as having a diversity of funding sources arranged that can be accessed when needed.

The Board receives reports on risk exposures and performance against approved limits. Oversight of liquidity risk is achieved through the Asset and Liability Committee ("ALCO") who meet regularly to review the Credit Union's liquidity profile.

(expressed in thousands of dollars)

The key elements of liquidity risk management are measurement and modeling, reporting, stress testing, contingency planning and funding diversification.

ii) Liquidity risk exposure

The following table showing cash flows associated with remaining contractual maturities represents the Credit Union's exposure to liquidity risk.

| | Less than 1 year $ | 1 - 3 years $ | 4 - 5 years $ | Total $ |
|---|---|---|---|---|
| **2016** | | | | |
| Member deposits | 2,146,558 | 493,303 | 52,325 | 2,692,186 |
| Borrowings | | | | |
| Secured borrowings | 46,590 | 122,063 | 242,879 | 411,532 |
| Derivative liabilities | 896 | - | - | 896 |
| **2015** | | | | |
| Member deposits | 1,874,944 | 541,830 | 30,613 | 2,447,387 |
| Borrowings | | | | |
| Money market loans | 44,996 | - | - | 44,996 |
| Secured borrowings | 25,090 | 92,490 | 130,533 | 248,113 |
| Derivative liabilities | 989 | - | - | 989 |

c) Market risk

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates and credit spreads will affect the Credit Union's income or the value of its holdings of financial instruments.

The Board of Directors reviews and approves market risk policies and limits annually. The application of the framework and monitoring of the Credit Union's market risk exposures and the activities that give risk to these exposures are overseen through the ALCO. The Credit Union establishes specific operating policies and sets limits at the product, portfolio, line of business and corporate-wide levels which are reviewed at least annually.

The principal market risk to which the Credit Union is exposed is interest rate risk.

i) Interest rate risk

Interest rate risk is the risk that the future cash flows or value of the Credit Union's financial instruments will fluctuate due to changes in market interest rates. Interest rate risk arises when there is variability or a mismatch in the timing of maturing and repricing assets and liabilities.

(expressed in thousands of dollars)

1) Interest rate risk management

The primary objective of interest rate risk management is to manage exposure to the risk within controllable and acceptable levels while maximizing profitability for the given level of risk. This is achieved through effective structuring of the balance sheet and through the use of swaps and other derivative instruments which are used to adjust the exposure to interest rate risk by modifying the repricing of the Credit Union's financial instruments. The Credit Union's derivative instruments are disclosed in note 24.

2) Interest rate risk measurement

The Credit Union engages a number of interest rate risk measurement techniques to inform the analysis and management activities including the use of asset-liability and interest rate sensitivity simulation models, gap analysis and duration analysis.

Sensitivity analysis is used to assess the change in value of the Credit Union's financial instruments against a range of incremental basis point changes in interest rates over a 12-month period. Interest rate shock analysis is calculated in a similar manner to sensitivity analysis but involves a more significant change of 100 basis points or greater in interest rates. Sensitivity analysis and interest rate shock analysis are calculated on a monthly basis and are reported to the ALCO. Based on current differences between financial assets and financial liabilities as at December 31, 2016, the Credit Union estimates that an immediate and sustained 100 basis point increase in interest rates would increase net interest income by $332 (2015 - ($117)) over the next 12 months while an immediate and sustained 100 basis point decrease in interest rates would increase net interest income by $1,668 (2015 - $1,033) over the next 12 months.

Gap analysis is used to assess the interest rate risk through analysis of the balances, interest rates and timing of maturity of assets and liabilities. An interest rate gap is represented by a difference in net cash flows in a particular period which is subject to a mismatch in repricing.

The following table represents the carrying amounts of interest-sensitive assets and liabilities presented in the periods in which they next reprice to market rates or mature and are summed to show the interest rate and maturity gap. The information represents the position outstanding at the close of the business day and may change significantly in subsequent periods based on member behaviour and the application of the Credit Union's asset and liability management policies.

Fixed term assets, such as residential mortgage loans and consumer loans, are reported based on scheduled repayments. Assets that are related to the Credit Union's prime rate or other short-term market rates are reported in the variable rate category.

Fixed rate liabilities, such as term deposits, are reported at scheduled maturity. Interest bearing deposits on which the member interest rate changes with prime rate or other short-term market rates are reported within variable rate category.

(expressed in thousands of dollars)

Yields are based on the effective interest rates for the assets and liabilities at the reporting date.

