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# Consolidated Financial Statements

# Community First Credit Union Limited

December 31, 2011

# Contents

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# Independent auditor's report

**Grant Thornton LLP**
5th Floor, Station Tower
421 Bay Street
Sault Ste. Marie, ON
P6A 1X3

T +1 705 945 9700
F +1 705 945 9705
www.GrantThornton.ca
www.GrantThornton.ca

To the Members of

Community First Credit Union Limited

We have audited the accompanying consolidated financial statements of Community First Credit Union Limited, which comprise the consolidated statement of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010 and the consolidated statements of income and comprehensive income, changes in members' equity and cash flows for the year then ended, and 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.

## Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits 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 auditors' 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 Credit Union'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 Credit Union'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 Community First Credit Union Limited as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and its cash flows for the years then ended in accordance with international financial reporting standards.

Sault Ste. Marie, Ontario

March 6, 2012

Grant Thornton LLP

Chartered accountants

Licensed public accountants

# Community First Credit Union Limited
# Consolidated Statement of Financial Position

| December 31, 2011 | | 2011 | | 2010 | | January 1, 2010 (As restated - Note 26) |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and short term investments (Note 5) | **$** | **9,755,053** | $ | 8,994,894 | $ | 5,815,653 |
| Investments (Note 6) | | **24,663,527** | | 26,855,683 | | 26,362,153 |
| Derivative swap asset (Note 7(c)) | | **-** | | 342,183 | | 501,270 |
| Deferred pension costs (Note 14) | | **2,620,025** | | 1,910,898 | | 1,288,100 |
| Prepaid expenses and other assets (Note 7(b)) | | **1,695,447** | | 2,022,250 | | 1,864,340 |
| Income taxes recoverable | | **192,004** | | 132,319 | | 138,014 |
| Accrued interest receivable | | **1,095,005** | | 1,017,929 | | 895,486 |
| Loans to members (Notes 8 and 9) | | **287,165,167** | | 273,681,936 | | 260,566,705 |
| Property and equipment (Note 11) | | **3,545,665** | | 2,307,681 | | 1,898,366 |
| Intangible assets (Note 12) | | **1,348,890** | | 1,366,730 | | 1,586,946 |
| Foreclosed asset | | **-** | | - | | 1,059,306 |
| | **$** | **332,080,783** | $ | 318,632,503 | $ | 301,976,339 |
| **Liabilities** | | | | | | |
| Member deposits (Notes 13 and 7(a)) | **$** | **289,472,513** | $ | 281,606,566 | $ | 271,122,711 |
| Term loans (Note 15) | | **20,500,000** | | 15,000,000 | | 11,000,000 |
| Payables and accruals | | **1,651,409** | | 2,214,158 | | 1,059,002 |
| Employee benefit plan obligation (Note 14) | | **80,249** | | 89,069 | | 102,089 |
| Deferred tax liability (Note 22) | | **471,660** | | 321,847 | | 127,237 |
| Derivative swap liability (Note 7(c)) | | **39,756** | | - | | - |
| Membership shares (Note 16) | | **72,281** | | 70,632 | | 71,714 |
| **Total liabilities** | | **312,287,868** | | 299,302,272 | | 283,482,753 |
| **Members' Equity** | | | | | | |
| Class A, Series 1 Shares (Note 16) | | **2,508,030** | | 2,508,030 | | 2,508,030 |
| Class B, Series 1 Shares (Note 16) | | **1,216,555** | | 1,266,667 | | 1,327,373 |
| Contributed surplus | | **1,315,305** | | 1,315,305 | | 1,315,305 |
| Retained earnings | | **14,357,543** | | 13,864,434 | | 13,187,049 |
| Accumulated other comprehensive income | | **395,482** | | 375,795 | | 155,829 |
| **Total members' equity** | | **19,792,915** | | 19,330,231 | | 18,493,586 |
| | **$** | **332,080,783** | $ | 318,632,503 | $ | 301,976,339 |

Commitments (Note 19)

On Behalf of the Board

________________________ Director ________________________ Director

See accompanying notes to the consolidated financial statements.

# Community First Credit Union Limited
# Consolidated Statements of Income and Comprehensive Income

| Year Ended December 31 | | **2011** | | 2010 |
|---|---|---|---|---|
| Interest revenue | | | | |
| Interest - personal loans | **$** | **2,724,274** | $ | 3,604,068 |
| Interest - personal mortgage loans | | **6,466,927** | | 5,463,716 |
| Interest - business loans and mortgages | | **4,622,132** | | 4,165,711 |
| Investment income | | **471,267** | | 425,661 |
| | | **14,284,600** | | 13,659,156 |
| Cost of financing | | | | |
| Interest on members' deposits (Notes 13 and 7(a)) | | **5,038,010** | | 5,559,387 |
| Interest on borrowing | | **286,181** | | 156,766 |
| Impairment losses on member loans | | **866,162** | | 649,065 |
| | | **6,190,353** | | 6,365,218 |
| Financial margin | | **8,094,247** | | 7,293,938 |
| Other revenue (Notes 7(b) and 7(c)) | | **2,726,935** | | 3,215,842 |
| | | **10,821,182** | | 10,509,780 |
| Other expenses | | | | |
| Depreciation of property and equipment | | **609,121** | | 469,304 |
| Amortization of intangibles | | **181,788** | | 215,787 |
| Automated networks | | **1,160,095** | | 993,854 |
| General and administration | | **1,580,399** | | 1,503,630 |
| Insurance | | **526,519** | | 431,454 |
| Loan costs | | **95,008** | | 84,712 |
| Occupancy | | **711,856** | | 676,759 |
| Salaries, wages and benefits | | **5,259,918** | | 5,162,942 |
| | | **10,124,704** | | 9,538,442 |
| Earnings before gain on sale of assets | | **696,478** | | 971,338 |
| Gain on sale of assets | | **27,958** | | - |
| Earnings before income taxes | | **724,436** | | 971,338 |
| Income taxes (Note 22) | | | | |
| Current | | **-** | | (12,518) |
| Future | | **149,813** | | 194,610 |
| | | **149,813** | | 182,092 |
| **Net income for the year** | | **574,623** | | 789,246 |
| **Other comprehensive income (net of tax)** | | | | |
| Change in unrealized gain (loss) on AFS investment | | **19,687** | | 210,553 |
| Reclassification of loss cash flow hedge to net income | | **-** | | 9,413 |
| **Total other comprehensive income (loss) for the year** | | **19,687** | | 219,966 |
| **Total comprehensive income for the year** | **$** | **594,310** | $ | 1,009,212 |

See accompanying notes to the consolidated financial statements.

# Community First Credit Union Limited
# Consolidated Statements of Changes in Members' Equity
Year Ended December 31

| | Members' Shares | Accumulated Other Comprehensive Income | Retained Earnings | Contributed Surplus | Total |
|---|---|---|---|---|---|
| **Balance at January 1, 2010** | $ 3,835,403 | $ 155,829 | $ 13,281,331 | $ 1,315,305 | $ 18,587,868 |
| Prior period adjustment (Note 26) | - | - | (94,282) | - | (94,282) |
| **Revised January 1, 2010 balance** | 3,835,403 | 155,829 | 13,187,049 | 1,315,305 | 18,493,586 |
| Net income | - | - | 789,246 | - | 789,246 |
| Distribution to members | - | - | (111,861) | - | (111,861) |
| Redemption of investment shares | (60,706) | - | - | - | (60,706) |
| Reclassification of loss on cash flow hedge to net income | - | 9,413 | - | - | 9,413 |
| Change in unrealized gains/(losses) on available for sale investments | - | 210,553 | - | - | 210,553 |
| **Balance at December 31, 2010** | 3,774,697 | 375,795 | 13,864,434 | 1,315,305 | 19,330,231 |
| Net income | - | - | 574,623 | - | 574,623 |
| Distribution to members | - | - | (81,514) | - | (81,514) |
| Redemption of investment shares | (50,112) | - | - | - | (50,112) |
| Change in unrealized gains/(losses) on available for sale investments | - | 19,687 | - | - | 19,687 |
| **Balance at December 31, 2011** | $ 3,724,585 | $ 395,482 | $ 14,357,543 | $ 1,315,305 | $ 19,792,915 |

# Community First Credit Union Limited
# Consolidated Statement of Cash Flows

| Year Ended December 31 | **2011** | 2010 (As restated – Note 26) |
|---|---|---|
| **Operating activities** | | |
| Net earnings | **$ 574,623** | $ 789,246 |
| Amortization of core deposits | **-** | 16,650 |
| Amortization of property and equipment | **609,121** | 469,304 |
| Amortization of intangibles | **181,788** | 215,787 |
| Deferred income taxes | **149,813** | 194,610 |
| Deferred income taxes from OCI | - | (41,606) |
| Decrease in derivative swap asset | **130,420** | 159,087 |
| Gain on disposal of excess land | **(27,958)** | - |
| Gain on disposal of foreclosed assets | **-** | (176,083) |
| Fair value of swap | **(61,981)** | - |
| Fair value of cash flow hedge | **-** | (9,413) |
| Provision for impaired loans | **866,162** | 649,065 |
| Distributions to members | **(81,514)** | (111,861) |
| Other non-cash items | | |
| (Increase) in accrued interest receivable | **(77,076)** | (122,443) |
| (Increase) decrease in income taxes recoverable | **(59,685)** | 5,695 |
| Decrease (increase) in prepaids and other assets | **326,803** | (157,910) |
| (Increase) in deferred pension | **(709,127)** | (622,798) |
| (Decrease) increase in payables and accruals | **(571,569)** | 1,142,136 |
| | **1,249,820** | 2,399,466 |
| **Financing activities** | | |
| Members' deposits | **7,865,947** | 10,483,855 |
| Proceeds on redemption of term deposits | **1,000,000** | - |
| Proceeds on redemption (purchase) of liquidity reserves, net | **1,627,822** | (328,614) |
| Member capital accounts, net | **(48,463)** | (61,788) |
| Proceeds from term loans, net | **5,500,000** | 4,000,000 |
| | **15,945,306** | 14,093,453 |
| **Investing activities** | | |
| Increase in loans to members, net | **(14,349,393)** | (13,764,296) |
| Proceeds on the disposal of capital assets | **87,958** | - |
| Proceeds received on swap derecognition | **313,500** | - |
| Distributions received from ABCP LP | **61,130** | 69,156 |
| Proceeds on disposal of foreclosed assets | **-** | 1,235,389 |
| Reduction in membership shares | **8,154** | 361,600 |
| Purchase of Central 1 shares | **(485,380)** | (345,512) |
| Redemptions of investments | **-** | 18,088 |
| Purchases of intangibles | **(163,948)** | (12,217) |
| Purchase of property and equipment | **(1,906,988)** | (875,886) |
| | **(16,434,967)** | (13,313,678) |
| Increase in cash and cash equivalents | **760,159** | 3,179,241 |
| Cash and cash equivalents | | |
| Beginning of year | **8,994,894** | 5,815,653 |
| End of year | **$ 9,755,053** | $ 8,994,894 |

See accompanying notes to the consolidated financial statements.