### 2016

| | Weighted average rate % | Variable rate $ | Within 3 months $ | 3 months to 1 year $ | 1 to 5 years $ | Over 5 years $ | Non-interest sensitive $ | Total $ |
|---|---|---|---|---|---|---|---|---|
| Assets | | | | | | | | |
| Cash and cash equivalents | 0.07 | 31,681 | 1,349 | - | - | - | (1,131) | 31,899 |
| Interest bearing deposits | 1.54 | - | 10,000 | 16,000 | 410,254 | - | - | 436,254 |
| Derivative financial instruments | 0.87 | - | 55 | 263 | 1,641 | - | - | 1,959 |
| Loans to members | 2.94 | 799,649 | 59,010 | 182,622 | 1,435,137 | 186,429 | 2,329 | 2,665,176 |
| Investments | 1.83 | 11,320 | 9,851 | 20,974 | 44,373 | - | 9,827 | 96,345 |
| Other | | - | - | - | - | - | 18,401 | 18,401 |
| | | 842,650 | 80,265 | 219,859 | 1,891,405 | 186,429 | 29,426 | 3,250,034 |
| Liabilities and Members' Equity | | | | | | | | |
| Borrowings | 1.54 | - | - | 46,591 | 363,473 | - | 1,468 | 411,532 |
| Member deposits | 1.20 | 888,829 | 385,059 | 854,799 | 545,628 | - | 17,871 | 2,692,186 |
| Derivative financial instruments | 0.00 | - | - | - | 539 | 357 | - | 896 |
| Other | | - | - | - | - | - | 145,420 | 145,420 |
| | | 888,829 | 385,059 | 901,390 | 909,640 | 357 | 164,759 | 3,250,034 |
| Statement of financial position mismatch | | (46,179) | (304,794) | (681,531) | 981,765 | 186,072 | (135,333) | - |
| Notional amount of derivatives | | - | (161,500) | 53,500 | 108,000 | - | - | - |
| Net mismatch | | (46,179) | (466,294) | (628,031) | 1,089,765 | 186,072 | (135,333) | - |

### 2015

| | Weighted average rate % | Variable rate $ | Within 3 months $ | 3 months to 1 year $ | 1 to 5 years $ | Over 5 years $ | Non-interest sensitive $ | Total $ |
|---|---|---|---|---|---|---|---|---|
| Assets | | | | | | | | |
| Cash and cash equivalents | 0.09 | 6,656 | - | - | - | - | (175) | 6,481 |
| Interest bearing deposits | 1.63 | - | 5,000 | 31,000 | 421,533 | - | - | 457,533 |
| Derivative financial instruments | 0.90 | - | 125 | 293 | 4,120 | 260 | - | 4,798 |
| Loans to members | 3.19 | 701,841 | 73,895 | 180,627 | 1,252,767 | 113,621 | 1,186 | 2,323,937 |
| Investments | 2.27 | 10,073 | 2,247 | 20,516 | 36,169 | - | 1,918 | 70,923 |
| Other | | - | - | - | - | - | 15,625 | 15,625 |
| | | 718,570 | 81,267 | 232,436 | 1,714,589 | 113,881 | 18,554 | 2,879,297 |
| Liabilities and Members' Equity | | | | | | | | |
| Borrowings | 1.70 | - | 70,086 | - | 220,018 | - | 3,005 | 293,109 |
| Member deposits | 1.36 | 762,426 | 341,030 | 752,564 | 572,443 | - | 18,924 | 2,447,387 |
| Derivative financial instruments | 0.62 | - | - | 80 | 909 | - | - | 989 |
| Other | | - | - | - | - | - | 137,812 | 137,812 |
| | | 762,426 | 411,116 | 752,644 | 793,370 | - | 159,741 | 2,879,297 |
| Statement of financial position mismatch | | (43,856) | (329,849) | (520,208) | 921,219 | 113,881 | (141,187) | - |
| Notional amount of derivatives | | - | (140,000) | 30,000 | 110,000 | - | - | - |
| Net mismatch | | (43,856) | (469,849) | (490,208) | 1,031,219 | 113,881 | (141,187) | - |

(expressed in thousands of dollars)

ii) Foreign exchange risk

Foreign exchange risk is not considered significant at this time as the Credit Union does not engage in any active trading of foreign currency positions or hold significant foreign currency denominated financial instruments for an extended period. Foreign currency denominated deposits are matched with foreign currency denominated liquidity to minimize any exposure. Foreign exchange revenues earned by the Credit Union are primarily generated by crystallized spreads on dollars exchanged with members.

## 23 Capital management

The FIA requires the Credit Union to maintain, at all times, a capital base which is adequate in relation to its business. Capital levels for credit unions in British Columbia are regulated pursuant to guidelines issued by the Financial Institutions Commission ("FICOM"). Minimum capital standards are based on a total capital to risk weighted assets ("RWA") ratio of 8%, along with a requirement that at least 35% of the capital base consist of retained earnings. The Credit Union met this requirement at December 31, 2016 and December 31, 2015. Capital is managed in accordance with policies established by the Board. Management regards a strong capital base as an integral part of the Credit Union's strategy. The Credit Union has a capital plan to provide a long-term forecast of capital requirements. All of the elements of capital are monitored throughout the year, and modifications of capital management strategies are made as appropriate.

The capital ratio as determined by FICOM's prescribed rules relating to on-statement of financial position and off-statement of financial position exposures is calculated by dividing total capital by RWA, which is the assets weighted according to relative risk (0% to 150%).

The total capital is as follows:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Equity shares | 7,441 | 7,676 |
| Retained earnings (non-consolidated) | 133,479 | 124,458 |
| Deferred income tax assets | (2,562) | (2,381) |
| 50% of the Credit Union's proportion of retained earnings in CUDIC, Central 1 and Stabilization Central Credit Union as advised by FICOM | 22,881 | 20,102 |
| Deductions from capital | (1,209) | (1,141) |
| | 160,030 | 148,714 |

(expressed in thousands of dollars)

## 24 Derivative financial instruments

The table below provides an analysis of the Credit Union's derivative-related credit exposure:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Notional amount $ | Fair value $ | Notional amount $ | Fair value $ |
| Equity options | 795 | 92 | 1,590 | 78 |
| Interest rate swaps | 320,000 | 971 | 300,000 | 3,731 |
| | | 1,063 | | 3,809 |

Notional amounts are the contract amounts used to calculate the cash flows to be exchanged; they do not represent credit or market risk exposure.

The table below presents the recognized financial instruments that are subject to enforceable master netting arrangements but not offset and shows in the 'Net' column the result if all set-off rights were exercised.

| | Amounts not offset | | Net |
|---|---|---|---|
| | Financial instruments $ | Cash collateral pledged received $ | $ |
| **2016** | | | |
| Derivative assets | 1,867 | - | 971 |
| Derivative liabilities | (896) | - | - |
| **2015** | | | |
| Derivative assets | 4,720 | - | 3,731 |
| Derivative liabilities | (989) | - | - |

The Credit Union is subject to an enforceable master netting arrangement in the form of an International Swaps and Derivatives Association ("ISDA") agreement with a derivative counterparty. Under the terms of that agreement, offsetting of derivative contracts is permitted only in the event of bankruptcy or default of either party to the agreement. No amounts are offset and presented net on the consolidated statement of financial position.

Fair values based on quoted market prices are not available for a significant portion of the Credit Union's derivative instruments. Consequently, fair values are derived using present value and other valuation techniques and may not be indicative of the net realizable values.

(expressed in thousands of dollars)

The following is a summary of the nature of derivative instruments utilized:

a) Interest rate swaps are transactions in which two parties exchange interest flows on a specified notional amount for a predetermined period, based on agreed upon fixed and floating rates. Notional amounts are not exchanged.

The Credit Union hedges a portion of the interest rate risk that arises on variable interest cash flows on prime rate mortgages through interest rate derivatives. Interest income and expense include the release from other reserves of gains or losses relating to the effective portion of qualifying hedging derivatives designated as cash flow hedges either:

i) as the hedged item is recorded in interest income (expense); or

ii) when the forecasted cash flow of the hedged item is no longer probable.

Any ineffectiveness in the hedging relationship is recorded directly in the consolidated statement of income.

During the year ended December 31, 2016, $793 (net of tax of $210) (2015 - $219) was the effective portion of changes in fair value for cash flow hedges in the year. This amount represents unrealized net gains on derivatives and is recorded in consolidated other comprehensive income. The ineffective portion transferred to the consolidated statement of income was $20 (net of tax of $5) (2015 - $nil).