## 1. Nature of operations

**Reporting entity**
Community First Credit Union Limited is incorporated under the Credit Unions and Caisses Populaires Act of Ontario and is a member of the Central 1 Credit Union Limited (Central 1). The Credit Union's Bond of Association includes all persons resident or employed in Ontario. The Credit Union currently operates two branches in the City of Sault Ste. Marie and one branch in the City of Timmins.

These financial statements have been authorized for issue by the Board of Directors on March 6, 2012.

## 2. Basis of financial statement presentation and statement of compliance

These consolidated financial statements of the Credit Union are the representations of management and have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (the IASB).

This is the first time that the Credit Union has prepared its financial statements in accordance with IFRS, having previously prepared its consolidated financial statements in accordance with pre-changeover Canadian Generally Accepted Accounting Principles (pre-changeover GAAP). Details on how the transition from pre-changeover Canadian GAAP to IFRS has affected the financial position, financial performance and cash flows are disclosed in Note 24.

These consolidated financial statements were prepared under the historical cost convention, as modified by the revaluation of available for sale financial assets and derivative financial instruments measured at fair value.

The Credit Union's functional and presentation currency is the Canadian dollar.

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

**Basis of consolidation**
These financial statements include all the accounts of the Credit Union and its wholly-owned subsidiary; Community First Holdings Inc. (CFHI) which is inactive.

### 3. Summary of significant accounting policies

**Cash and cash equivalents**
Cash and cash equivalents includes cash on hand, deposits with other financial institutions, other short term highly liquid investments with original maturities of three months or less; and for the purpose of the Statement of Cash Flows, bank overdrafts that are repayable on demand.

**Investments**
***Central 1 deposits***
These deposit instruments are classified as loans and receivables and are initially measured at fair value plus transaction costs that are directly attributable to their acquisition. Subsequently they are carried at amortized cost, which approximates fair value.

***Equity instruments***
These instruments are classified as available-for-sale and are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition. 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.

Changes in fair value, except for those arising from interest calculated using the effective interest rate, are recognized as a separate component of other comprehensive income.

Where there is a significant or prolonged decline in the fair value of an equity instrument (which constitutes objective evidence of impairment), the full amount of the impairment, including any amount previously recognized in other comprehensive income, is recognized in net income.

Purchases and sales of equity instruments are recognized on settlement date with any change in fair value between trade date and settlement date being recognized in other comprehensive income.

On disposal, the amount held in accumulated other comprehensive income associated with that instrument is removed from equity and recognized in net income.

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

Financial assets are derecognized when contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred.

A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

Financial assets and financial liabilities are initially measured at fair value plus transaction costs, except for financial assets and financial liabilities carried at fair value through net income, which are initially measured at fair value. Subsequent measurement of financial assets and financial liabilities is as described below.

### 3. Summary of significant accounting policies (continued)

**Financial instruments (continued)**

***Financial assets***

For the purpose of subsequent measurement, financial assets other than those designated and effective as hedging instruments are classified into the following categories upon initial recognition:

- loans and receivables;
- held to maturity investments; and
- available-for-sale financial assets

The category determines subsequent measurement and whether any resulting income and expense is recognized in net income or in other comprehensive income.

At least at each reporting date, all financial assets are subject to a review for impairment. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial assets, which are described below.

All income and expenses relating to financial assets that are recognized in net income are presented within interest revenue or interest expense.

***Loans and receivables***

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and have been classified as loans and receivables. The Credit Union classifies cash and cash equivalents, liquidity reserves, term deposits and loans to members in this category.

***Held-to-maturity investments***

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity other than loans and receivables.

Investments are classified as held-to-maturity if the Credit Union has the intention and ability to hold them until maturity. The Credit Union does not hold any investments designated into this category.

Held-to-maturity investments are measured subsequently at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings, the financial asset is measured at the present value of estimated future cash flows.

Any change to the carrying amount of the investment, including impairment loss, is recognized in net income.

## 3. Summary of significant accounting policies (continued)

**Financial instruments (continued)**

***Available-for-sale financial assets***

Available-for-sale financial assets are non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. The Credit Union's available-for-sale financial assets include the Credit Union’s investments in Central 1, CUCO Coop, Credential Securities, Concentra and The Co-operators Group.

These investments are measured at cost less any impairment charges, when their fair value cannot currently be estimated reliably. Impairment charges are recognized in net income.

All other available-for-sale financial assets are measured at fair value. Gains and losses are recognized in other comprehensive income and reported within the accumulated and other comprehensive income, except for impairment losses and foreign exchange differences on monetary assets, which are recognized in net income. When the asset is disposed of or is determined to be impaired the cumulative gain or loss recognized in other comprehensive income is reclassified from the members’ equity to net income and presented as a reclassification adjustment within other comprehensive income. Interest calculated using the effective interest method and dividends are recognized in net income within 'other income'.

Reversals of impairment losses are recognized in other comprehensive income, except for financial assets that are debt securities which are recognized in net income only if the reversal can be objectively related to an event occurring after the impairment loss was recognized.

***Financial liabilities***

The Credit Union’s financial liabilities include member deposits, derivative financial instruments, term loans, payables and accruals and shares classified as liabilities.

Financial liabilities are initially measured at fair value and are measured subsequently at amortized cost using the effective interest method, except for financial liabilities held for trading or designated at fair value through net income, that are carried subsequently at fair value with gains or losses recognized in net income.

All interest-related charges and, if applicable, changes in an instrument's fair value that are reported in net income are included within 'interest revenue' or 'interest expense'.

**Derivative financial instruments**

The Credit Union designates certain financial assets upon initial recognition at fair value through net income (fair value option). Financial instruments included in this category are the embedded derivatives and derivatives related to index linked term deposits and interest rate swaps not designated as hedging instruments.

These instruments are measured at fair value, both initially and subsequently. The related transaction costs are expensed. Gains and losses arising from changes in fair value of these instruments are recorded in net income.

## 3. Summary of significant accounting policies (continued)

### Member loans

All member loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and have been classified as loans and receivables.

Member loans are initially measured at fair value. Loan costs which include title costs, mortgage cash-back incentives and appraisal fees are deferred and amortized over the average remaining term of the related loans, being four years. Member loans are subsequently measured at amortized cost, using the effective interest rate method, less any impairment losses. Loans considered uncollectible are written off.

Loans to members are reported at their recoverable amount representing the aggregate amount of principal, less any allowance or provision for impaired loans, plus accrued interest. Interest is accounted for on the accrual basis for all loans.

### Allowance for impaired loans

If there is objective evidence that an impairment loss on members loans carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the loans carrying amount and the present value of expected cash flows discounted at the loans original effective interest rate. Short-term balances are not discounted.

The Credit Union first assesses whether objective evidence of impairment exists individually for loans that are individually significant.

Loans classified as impaired include loans for which interest or principal payments are 90 days past due, unless the loan is both well secured and is in the process of collection, in which case they are only classified as impaired if the payments are 180 days past due. Estimated realizable amounts are determined by discounting the expected future cash flows at the effective interest rate inherent in the loans, by estimating the fair value of security underlying the loans and deducting costs of realization, or by estimating market prices for the loans.

If it is determined that no objective evidence of impairment exists for an individually assessed loan, whether significant or not, the asset is included in a group of loans with similar credit risk characteristics and that group of loans is collectively assessed for impairment. Loans that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment. The expected future cash outflows for a group of loans with similar credit risk characteristics are estimated based on historical loss experience.

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. Any subsequent reversal of an impairment loss is recognized in net income.

### Bad debts

Bad debts are written off from time to time as determined by management and approved by the Board of Directors when it is reasonable to expect that the recovery of the debt is unlikely. Bad debts are written off against the provisions for impairment, if a provision for impairment had previously been recognized. If no provision had been recognized, the write offs are recognized as expenses in net income.

## 3. Summary of significant accounting policies (continued)

**Loan securitization**
The Credit Union periodically securitizes residential mortgage loans by selling them to Central 1. Central 1 then resells the loans to independent special purpose entities or trusts that issue securities to investors.

For securitization transactions initiated prior to the date of transition to IFRS, in accordance with pre-changeover Canadian GAAP, loan securitizations were treated as a sale, provided that control over the transferred loans has been surrendered and consideration other than beneficial interests in the transferred loans has been received in exchange. Gains on these transactions were reported as other income on the statement of income and comprehensive income. The amount of these gains are based on the present value of expected future cash flows using management's best estimates and key assumptions such as prepayment rates, excess spread, credit losses and discount rates. The Credit Union has a contractual obligation to service the loans on behalf of the transferee. Revenue from servicing mortgages is recorded as the services are provided.

For securitization transactions initiated after the date of transition to IFRS, loans are derecognized only when the contractual rights to receive the cash flows from these assets have ceased to exist or substantially all the risks and rewards of the loans have been transferred. If the criteria for derecognition has not been met, the securitization is reflected as a financing transaction and the related liability is initially recorded at fair value and subsequently measured at amortized costs, using the effective interest rate method.

**Property and equipment**
Property and equipment is initially recorded at cost and subsequently measured at cost less accumulated depreciation and any accumulated impairment (losses), with the exception of land which is not depreciated. Depreciation is recognized in net income and is provided on a straight-line basis over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Building | 2.5% - 10% |
| Leasehold improvements | 10% |
| Furniture and equipment | 10% - 20% |
| Automated teller machines | 10% - 20% |
| Computer equipment and software | 20% - 33% |

Depreciation in the first year is taken at one-half the above rate. Additions to property and equipment which are not in use as at the balance sheet date are not depreciated until the period in which they are considered to be in use. Depreciation methods, useful lives and residual values are reviewed annually and adjusted if necessary.

**Leased assets**
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.

## 3. Summary of significant accounting policies (continued)

**Intangible assets**
Intangible assets reflect costs associated with branding related to Community First's name change launch, merger costs associated with the Timmins' amalgamation and the fair value of core deposits acquired and costs associated with the development of the banking system. Management considers these costs to provide current and future benefits for the membership.

When the Credit Union enters into a business combination, any intangible assets acquired through amalgamation are recorded at their fair value as determined at that time. These intangible assets which have a limited life are amortized to income over the period during which the assets are anticipated to provide economic benefit.

Intangible assets are initially recorded at cost and subsequently measured at cost less accumulated amortization and any accumulated impairment (losses). The banking system is being amortized on a straight-line basis at a rate of 10%. Other intangible assets are being amortized on a straight-line basis for a period not exceeding five years.

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

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash flows. Impairment charges are included in net income, except to the extent that they reverse gains previously recognized on other comprehensive income.

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

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

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting nor taxable net income.

## 3. Summary of significant accounting policies (continued)

**Income taxes (continued)**
Recognition of deferred tax assets for unused tax (losses), tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available which allow the deferred tax asset to be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

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

**Member deposits**
All member deposits are initially measured at fair value, net of any transaction costs directly attributable to the issuance of the instrument.

Member deposits are subsequently measured at amortized cost, using the effective interest rate method.

**Pension plan**
The Credit Union maintains two defined benefit pension plans, which cover all employees. The management plan is contributory and the non-management plan is non-contributory.

Under the Credit Union's defined benefit plans, the amount of pension benefit that an employee will receive on retirement is dependent on one or more factors such as age, years of service and compensation. The legal obligation for any benefit remains with the Credit Union.

The asset recognized in the Consolidated Statement of Financial Position for the defined benefit plans is the present value of the defined benefit obligation (DBO) at the reporting date less the fair value of the plan assets together with adjustments for unrecognized actuarial gains or losses and past service costs.

Management estimates the DBO annually with the assistance of independent actuaries. This is based on standard rates of inflation, and mortality. It also takes into account the Credit Union's anticipation of future salary increases and retirement experience. Discount factors are determined at each year end by reference to high quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses are not recognized as an expense unless the total unrecognized gain or loss exceeds 10% of the greater of the obligation and related plan assets. The amount exceeding this 10% corridor is charged or credited to net income over the employees' expected average remaining working lives. Actuarial gains and losses within the 10% corridor are disclosed separately. Past service costs are recognized immediately in net income unless the charges to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortized on a straight line basis over the vesting period.

**3. Summary of significant accounting policies (continued)**

**Accounts payable and other payables**
Liabilities for trade creditors and other payables are classified as other financial liabilities and initially measured at fair value net of any transaction costs directly attributable to the issuance of the instrument and subsequently carried at amortized cost using the effective interest rate method.

**Provisions**
Provisions are recognized for liabilities of uncertain timing or amount that have arisen as a result of past transactions, including legal or constructive obligations. The provision is measured at the best estimate of the expenditure required to settle the obligation at the reporting date.

**Membership shares**
As a requirement of membership, members must hold membership shares. Membership shares are classified on the statement of financial position as a liability as the shares are redeemable at the option of the member, either on demand or on withdrawal from membership. Membership shares would be classified as equity only to the extent that they do not meet the definition of a financial liability or financial asset.

**Class A, Series 1 Shares (formerly Class A investment shares)**
Class A, Series 1 shares are redeemable at the option of the member and are classified as member equity on the Consolidated Statement of Financial Position. In no case, shall total redemptions approved for holders of Class A, Series 1 shares in any fiscal year exceed an amount equal to 10% of the total Class A, Series 1 shares outstanding at the end of the previous fiscal year.

**Class B, Series 1 Shares**
Class B, Series 1 Shares are classified on the Consolidated Statement of Financial Position as member equity as the shares are redeemable only under certain restrictions. In no case, shall total redemptions approved for holders of Class B, Series 1 shares in any fiscal year exceed an amount equal to 10% of the total Class B, Series 1 Shares outstanding at the end of the previous fiscal year.

**Distributions to members**
Class A and B share dividends are recognized through retained earnings when declared. Membership share dividends are recognized in net income when declared.

**Revenue recognition**
Revenue from the provision of services to members is recognized when earned, specifically when amounts are fixed or can be determined and the ability to collect is reasonably assured.

## 3. Summary of significant accounting policies (continued)

**Foreign currency translation**
Foreign currency accounts are translated into Canadian dollars as follows:

At the transaction date, each asset, liability, revenue and expense denominated in a foreign currency is translated into Canadian dollars using the exchange rate in effect at that date. At the year-end date, unsettled monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at the year-end date and the related translation differences are recognized in net income. Exchange gains and losses arising on the retranslation of monetary available-for-sale financial assets are treated as a separate component of the change in fair value and recognized in net income.

Non-monetary assets and liabilities that are measured at fair value or a revalued amount are translated into Canadian dollars by using the exchange rate in effect at the date the value is determined and the related translation differences are recognized in net income or other comprehensive income consistent with where gain or loss on the underlying non-monetary asset or liability has been recognized.

**Interest income and expense**
Interest income and expense is recognized in the Consolidated Statement of Income and Comprehensive Income for all interest bearing financial instruments classified as held to maturity, available for sale, loans and receivables and other financial liabilities using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial asset or liability and allocating the interest income or expense over the relevant period. The effective interest rate is the rate that discounts the expected future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial instrument. The application of this method has the effect of recognizing income and expense on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.

In calculating the effective interest, the Credit Union estimates cash flow using projections based on its experience considering all contractual terms of the financial instruments but excluding future credit losses. Related fees are included in the calculation to the extent that they can be measured and are considered to be an integral part of the effective interest rate. However, in rare cases when it is not possible to estimate reliably the cash flows or the expected life of the financial instrument (or group of financial instruments) the Credit Union uses the contractual cash flows over the full term of the financial instrument (or group of financial instruments).

## 3. Summary of significant accounting policies (continued)

**Standards, Amendments and Interpretations not yet effective**

Certain new standards, amendments and interpretations have been published that are mandatory for the Credit Union's accounting periods beginning on or after January 1, 2013 or later periods that the Credit Union has decided not to early adopt. The standards, amendments and interpretations that will be relevant to the Credit Union are:

IFRS 9 Financial Instruments is part of the IASB's wider project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets, amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2015. Further changes dealing with impairment methodology and hedge accounting are still being developed. The Credit Union is in the process of evaluating the impact of the new standards and developments.

IFRS 13 Fair Value Measurement defines fair value, provides guidance on the measurement of fair value, and requires disclosures about fair value measurements. IFRS 13 does not determine when an asset, a liability or an entity's own equity instrument is measured at fair value. Rather, the measurement and disclosure requirements of IFRS 13 apply when another IFRS requires or permits the item to be measured at fair value (with limited exceptions). The standard is effective for annual periods beginning on or after January 1, 2013. The Credit Union is in the process of evaluating the impact of the new standard.

The Credit Union has early adopted the amendments to IFRS 1 which replaces references to a fixed date of '1 January 2004' with 'the date of transition to IFRS. This eliminates the need for the Credit Union to restate derecognition transactions (securitizations) that occurred before the date of transition to IFRS. The amendment is effective for year-ends beginning on or after July 1, 2011; however, the Credit Union has early adopted the amendment. The impact of the amendment and early adoption is that the Credit Union only applies IAS 39 derecognition requirements to transactions that occurred after the date of transition to IFRS.

## 4. Critical accounting estimates and judgments

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

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

The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

## 4. Critical accounting estimates and judgments (continued)

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

**Useful lives of depreciable assets**
Management reviews the useful lives of depreciable assets at each reporting date. At December 31, 2011, management assesses that the useful lives represent the expected utility of the assets to the Credit Union. The carrying amounts are analyzed in Note 11. Actual results, however, may vary due to technical obsolescence, particularly for software and electronic equipment.

**Impairment**
An impairment loss is recognized for the amount by which an asset's carrying amount exceeds its recoverable amount, which is the higher of fair value less cost to sell and value-in-use. To determine the value-in-use, management estimates expected future cash flows from each asset or cash generating unit and determines a suitable interest rate in order to calculate the present value of those cash flows. In most cases, determining the applicable discount rate involves estimating the appropriate adjustment to market risk and the appropriate adjustment to asset-specific risk factors. In the process of measuring expected future cash flows management makes assumptions about future operating results. These assumptions relate to future events and circumstances.