From time to time, the Credit Union enters into derivative transactions to economically hedge certain business strategies that do not otherwise qualify for hedge accounting, or where hedge accounting is not considered economically feasible to implement. During the year ended December 31, 2016, ($1,735) (2015 - $1,801) was recorded in net interest income as unrealized changes in fair value of these derivatives. In addition, net interest income includes $272 (2015 - $807) in realized net gains, of which $nil (2015 - $177) was released from other comprehensive income.

b) Index-linked call options are equity contracts to pay or receive cash flows based on the increase or decrease in the underlying index or security. The Credit Union utilizes index-linked option contracts in order to economically hedge interest expense on the equity index-linked deposits.

The fair value of all outstanding derivative contracts in a gain position, which takes into account credit risk without factoring in the impact of master netting agreements, totalled $1,867 as at December 31, 2016 (2015 - $4,798). The Credit Union manages this credit risk by dealing with counterparties with a minimum credit rating of “A”, and setting specific limits for investments with those counterparties, which are reviewed monthly.

(expressed in thousands of dollars)

## 25 Fair value of financial instruments

The Credit Union has estimated fair values taking into account changes in interest rates and credit risk that have occurred since the assets and liabilities were acquired. These calculations represent management's best estimates based on a range of methods and assumptions; since they involve uncertainties, the fair values may not be realized in an actual sale or immediate settlement of the instruments. Interest rate changes are the main cause of changes in the fair value of the Credit Union's financial instruments. The carrying value is a reasonable approximation of fair value for the Credit Union's cash and cash equivalents, demand deposits, and certain other financial assets and liabilities.

The fair values of financial instruments are as follows:

a) Interest bearing deposits

The fair value of interest bearing deposits is determined by discounting remaining contractual cash flows at current market interest rates offered for deposits with similar terms and risks.

b) Derivative financial instruments

The fair value of derivative financial instruments is determined by using quoted market benchmark rates from an independent source. The Credit Union uses a valuation method that includes discounted cash flows on the remaining contractual life of a derivative instrument, and valuation models that use observable market data together with a consideration of the credit risk of both parties to the derivative.

c) Loans to members

In determining the fair value of loans to members, the Credit Union incorporates the following assumptions:

i) Fair values are determined by discounting remaining contractual cash flows at current market interest rates offered for loans with similar terms, adjusting for estimated prepayments expected.

ii) The total value of loans determined using the above assumption is reduced by the allowance for credit losses to determine the fair value of the Credit Union's loan portfolio.

d) Investments

The majority of the Credit Union's investments are fair valued based on market pricing with the exception of certain investments that are measured at cost. These investments are the Level 3 investments discussed later in this note, which include Central 1 equity shares and accrued dividends, and shares in other investments that were issued in a private offering, and have no active market or are not publically traded. As a result, the fair value of these investments cannot be determined and consequently these investments are measured at cost. The Credit Union has no immediate plans for disposal of any of these investments.

(expressed in thousands of dollars)

During the year ended December 31, 2016, ($5) (net of tax of $1) (2015 - ($215)) was recognized in other comprehensive (loss) income for the year, as an unrealized change in fair value of available-for-sale investments.

e) Borrowings

The fair value of borrowings is determined by discounting remaining contractual cash flows at current market interest rates offered for borrowings with similar terms and risks.

f) Member deposits

In determining the fair value of member deposits, the Credit Union incorporates the following assumptions:

i) For fixed rate, fixed maturity deposits, the Credit Union discounts the remaining contractual cash flows, adjusted for expected redemptions, at market interest rates offered for deposits with similar terms and risks.

ii) For floating rate deposits, changes in interest rates have minimal impact on the fair value since deposits reprice to market frequently. On that basis, fair value is assumed to equal carrying value.

The following represents the approximate fair values of financial instruments of the Credit Union as at the consolidated statement of financial position date:

| | | | 2016 | | | 2015 |
|---|---|---|---|---|---|---|
| | Carrying value $ | Fair value $ | Difference $ | Carrying value $ | Fair value $ | Difference $ |
| Financial assets | | | | | | |
| Interest bearing deposits | 436,254 | 434,377 | (1,877) | 457,533 | 458,296 | 763 |
| Derivative financial instruments | 1,959 | 1,959 | - | 4,798 | 4,798 | - |
| Investments | 96,345 | 96,798 | 453 | 70,923 | 71,555 | 632 |
| Loans to members | 2,662,385 | 2,674,889 | 12,504 | 2,321,062 | 2,337,486 | 16,424 |
| Financial liabilities | | | | | | |
| Borrowings | 411,532 | 406,691 | 4,841 | 293,109 | 294,822 | (1,713) |
| Member deposits | 2,692,349 | 2,697,648 | (5,299) | 2,447,570 | 2,453,883 | (6,313) |
| Derivative financial instruments | 896 | 896 | - | 989 | 989 | - |

(expressed in thousands of dollars)

The following tables summarize the fair value of financial instruments which are accounted for at fair value on the Credit Union's consolidated statement of financial position or disclosed at fair value elsewhere in the notes to the consolidated financial statements. Fair value measurements are analyzed according to a fair value hierarchy of three levels, as outlined below. Observable inputs represent instances where market data is obtained from independent sources. Unobservable inputs are based on the Credit Union's own internal assumptions. There were no transfers between levels for the current year.