**Member loan loss provision**
In determining whether an impairment loss should be recorded in the Consolidated Statement of Income and Comprehensive Income, the Credit Union makes judgment on whether objective evidence of impairment exists individually for financial assets that are individually significant. Where this does not exist the Credit Union uses its judgment to group member loans with similar credit risk characteristics to allow a collective assessment of the group to determine any impairment loss.

In determining the collective loan loss provision management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment. Further details on the estimates used to determine the allowance for impaired loans collective provision are provided in Note 9.

**Income taxes**
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. Management believes they have adequately provided for the probable outcome of these matters; however, the final outcome may result in a materially different outcome than the amount included in the tax liabilities.

## 5. Cash and short term investments

The Credit Union's cash in current accounts are held with Central 1.

| **Cash and cash equivalents** | **2011** | 2010 | January 1, 2010 |
|---|---|---|---|
| Cash on hand | $ **2,478,584** | $ 2,665,801 | $ 2,447,834 |
| Cash in current account | **7,276,469** | 6,329,093 | 3,367,819 |
| | $ **9,755,053** | $ 8,994,894 | $ 5,815,653 |

## 6. Investments

As a condition of maintaining membership in Central 1 in good standing, the Credit Union is required to maintain a liquidity reserve deposit equal to 6% of its total assets as at each preceding month. The deposits bear interest at varying rates, dependent upon the term of the investment. The investments can be withdrawn only if there is a sufficient reduction in the Credit Union's total assets or upon withdrawal of membership from Central 1. The liquidity reserves mature at varying times between one month and three years. At maturity, these deposits are reinvested at market rates for various terms.

The following tables provide information on the investments by type of security and issuer.

| **Central 1 Deposits** | **2011** | 2010 | January 1, 2010 |
|---|---|---|---|
| Liquidity reserve deposit | $ **20,301,899** | $ 21,929,721 | $ 21,601,107 |
| Term deposit | **-** | 1,000,000 | 1,000,000 |
| Total Central 1 deposits | **20,301,899** | 22,929,721 | 22,601,107 |
| **Equity Instruments** | | | |
| Central 1 Membership shares | **-** | 8,154 | 369,754 |
| Central 1 Class A Shares | **1,197,946** | 712,566 | 730,654 |
| Central 1 Class E Shares | **1,395,300** | 1,395,300 | 1,033,700 |
| Concentra Financial, Class A, Series 1 | **2,352** | 2,352 | 2,362 |
| Concentra Financial, Membership (1 share) | **10** | 10 | - |
| CUCO Co-op Class B Investment Shares, formerly ABCP Limited Partnership | **1,429,880** | 1,471,440 | 1,288,436 |
| Credential Securities Inc., subordinated debenture | **5,000** | 5,000 | 5,000 |
| Credential Securities Inc., participating loan | **30,000** | 30,000 | 30,000 |
| The Co-operators Group Limited, preference shares | **150,000** | 150,000 | 150,000 |
| The Co-operators Group Limited, term certificates | **151,140** | 151,140 | 151,140 |
| | **4,361,628** | 3,925,962 | 3,761,046 |
| Total investments | $ **24,663,527** | $ 26,855,683 | $ 26,362,153 |

### a) Central 1 Shares

The Credit Union previously maintained a membership in Credit Union Central of Ontario (CUCO). As of July 31, 2008, CUCO sold substantially all of its net assets to Credit Union Central of British Columbia (CUCBC) to form a new national financial services entity named Central 1.

### 6. Investments (continued)

**Class A Shares**
The shares in Central 1 are required as a condition of membership and are redeemable upon withdrawal of membership or at the discretion of the Board of Directors of Central 1. The Credit Union's allocation of Class A Central 1 shares is based on the assets of each credit union in proportion to the combined assets of the British Columbia credit union system and the assets of Central 1's member credit unions in Ontario. This allocation is adjusted each June 30th to reflect changes in credit union assets. In addition, the member Credit Unions are subject to additional capital calls at the discretion of the Board of Directors.

There is no separately quoted market value for these shares, however, fair value is determined to be equivalent to the par value due to the fact transactions occur at par value on a regular and recurring basis.

**Class E Shares**
Class E Central 1 shares are issued with a par value however are redeemable at the option of Central 1. There is no separately quoted market value for these shares and the fair value could not be measured reliably. Fair value cannot be measured reliably as 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. Therefore, they are recorded at cost.

The Credit Union is not intending to dispose of any Central 1 shares as the services supplied by Central 1 are relevant to the day to day activities of the Credit Union.

Dividends on these shares are at the discretion of the Board of Directors of Central 1.

**b) ABCP Limited Partnership and CUCO Co-op Class B shares**
On June 18, 2011, credit unions voted on the purchase of the investment portfolio and certain other assets and liabilities of the ABCP LP by CUCO Co-op, and the subsequent dissolution of the ABCP LP (the "LP"). The first step was fulfilled when CUCO officially became the CUCO Co-operative Association ("CUCU Co-op") on August 17, 2011 on the authority of approvals received from the Financial Services Commission of Ontario and from Industry Canada. The second step was completed on August 31, 2011, when the CUCO Co-op and the LP fulfilled the terms of the purchase agreement whereby the LP assets were sold to CUCO Co-op in exchange for Class B Investment Shares. On September 2, 2011, the LP distributed to each credit union such credit union's proportionate share of CUCO Co-op Class B Investment Shares. The value previously held in the form of a credit union's LP units has effectively transferred to its new CUCO Co-op Class B Investment Shares and the LP units have no value. As of September 2, 2011, the Credit Union received 507,868,913 Class B Investment Shares, which is 1.45591% of the total Class B Investment Shares outstanding.

The Credit Union received distributions of $61,130 (2010: $69,156) which were recorded directly as a reduction to the carrying value of the investment.

### 6. Investments (continued)

At December 31, 2011, an independent valuation was completed on the underlying investments of CUCO Co-op utilizing valuation techniques based on discounting expected future cash flows. The valuation was based on conditions existing at the balance sheet date. As a result of this valuation, the carrying value of the investment in CUCO Co-op on the Credit Union's balance sheet was increased by $19,687 to $1,429,880. These investments are classified as available for sale instruments. Therefore, the fair value adjustment of $19,687 (2010: $252,160) has been tax effected and recorded to other comprehensive income. As the valuation of this investment is based on estimates prepared by a third party, it is subject to measurement uncertainty and subsequent valuations may vary significantly from the original valuation due to the impact of a variety of market factors.

#### c) Other investments

The other investments are classified as available for sale but have no separately quoted market value and the fair value could not be measured reliably. Fair value cannot be measured reliably as the timing of redemption of these investments cannot be determined, therefore, the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed. Therefore, they are recorded at cost.

### 7. Derivative financial instruments

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

**Equity swap agreements**
The Credit Union offers members term deposits whose rate is derived from a market index or basket of stocks. These index-linked term deposits offer principal guarantee and a variable rate of return contingent on the performance of equity markets.

The Credit Union enters into equity swap agreements to hedge the risk of interest payments due at the maturity date of index-linked term deposits. The equity swaps involve the Credit Union paying a fixed rate of interest and receiving a variable amount matching the return owed to members on the index-linked term deposits. The fixed interest paid is deferred and amortized over the term of the respective index-linked term deposit. These products are considered economic hedges and are designated as held for trading.

**Interest rate swap agreements**
The Credit Union offers members a choice of terms for loans and deposits. Variation in member preferences results in asset and liability maturity dates that are not perfectly matched. This mismatch creates an opportunity and risk that changes in interest rates will affect earnings either positively or negatively.

## 7. Derivative financial instruments (continued)

**Interest rate swap agreements (continued)**
The Credit Union enters into interest rate swap agreements to manage its exposure to interest rate risk. Interest rate swaps involve the exchange of a fixed rate interest payment for a floating rate payment on a notional principal amount.

From January 1, 2007, the Credit Union elected not to apply hedge accounting on its interest rate swap agreements. Under this methodology, any cumulative gain/loss on the derivatives has been reflected as a transitional adjustment on adoption of new accounting policies in "Accumulated Other Comprehensive Income". This is being reclassified to net earnings over the term of the related contracts. Any gains or losses as a result of fair value measurement are being recorded in the year they occur through the Consolidated Statement of Income and Comprehensive Income.

**(a) Embedded derivative liability – index link contract with members**
The Credit Union has outstanding index linked term deposits to its members. The index linked term deposits are three and five year deposits that pay interest at the end of the term, based on the performance of a variety of indices. The embedded derivative associated with these deposits is presented in members' deposits on the Consolidated Statement of Financial Position and was adjusted to its fair value of $224,531 (2010: $393,814). The fair value adjustment resulted in a gain on the index link term of $169,282 which is included in interest on members' deposits on the Consolidated Statement of Income and Comprehensive Income.

**(b) Embedded derivative asset – index link contract with Credit Union Central of Ontario**
The Credit Union has entered into equity swap agreements with Central 1 to hedge the risk of interest payments due at the maturity date of the index linked term deposits. The Credit Union pays a fixed rate of interest for the term of each index linked term deposit on the face value of the deposits sold. At the end of the term, the Credit Union receives an amount equal to the amount that will be paid to the depositors, based on the performance of the indices. At December 31, 2011, the embedded derivative asset was adjusted to its fair value of $224,531, which is included in prepaid expenses and other assets on the Consolidated Statement of Financial Position. The fair value adjustment resulted in a loss on the index link asset of $169,283 which is included in other revenue on the Consolidated Statement of Income and Comprehensive Income.

**(c) Derivative asset (liability) – swap agreements**
The Credit Union enters into interest rate swap contracts in order to hedge against exposure to interest rate risks. The Credit Union does not enter into these contracts for trading or speculative purposes. The Credit Union has a derivative asset/liability related to its interest rate swap agreements that is included on the Consolidated Statement of Financial Position as "Derivative swap asset/ liability".

Swap agreements were terminated in the year and new ones purchased. The remaining unamortized amounts related to past swaps which were included in accumulated other comprehensive income of $9,413 net of tax, were brought into net income in 2010. The loss was included in the Consolidated Statement of Income and Comprehensive Income in interest on loans, as the swap was acquired as a cash flow hedge for variable rate loans.

### 7. Derivative financial instruments (continued)

**Interest rate swap agreements (continued)**

At December 31, 2011 the newly acquired swaps were adjusted to reflect their fair value of ($39,756) which has been recorded as a derivative liability (2010: $342,183 derivative asset) on the Consolidated Statement of Financial Position. The resulting loss on the fair value adjustment of the swaps held throughout the year of $130,420 (2010: $159,087) has been recorded in the Consolidated Statement of Income and Comprehensive Income in “other revenue”.

At December 31, 2011, the Credit Union was party to two interest rate swap contracts (two in 2010) representing a total notional principal of $10,000,000 (2010: $10,000,000). Under the terms of the contracts, the Credit Union has contracted with the Central 1 to receive (2010: pay) interest at a variable rate to be repriced monthly, while paying (2010: receiving) interest at a fixed rate on the notional principal amount. The variable rate is equivalent to the one month Canadian Deposit Offering Rate (CDOR).

Revenues and expenses resulting from these transactions are recorded as incurred during the term of the agreements.

| Counter Party | Notional Amount | Maturity Date | Variable Receive | Fixed Pay |
|---|---|---|---|---|
| Central 1 | $ 5,000,000 | August 8, 2014 | 1 Month CDOR | 1.075% |
| Central 1 | $ 5,000,000 | August 8, 2015 | 1 Month CDOR | 1.315% |

### 8. Member loans

| | 2011 | 2010 | January 1, 2010 |
|---|---|---|---|
| Loans with variable interest rates | | | |
| Personal | **$ 24,535,140** | $ 28,809,741 | $ 31,024,370 |
| Personal mortgages | **51,015,854** | 49,713,691 | 45,437,868 |
| Business | **26,262,271** | 21,802,493 | 12,850,252 |
| Loans with fixed interest rates | | | |
| Personal | **22,021,471** | 17,648,577 | 17,564,576 |
| Business | **6,875,219** | 8,981,922 | 12,803,113 |
| Personal mortgages | **105,967,680** | 99,576,113 | 91,963,298 |
| Business mortgages | **52,071,552** | 48,400,648 | 50,081,158 |
| | **288,749,187** | 274,933,185 | 261,724,635 |
| Allowance for impaired loans (Note 9) | **(1,584,020)** | (1,251,249) | (1,157,930) |
| Net loans to members | **$ 287,165,167** | $ 273,681,936 | $ 260,566,705 |

## 8. Member loans (continued)

**Terms and conditions**

Member loans can have either a variable or fixed rate of interest and have a maturity not exceeding ten years.

Personal and business loans on variable rate contracts include a repayment on demand provision. In addition, all loans except mortgages are open to repayment at any time without penalty.

Variable rate loans are based on a “prime rate” formula. The Credit Union’s prime rate at December 31, 2011 was 3%. For fixed and variable rate loans, the rate is determined by the type of security offered and the members’ credit worthiness.

Personal loans consist of term loans and lines of credit that are non real estate secured and, as such, have various repayment terms. Some of the personal loans are secured by wage assignments and personal property or investments, and others are secured by wage assignments only.

Personal mortgages are loans and lines of credit secured by residential property and are repayable with either blended payments of principal and interest or interest only.

Commercial loans consist of term loans, operating lines of credit and mortgages to individuals, partnerships and corporations and have various repayment terms. They are secured by various types of collateral, including mortgages on real property, general security agreements, charges on specific equipment and investments.

**Concentration of risk**

The Credit Union has an exposure to groupings of individual loans which concentrate risk and create exposure to particular segments. As outlined in the Credit Union’s Credit Risk Management Policy, prudent lending limits of no more than 25% of regulatory capital have been established by management and approved by the Board of Directors as outlined in Section 59(2) of the Ontario Regulations Act 237/09. The Credit Union is compliant with the Act.

### 9. Allowance for impaired loans

The Credit Union's allowance for impaired loans was calculated in accordance with By-Law No. 6 of the Deposit Insurance Corporation of Ontario (DICO).

| | **2011** | 2010 | January 1, 2010 |
|---|---|---|---|
| Total allowance for impaired loan provision comprises: | | | |
| Collective provision | **$ 291,023** | $ 300,000 | $ 300,000 |
| Individual specific provision | **1,292,997** | 951,249 | 857,930 |
| Total provision | **$ 1,584,020** | $ 1,251,249 | $ 1,157,930 |

| **2011** | **Personal Mortgage** | **Personal Loans** | **Commercial Loans** | **Total** |
|---|---|---|---|---|
| **Balance at January 1, 2011** | **$ 19,687** | **$ 563,604** | **$ 667,958** | **$ 1,251,249** |
| **Recoveries of loans previously written off** | **-** | **30,580** | **-** | **30,580** |
| **Provision charged to net income** | **357,514** | **78,438** | **430,271** | **866,223** |
| | **377,201** | **672,622** | **1,098,229** | **2,148,052** |
| **Loans written off** | **(74,926)** | **(262,612)** | **(226,494)** | **(564,032)** |
| **Balance at December 31, 2011** | **$ 302,275** | **$ 410,010** | **$ 871,735** | **$ 1,584,020** |
| **Gross principal balance of individually impaired loans** | **$ 1,796,853** | **$ 394,228** | **$ 2,162,528** | **$ 4,353,609** |

| 2010 | Personal Mortgage | Personal Loans | Commercial Loans | Total |
|---|---|---|---|---|
| Balance at January 1, 2010 | $ - | $ 299,292 | $ 858,638 | $ 1,157,930 |
| Recoveries of loans previously written off | - | 25,910 | - | 25,910 |
| Provision charged to net income | 260,410 | 83,060 | 305,595 | 649,065 |
| | 260,410 | 408,262 | 1,164,233 | 1,832,905 |
| Loans written off | - | (401,247) | (180,409) | (581,656) |
| Balance at December 31, 2010 | $ 260,410 | $ 7,015 | $ 983,824 | $ 1,251,249 |
| Gross principal balance of individually impaired loans | $ 1,590,520 | $ 507,313 | $ 1,866,502 | $ 3,964,335 |

**Key assumptions in determining the allowance of impaired loans collective provision**

A collective provision is established to cover estimated loan losses which have not yet been specifically identified as impaired. In determining the allowance for impaired loans, management considers factors such as the composition and credit quality of the portfolio, current economic conditions and trends and historical loss experience.

For purposes of the collective provision loans are classified into separate groups with similar risk characteristics, based on the type of product and type of security.

## 9. Allowance for impaired loans (continued)

At December 31st, the balances of loans in arrears within the portfolio (excluding accrued interest) were as follows:

| **2011** | **Residential Mortgage** | **Personal Loans** | **Commercial Loans** | **Total** |
|---|---|---|---|---|
| **Days in arrears** | | | | |
| **Current** | **$ 150,971,480** | **$ 43,623,020** | **$ 79,137,469** | **4 273,731,969** |
| **Under 30 days** | **4,969,956** | **2,678,526** | **3,947,751** | **$ 11,596,233** |
| **30 to 90 days** | **127,201** | **99,834** | **-** | **227,035** |
| **Over 90 days** | **914,896** | **155,234** | **2,123,820** | **3,193,950** |
| **Balance at December 31, 2011** | **$ 156,983,533** | **$ 46,556,614** | **$ 85,209,040** | **$ 288,749,187** |

| 2010 | Residential Mortgage | Personal Loans | Commercial Loans | Total |
|---|---|---|---|---|
| Days in arrears | | | | |
| Current | $ 142,660,819 | $ 44,040,720 | $ 74,475,057 | $ 261,176,596 |
| Under 30 day | 5,473,381 | 1,951,355 | 3,023,422 | 10,448,158 |
| 30 to 90 days | 462,894 | 122,431 | 21,069 | 606,394 |
| Over 90 days | 692,706 | 343,814 | 1,665,517 | 2,702,037 |
| Balance at December 31, 2011 | $ 149,289,800 | $ 46,458,320 | $ 79,185,065 | $ 274,933,185 |

## 10. Mortgage securitization

At December 31, 2011, the aggregate value of securitized loans outstanding amounted to $7,075,620 (2010: $8,398,846). The net gain on the sale of mortgages resulting from these securitizations was immediately recognized in the Consolidated Statement of Income and Comprehensive Income as “other revenue”. As at December 31, 2011, there was one delinquent loan in this pool of mortgages which remained in the program until February 2012. In addition, there were no credit losses incurred in the mortgages transferred. Since these mortgages are sold on a serviced basis, the Credit Union has a servicing liability of $59,318 (2010: $80,577) included on its Consolidated Statement of Financial Position.

There were no new securitizations in 2010 or 2011. The following table, rounded to the thousands, summarizes securitization activity that occurred in 2009.

| | |
|---|---|
| Principle value of mortgages sold (net of provision) | $ 9,858,000 |
| Net cash proceeds received | 9,916,000 |
| Retained rights to future excess spread | 589,000 |
| Servicing liability | 103,000 |
| Pre-tax gain | 460,000 |

Retained rights to cash reserves and to future excess spread are included in “other assets” on the Consolidated Statement of Financial Position.