Level 1: Unadjusted market prices in active markets for identical assets and liabilities.

Level 2: Inputs, other than quoted prices included within Level 1, that are observable for the asset or liability either directly or indirectly. This level includes the majority of over the counter derivatives and certain monetary instruments.

Level 3: Inputs which are not based upon market observable data.

| | | | 2016 |
|---|---|---|---|
| | Level 1<br>$ | Level 2<br>$ | Level 3<br>$ |
| Financial assets | | | |
| Interest bearing deposits | - | 434,377 | - |
| Derivative financial instruments | - | 1,959 | - |
| Investments | - | 83,628 | 13,170 |
| Loans to members | - | 2,674,889 | - |
| Financial liabilities | | | |
| Borrowings | - | (406,691) | - |
| Member deposits | - | (2,697,648) | - |
| Derivative financial instruments | - | (896) | - |
| | - | 89,618 | 13,170 |

| | | | 2015 |
|---|---|---|---|
| | Level 1<br>$ | Level 2<br>$ | Level 3<br>$ |
| Financial assets | | | |
| Interest bearing deposits | - | 458,296 | - |
| Derivative financial instruments | - | 4,798 | - |
| Investments | - | 59,564 | 11,991 |
| Loans to members | - | 2,337,486 | - |
| Financial liabilities | | | |
| Borrowings | - | (294,822) | - |
| Member deposits | - | (2,453,883) | - |
| Derivative financial instruments | - | (989) | - |
| | - | 110,450 | 11,991 |

(expressed in thousands of dollars)

The Credit Union has financial instruments classified as Level 3 in the fair value hierarchy and has provided an analysis of movements in Level 3:

| | 2016 $ | 2015 $ |
|---|---|---|
| At January 1 | 11,991 | 9,838 |
| Changes in Central 1 equity shares and other investments | 1,179 | 2,153 |
| At December 31 | 13,170 | 11,991 |

As described in note 7, the fair value of the Credit Union's Level 3 investments cannot be reliably determined; therefore, they are recorded at cost. Accordingly, no sensitivity analysis can be provided.

## 26 Related party disclosure

Related parties of the Credit Union include subsidiaries, associates, post-employment benefit plans, directors and other key management personnel ("key management"), close family members of key management and entities which are controlled, jointly controlled or significantly influenced, or in which significant voting power is held, by key management or their close family members.

a) Loans and deposits

The Credit Union provides banking services to key management and persons connected to them.

A number of transactions were entered into with key management in the normal course of business. All loans to directors, executive management and employees of the Credit Union are subject to the credit policies established for all members. Credit Union employees may receive special rates or other considerations with respect to loans at the Credit Union. Directors do not receive special rates or other considerations with respect to loans or deposits at the Credit Union.

(expressed in thousands of dollars)

No provisions or loan write-offs have been recognized in respect of loans given to related parties (2015 - $nil).

| | | 2016<br>$ | 2015<br>$ |
|---|---|---|---|
| i) | Loans to related parties: | | |
| | Loans outstanding at January 1 | 7,307 | 7,066 |
| | Loans issued in the year | 6,120 | 5,878 |
| | Loan repayments in the year | (7,658) | (5,637) |
| | Loans outstanding at December 31 | 5,769 | 7,307 |
| | Interest income earned | 192 | 216 |
| ii) | Deposits from related parties: | | |
| | Balance on deposit at January 1 | 4,223 | 3,984 |
| | Deposits received in the year | 16,202 | 12,971 |
| | Deposits repaid in the year | (14,403) | (12,732) |
| | Balance on deposit at December 31 | 6,022 | 4,223 |
| | Interest expense on deposits | 67 | 68 |

b) Key management compensation

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Salary and other short-term employee benefits | 3,007 | 2,890 |
| Post-employment benefits | 509 | 462 |
| Termination benefits | 291 | 837 |
| | 3,807 | 4,189 |