Weighted average key assumptions for the securitization undertaken by the Credit Union in 2009 were as follows:

| | |
|---|---|
| Average life | 4.25 to 4.58 years |
| Excess spread | 1.43% |
| Discount rate (residual cash flow) | 4.49% |

### 11. Property and equipment

| | Land | Buildings | Leasehold Improvements | Furniture & Equipment | Automated Teller Machines | Computer Equipment | Total |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| Balance at January 1, 2010 | $ 299,000 | $ 1,096,865 | $ 1,137,786 | $ 1,531,278 | $ 695,858 | $3,836,363 | $8,597,150 |
| Additions | - | - | 73,687 | 14,967 | 378,206 | 411,760 | 878,620 |
| Disposals | - | - | - | (1,098,954) | (548,198) | (2,273,383) | (3,920,535) |
| Balance on December 31, 2010 | 299,000 | 1,096,865 | 1,211,473 | 447,291 | 525,866 | 1,974,740 | 5,555,235 |
| Additions | - | - | 1,202,350 | 190,773 | 33,198 | 480,784 | 1,907,105 |
| Disposals | (60,000) | - | - | - | - | - | (60,000) |
| Balance on December 31, 2011 | $ 239,000 | $ 1,096,865 | $ 2,413,823 | $ 638,064 | $ 559,064 | $2,455,524 | $7,402,340 |
| **Accumulated depreciation** | | | | | | | |
| Balance at January 1, 2010 | $ - | 712,495 | 669,912 | 1,459,732 | 654,685 | 3,201,960 | 6,698,784 |
| Depreciation expense | - | 11,874 | 55,822 | 30,986 | 66,388 | 304,235 | 469,304 |
| Disposals | - | - | - | (1,098,954) | (548,198) | (2,273,383) | (3,920,535) |
| Balance on December 31, 2010 | - | 724,369 | 725,734 | 391,764 | 172,875 | 1,232,812 | 3,247,554 |
| Depreciation expense | - | 45,951 | 159,514 | 49,164 | 90,998 | 263,494 | 609,121 |
| Disposals | - | - | - | - | - | - | - |
| Balance on December 31, 2011 | $ - | $ 770,320 | $ 885,248 | $ 440,928 | $ 263,873 | $1,496,306 | $3,856,675 |
| **Net book value** | | | | | | | |
| January 1, 2010 | $ 299,000 | $ 384,370 | $ 467,874 | $ 71,546 | $ 41,173 | $ 634,403 | $1,898,366 |
| December 31, 2010 | $ 299,000 | $ 372,496 | $ 485,739 | $ 55,527 | $ 352,991 | $ 741,928 | $2,307,681 |
| December 31, 2011 | $ 239,000 | $ 326,545 | $ 1,528,575 | $ 197,136 | $ 295,191 | $ 959,218 | $3,545,665 |

## 12. Intangible assets

| | Fair value of Core Deposits | Name Change & Merger costs | Banking System | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance at January 1, 2010 | $ 159,753 | $ 162,170 | $ 1,734,502 | $ 2,056,425 |
| Additions | - | - | 12,217 | 12,217 |
| Balance on December 31, 2010 | 159,753 | 162,170 | 1,746,719 | 2,068,642 |
| Additions | - | - | 163,947 | 163,947 |
| Balance on December 31, 2011 | $ 159,753 | $ 162,170 | $ 1,910,666 | $ 2,232,589 |
| **Accumulated amortization** | | | | |
| Balance at January 1, 2010 | $ 143,103 | $ 105,533 | $ 220,842 | $ 469,478 |
| Amortization expense | 16,650 | 46,097 | 169,686 | 232,433 |
| Balance on December 31, 2010 | 159,753 | 151,630 | 390,528 | 701,911 |
| Amortization expense | - | 9,543 | 172,245 | 181,788 |
| Balance on December 31, 2011 | $ 159,753 | $ 161,173 | $ 562,773 | $ 883,699 |
| **Net book value** | | | | |
| January 1, 2010 | $ 16,650 | $ 56,637 | $ 1,513,660 | $ 1,586,947 |
| December 31, 2010 | $ - | $ 10,540 | $ 1,356,191 | $ 1,366,731 |
| December 31, 2011 | $ - | $ 997 | $ 1,347,893 | $ 1,348,890 |

The cost amount for the banking system for 2010 and 2011 includes $105,000 of assets not in use at year end. The amortization on these assets will commence when the asset is placed in use.

## 13. Members' deposits

| | **2011** | 2010 | January 1, 2010 |
|---|---|---|---|
| Deposits with variable interest rates | | | |
| Chequing | **$ 51,410,377** | $ 51,245,813 | $ 48,806,094 |
| Savings | **51,845,776** | 49,925,851 | 46,771,934 |
| Plan 24 | **14,753,495** | 14,672,173 | 14,678,832 |
| Registered retirement savings plans | **6,578,445** | 6,502,025 | 8,325,030 |
| Registered retirement income funds | **2,840,530** | 3,290,784 | 4,543,214 |
| Tax free savings accounts | **7,288,303** | 5,222,071 | 3,217,057 |
| | **134,716,926** | 130,858,717 | 126,342,161 |
| Deposits with fixed interest rates | | | |
| Term deposits | **88,997,107** | 86,097,999 | 84,143,960 |
| Tax free savings accounts | **5,413,445** | 3,290,413 | 956,866 |
| Registered retirement savings plans | **38,893,944** | 40,011,556 | 39,517,949 |
| Registered retirement income funds | **18,664,096** | 18,436,967 | 17,277,085 |
| Accrued interest | **2,786,995** | 2,910,914 | 2,884,690 |
| | **154,755,587** | 150,747,849 | 144,780,550 |
| | **$ 289,472,513** | $ 281,606,566 | $ 271,122,711 |

### Terms and conditions

Members' accounts with variable interest rates may be withdrawn on demand. Term deposits are for terms up to five years. Interest can be paid annually, semi-annually, monthly or upon maturity.

### 13. Members' deposits (continued)

**Terms and conditions (continued)**
Registered retirement savings plans (RRSP), registered retirement income funds (RRIFs) and Tax free savings accounts (TFSA) have terms and rates that are similar to the term deposit accounts. Members may make withdrawals from a RRIF account on a monthly, semi-annual, or annual basis. The regular withdrawal amounts vary according to individual needs and statutory requirements.

| Interest on members' deposits consists of: | 2011 | 2010 |
|---|---|---|
| Demand deposits | **$ 690,163** | $ 563,568 |
| Term deposits | **2,259,947** | 2,471,491 |
| Registered retirement savings plans | **1,303,931** | 1,389,844 |
| Registered retirement income funds | **604,600** | 1,030,125 |
| Tax free savings accounts | **179,369** | 87,715 |
| Amortization of core deposit intangible | **-** | 16,644 |
| | **$ 5,038,010** | $ 5,559,387 |

### 14. Pension obligations

The Credit Union maintains two defined benefit pension plans, which cover all employees. The management plan is contributory and the non-management plan is non-contributory. The following information relates to the pension plans:

| | 2011 | 2010 |
|---|---|---|
| **Plan assets** | | |
| Fair value at beginning of year | **$ 10,227,500** | $ 8,713,100 |
| Expected investment return | **786,100** | 674,100 |
| Benefit payments | **(443,700)** | (388,700) |
| Employer contributions | **867,400** | 860,100 |
| Employee contributions | **82,300** | 79,500 |
| Actuarial gain (loss) | **(1,512,300)** | 289,400 |
| Fair value at end of year | **10,007,300** | 10,227,500 |
| **Accrued benefit obligation** | | |
| Balance at beginning of year | **10,172,100** | 9,235,300 |
| Current and past service cost | **368,400** | 319,500 |
| Interest cost | **520,100** | 519,200 |
| Benefit payments | **(443,700)** | (388,700) |
| Employee contributions | **82,300** | 79,500 |
| Actuarial (gains) losses | **563,000** | 407,300 |
| Balance at end of year | **11,262,200** | 10,172,100 |
| Fund status-plan (deficit) surplus, being deferred pension costs | **(1,254,900)** | 55,400 |
| Unrecognized actuarial losses | **3,874,925** | 1,855,498 |
| **Deferred pension costs** | **$ 2,620,025** | $ 1,910,898 |

| 14. Pension obligations (continued) | 2011 | 2010 |
|---|---|---|
| **Pension expense** | | |
| Current and past service cost | **$ 368,400** | $ 319,500 |
| Expected investment return | **(786,100)** | (674,100) |
| Interest cost | **520,100** | 519,200 |
| Actuarial losses recognized | **55,900** | 72,700 |
| | **$ 158,300** | $ 237,300 |
| **Unrecognized actuarial losses** | **$ (3,874,925)** | $ (1,855,498) |

As part of the transition to IFRS, the Credit Union elected to use the corridor approach to recognize a portion of its actuarial gains and losses as income or expense if the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded the greater of:

(a) 10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and
(b) 10% of the fair value of any plan assets at that date.

The limits have been calculated and applied separately for each defined benefit plan. For 2011, actuarial gains and losses recognized in net income according to the corridor approach were $55,873 (2010: $72,702).

As a result of the election, the following past service costs, unamortized initial net obligation and unamortized gains/(losses) were recognized in the opening balance of retained earnings on January 1, 2010

| | |
|---|---|
| Unamortized initial net obligation | $ 224,600 |
| Unamortized gains | 230,300 |
| Past service costs | 242,600 |
| Reduction to January 1, 2010 Retained Earnings (transition to IFRS ) (corridor method) | $ 697,500 |

The accrued benefit obligation for the management plan of $5,088,700 exceeds the fair value of the plan assets of $3,798,800 resulting in a deficit of $1,289,900. The fair value of the plan assets for the staff plan of $6,208,500 exceeds the accrued benefit obligation for the staff plan of $6,173,500 resulting in a surplus of $35,000.

Subsequent to year end, the Credit Union approved an amendment to the staff and management pension plans whereby all new members admitted to the plans after January 1, 2012 will be enrolled in a defined contribution plan.

### 14. Pension obligations (continued)

The assumptions used in the measurement of the benefit obligations are as follows:

| | |
|---|---|
| Discount rate, January 1, 2010 | 5.50% |
| Discount rate, December 31, 2010 | 5.00% |
| Discount rate, January 1, 2011 | 5.00% |
| Discount rate, December 31, 2011 | 4.75% |
| Expected long-term rate of return on plan assets | 7.50% |
| Rate of compensation increase | 2.50% |
| Rate of inflation | 2.00% |

**Employee benefit plan obligation**

The employee benefit plan obligation relates to an early retirement defined benefit plan established in 2004 under the former Timmins Regional Credit Union Ltd. The benefit is paid out to specific employees in the years in which entitlement occurs. At December 31, 2011, the Credit Union records reflect an obligation in the amount of $80,249 (2010: $89,069). This is being reduced as entitlements under the plan come due.

### 15. Term loans

The Credit Union has access to a total credit facility of $32,300,000 with Central 1 Credit Union. The credit facility is secured by a general security agreement. At December 31, 2011, the Credit Union has partially utilized this facility. Term loans outstanding at year end of $20,500,000 (2010: $15,000,000) have an average interest rate of 1.62% (2010: 1.44%) and are classified as financial liabilities.

### 16. Membership shares

**Share Capital**

Membership shares, which are classified as a liability, represent a residual interest in the equity of the Credit Union. They are not covered by deposit insurance. Membership shares are redeemable upon the request of the member, withdrawal from membership and approval of the directors.

Membership shares have an assigned value of $5 per share and members are required to have a minimum of 1 share.

**Class A, Series 1 Shares**

The Credit Union is authorized to issue a limited number of Class A, Series 1 non-cumulative, non-voting, non-participating special shares having an issue price of $1. The Credit Union has $2,508,030 (2010: $2,508,030) Class A, Series 1 Shares issued and outstanding.

The Class A Series 1 Shares have been classified as member equity. In no case shall the total redemptions approved for holders of Class A Series 1 Shares, in any fiscal year, exceed an amount equal to 10% of the total Class A Series 1 Shares outstanding at the end of the previous fiscal year.

## 16. Membership shares (continued)

**Class B, Series 1 Shares**
The Credit Union is authorized to issue a limited number of Class B, Series 1 non-cumulative, non-voting, non-participating special shares having an issue price of $1. The Credit Union has $1,216,555 (2010: $1,266,667) Class B, Series 1 Shares issued and outstanding.

The Class B Series 1 Shares have been classified as member equity. In no case shall the total redemptions approved for holders of Class B Series 1 Shares, in any fiscal year, exceed an amount equal to 10% of the total Class B Series 1 Shares outstanding at the end of the previous fiscal year.

## 17. Regulatory capital

The Credit Union's capital management plan is designed to establish a strong equity base for future growth, the payment of dividends, as well as provide a cushion in the event of market volatility. The Credit Unions and Caisses Populaires Act, 1994 requires the Credit Union to maintain regulatory capital at the following minimum levels:

| % total assets | % risk weighted assets |
|---|---|
| 4.00 | 8.00 |

The regulatory capital guidelines measure capital in relation to assets and risk-weighted assets. The Credit Union has capital policies, procedures and controls which it utilizes to achieve its goals and objectives including: providing sufficient capital to maintain the confidence of investors and depositors, and being an appropriately capitalized Credit Union, as measured internally, defined by regulatory authorities and compared with the Credit Union's peers.

The risk weighted equivalent value is calculated by applying risk weight percentages as prescribed by the Act to various assets, operational and interest rate risk criteria.

The Credit Union is in compliance with the Act and regulations regarding regulatory capital. Regulatory capital consists of the following:

| | **2011** | 2010 |
|---|---|---|
| **Tier 1 capital** | | |
| Membership shares | **$ 72,281** | $ 70,632 |
| Class A and B shares | **3,473,782** | 3,523,894 |
| Retained earnings, contributed surplus less revaluation surplus | **15,487,155** | 14,994,046 |
| Total Tier 1 | **19,033,218** | 18,588,572 |
| | | |
| **Tier 2 capital** | | |
| 10% of redeemable Class A shares | **250,803** | 250,803 |
| Collective provision | **291,023** | 300,000 |
| Total Tier 2 | **541,826** | 550,803 |
| Total regulatory capital | **$ 19,575,044** | $ 19,139,375 |

| **17. Regulatory capital (continued)** | **2011** | 2010 |
|---|---|---|
| Assets | **$332,080,783** | $ 318,632,503 |
| Regulatory capital as % of total assets | **5.9%** | 6.0% |
| Regulatory capital as % of risk weighted asset | **10.8%** | 10.9% |
| Risk weighted assets | **$181,295,188** | $ 175,425,781 |

## 18. Interest rate sensitivity

Interest rate risk is the sensitivity of the Credit Union's financial position to movements in interest rates. The carrying amounts of interest sensitive assets and liabilities and the notional amount of swaps and other derivative financial instruments used to manage interest rate risk are presented below in the periods in which they next re-price to market rates or mature, and are summed to show the interest rate sensitivity gap.

The average rates presented represent the weighted average effective yield.

| **(thousands of dollars)** | **Variable Floating Rate** | **Fixed Within 3 Months** | **Fixed 3 Months to 1 year** | **Fixed 1 to 5 Years** | **Non-Rate Sensitive** | **Total** |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and Investments | 12,349 | 3,539 | 3,480 | 13,283 | 1,768 | 34,419 |
| *Yield (%)* | *.01* | *1.57* | *1.82* | *2.00* | | *1.18* |
| Loans to members | 101,813 | 5,859 | 17,719 | 163,358 | (1,584) | 287,165 |
| *Yield (%)* | *4.07* | *5.97* | *5.78* | *5.03* | | *4.78* |
| Other assets | | | | | 10,497 | 10,497 |
| ***Total assets*** | ***114,162*** | ***9,398*** | ***21,199*** | ***176,641*** | ***10,681*** | ***332,081*** |
| Members' deposits | 134,717 | 15,240 | 57,290 | 79,438 | 2,787 | 289,472 |
| *Yield (%)* | *0.55* | *3.92* | *3.66* | *2.36* | | *1.84* |
| Term loan | 20,500 | | | | | 20,500 |
| *Yield (%)* | *1.62* | | | | | *1.62* |
| Other liabilities | | | | | 2,243 | 2,243 |
| Membership shares | | | | | 72 | 72 |
| Class A, Series 1 shares | | | 2,508 | | | 2,508 |
| Yield (%) | | | *2.28* | | | |
| *Class B, Series 1 shares* | | | *1,217* | | | 1,217 |
| *Yield (%)* | | | *2.00* | | | |
| Members' equity | | | | | 16,069 | 16,069 |
| ***Total liabilities*** | ***155,217*** | ***15,240*** | ***61,015*** | ***79,438*** | ***21,171*** | ***332,081*** |
| Derivatives | 10,000 | | | (10,000) | | |
| Interest sensitivity position - 2011 | **$(31,055)** | **$(5,842)** | **$ (39,816)** | **$87,203** | **$(10,490)** | |
| Interest sensitivity position – 2010 | $(46,420) | $ (10,738) | $ 932 | $66,999 | $(10,773) | |

## 19. Commitments

### (a) Leases and contracts

The Credit Union leases office space and leases property to operate its automated teller machines under long-term lease agreements. In addition various operating contracts have been negotiated with suppliers. Future minimum commitments in each of the next five years under long-term leases and contracts are:

| | |
|---|---|
| 2012 | $ 644,000 |
| 2013 | 596,000 |
| 2014 | 553,000 |
| 2015 | 542,000 |
| 2016 | 430,000 |

### (b) Banking system

The Credit Union has entered a service bureau contract with Open Solutions Canada Inc. to provide banking services over a seven year period commencing in 2008. Future minimum commitments in each of the next four years under this arrangement are approximately as follows:

| | |
|---|---|
| 2012 | $ 517,000 |
| 2013 | 514,000 |
| 2014 | 471,000 |
| 2015 | 400,000 |

### (c) Member loans

At December 31, 2011, the following loans and letters of credit had been approved but not advanced:

| | |
|---|---|
| Mortgages/loans | $ 5,008,655 |
| Lines of credit | 59,392,178 |
| Letters of credit | 2,455,184 |

## 20. Related party transactions

The Credit Union's related parties include key management, as those persons having authority and responsibility for planning, directing and controlling the activities of the Credit Union, including executive management and the Board of Directors. Unless otherwise stated, none of the transactions incorporate special terms and conditions and no guarantees were given or received. Outstanding balances are usually settled in cash.

Total directors' remuneration was $43,125 in 2011 (2010: $47,500).

## 20. Related party transactions (continued)

At December 31, 2011 loans due from restricted parties are as follows:

| | 2011 | 2010 |
|---|---|---|
| Directors, officers and management | **$ 3,075,739** | $ 3,074,785 |
| Staff | **5,078,889** | 5,034,091 |
| | **8,154,628** | 8,108,876 |
| Allowance for impaired loans | **-** | - |
| | **$ 8,154,628** | $ 8,108,876 |

These loans were made on the same terms and conditions as those made to other members, with the exception of computer and professional dress attire loans in the amount of $22,345 which are interest free.

| | 2011 | 2010 |
|---|---|---|
| Deposits from key management personnel | | |
| Aggregate value of term and savings deposits | **$ 1,056,079** | $ 1,118,284 |
| Total interest paid on term and saving deposits | **13,365** | 9,985 |

The Credit Union's policy for receiving deposits from key management personnel is that all transactions are approved and deposits accepted in accordance with the same conditions which apply to members for each type of deposit.

## 21. Fair values of financial instruments

The estimated fair value of the Credit Union's financial instruments as at December 31, 2011 is set out below. No fair values have been determined for property and equipment, or any other asset that is not a financial instrument.

| (thousands of dollars) | Book Value | Estimated Fair Value | **2011 Estimated Fair Value Over (Under) Book Value** | 2010 Estimated Fair Value Over (Under) Book Value |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and investments | $ 32,989 | $ 33,211 | **$ 223** | $ 48 |
| Loans to members | 295,825 | 298,225 | **2,400** | 2,974 |
| Other assets | 3,267 | 3,267 | **-** | 450 |
| **Liabilities** | | | | |
| Members' deposit accounts | 286,686 | 288,193 | **1,507** | 1,793 |
| Borrowings | 24,938 | 24,938 | **-** | - |
| Other liabilities | 592 | 592 | **-** | - |
| Equity | 19,865 | 19,865 | **-** | - |
| **Derivatives** | | | | |
| Swaps | - | (39) | **(39)** | - |

## 21. Fair values of financial instruments (continued)

The fair value of member loans at December 31, 2011 was $298,225,000, December 31, 2010: $276,909,000; and January 1, 2010: $264,181,174.

The estimated fair value of the variable rate loans is assumed to be equal to book value as the interest rates on these loans re-price to market on a periodic basis. The estimated fair value of fixed rate loans is determined by discounting the expected future cash flows at current market rates for products with similar terms and credit risks.

The differences between the book and estimated fair value of the Credit Union's loans, deposits and other financial instruments are due primarily to changes in interest rates. With the exception of mark to market adjustments related to derivatives, the carrying value of the Credit Union's financial instruments is not adjusted to reflect increases or decreases in fair value due to interest rate changes, as it is the Credit Union's intention to realize their value over time by holding them to maturity.

## 22. Income taxes

The significant components of tax expense included in net income are comprised of:

| | **2011** | 2010 |
|---|---|---|
| Current tax expense | | |
| Based on current year taxable income | **$ -** | $ (12,518) |
| Deferred tax expense | | |
| Origination and reversal of temporary differences | **149,813** | 194,610 |
| Total income tax expense | **$ 149,813** | $ 182,092 |

The significant components of the tax effect of the amounts recognized in other comprehensive income are composed of:

| | **2011** | 2010 |
|---|---|---|
| Current tax expense | | |
| Change in unrealized gains/(losses) on available-for-sale investments | **$ -** | $ 41,606 |

The significant components of deferred tax assets (liabilities) relate to:

| | **2011** | 2010 | January 1, 2010 |
|---|---|---|---|
| Deferred pension costs | **$ (406,104)** | $ (296,189) | $ (199,656) |
| Property and equipment | **(199,309)** | (197,491) | (155,843) |
| Allowance for impaired loans | **65,150** | 61,244 | 100,860 |
| Corporate minimum tax credit | **59,018** | 59,018 | 72,305 |
| Prior period adjustment | **-** | 54,471 | 54,471 |
| Other | **9,585** | (2,900) | 625 |
| Deferred tax liability | **$ (471,660)** | $ (321,847) | $ (127,238) |

### 22. Income taxes (continued)

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory rate of 15.5% (2010: 16%) are as follows:

| | **2011** | 2010 |
|---|---|---|
| Net income for the year, adjusted for distributions to members | **$ 724,436** | $ 971,338 |
| Expected taxes based on the statutory rate of 15.5% (2010: 16%) | **112,288** | 155,414 |
| Distributions to members | **(12,635)** | (17,898) |
| Other non deductible portion of expenses | **6,646** | 1,827 |
| Other | **43,514** | 42,749 |
| Total income tax expense | **$ 149,813** | $ 182,092 |

### 23. Risk management

#### (a) Liquidity risk

Liquidity risk is defined as the risk that the Credit Union will be unable to guarantee the orderly funding of member needs and other obligations as they fall due, or become unable to meet commitments to lend money in terms of normal business activity and unforeseen liquidity needs. The Credit Union manages liquidity risk within Board Policy limits to ensure the Credit Union has sufficient liquidity to meet obligations. The Credit Union achieves this through a combination of active management of organic growth and borrowing.

#### (b) Credit risk

Credit risk is defined as the risk of financial loss resulting from the failure of a borrower or counterparty to meet its obligations in accordance with contractual terms and arises from our direct lending, investment and hedging activities. Granting loans to members is one of the Credit Union's primary sources of income and the Credit Union grants credit through defined credit policies and procedures. Members' financial situations are monitored through the life of the loan and all current receivables are expected to be collected. Debt that is in arrears is impaired to the extent that a loss is expected. The Credit Union uses internal risk scoring measures to assess the credit quality of commercial borrowers. These measures are derived from the underlying credit experience, collateral, management expertise, and other objective financial measures.

To manage credit risk, the Credit Union secures collateral against all types of loans. In the event that a member is unwilling or unable to meet their obligations as a borrower, security is liquidated to repay the obligation to the Credit Union. Collateral is taken on each loan funded with regard to the owner's overall credit worthiness including credit history, character, capacity for debt, and type of loan granted. Unsecured credit is extended to high credit worthy members with strong beacon scores. Loan approval limits which are established are based on the experience of the lender. These policies are reviewed on an annual basis. Collateral is generally secured for each type of loan as follows:

### 23. Risk management (continued)

#### (b) Credit risk (continued)

| Loan Type | Nature of collateral |
|---|---|
| **Mortgages** | Mortgage loans are secured by real property. Credit Union members generally have equity in the property being mortgaged |
| **Term loans** | Term loans are generally secured by assets which are equivalent to the approved balance. Term loans can be unsecured. Risk of unsecured term loans are reflected in the rate of the loan |
| **Lines of credit** | Lines of credit are generally secured by assets which are equivalent to the approved balance of the facility. Lines of credit can be unsecured. Risk of unsecured lines of credit are reflected in the rate of the facility |

#### (c) Structural/Market risk

Structural/Market risk is defined as the risk that the Credit Union's ability to meet business objectives will be adversely affected by volatility in interest rates. The Credit Union manages market risk using an Earnings at Risk approach. The primary objective of this approach is to maximize earnings on a consistent basis while minimizing reductions to net income resulting from changes in future interest rates.

Structural/Market risk is monitored through the Structural Risk Management Policy with the objective of ensuring that the Credit Union manages its cash flows in a manner that contributes adequately to earnings and limits the risk to the financial margin and equity of the Credit Union, ensuring product terms, pricing and Statement of Financial Position mix balance members product demands with the need to protect the equity of the Credit Union, and to ensure that financial derivative instruments be used only to limit interest rate risk and not be used for speculative or investment purposes.

The Credit Union uses income simulation modelling to measure exposure to changes in interest rates over short term periods. Earnings at Risk is calculated by forecasting the net interest margin for the next 12 month period using most likely assumptions. Most likely assumptions include management's best estimates for planned growth rates and the use of future interest rates. Planned growth rates are recorded at the start of the fiscal period as initially set out in the budget and modified to actual experience through the fiscal period. Future interest rates on new business and product renewals are determined using the future interest rates derived mathematically based on the term structure of interest rates. The impact of rate shock scenarios are measured against the most likely forecast [ML] as defined above. The resulting change in the forecast as a result of interest rate shocks is then compared to the ML forecast to determine the Earnings at Risk amount. Maximum change limits under these interest rate scenarios have been defined and approved by the Board of Directors. These scenarios are based on hypothetical simulations assuming the markets are shocked with a 100 or 200 basis point volatility. At the current time, the Credit Union is in compliance with all limits set by the Board of Directors in the Structural Risk Management Policy.

### 23. Risk management (continued)

### (c) Structural/Market risk (continued)

| Asset Liability Management Limits | Maximum Change Limit (as % of assets) | Projected Change to Earnings | Status |
|---|---|---|---|
| | (in thousands of Dollars) | | |
| Most Likely Shocked + 200 basis points | N/A | 774 | Compliant |
| Most Likely Shocked + 100 basis points | 0.15% | 386 | Compliant |
| Most Likely Forecast Scenario | 0% | 0 | Compliant |
| Most Likely Shocked - 100 basis points | (0.15%) | (218) | Compliant |
| Most Likely Shocked - 200 basis points | N/A | (335) | Compliant |

### (d) Operational risk

Operational risk is the risk of loss associated with failed internal processes, people and systems and from external events. Operational risk is managed through Operational Risk Management Policy which establishes defined and prudent levels of decision-making authority, ensures the security and efficient operation of a management information system, technology development and maintenance, the safeguarding of the Credit Union's premises, assets and records, proper disaster recovery and business continuity plans, efficient process for outsourcing, monitoring of controls and compliance with bonding requirements and the Deposit Insurance Corporation of Ontario Standards of Sound Business and Financial Practices.

### 24. First time adoption of international financial reporting standards

IFRS 1, First Time Adoption of International Financial Reporting Standards, requires that comparative financial information be provided. As a result, the first date at which the Credit Union has applied IFRS was January 1, 2010 (the "Transition Date"). IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Credit Union will be December 31, 2011. Therefore, the financial statements for the year-ended December 31, 2010 and the opening IFRS statement of financial position at January 1, 2010 are prepared in accordance with IFRS standards effective at the reporting date. However, IFRS also provides for certain optional exemptions and certain mandatory exceptions for first-time IFRS adopters.

In preparing its opening IFRS Statement of Financial Position, the Credit Union has adjusted amounts reported previously in financial statements prepared in accordance with pre-changeover Canadian GAAP. An explanation of how the transition from pre-changeover Canadian GAAP to IFRS has affected the Credit Union's financial position, financial performance and cash flows is set out in the following notes and tables.

## 24. First time adoption of international financial reporting standards (continued)

### IFRS 1 Exemptions and Exceptions

The IFRS 1 applicable exemptions and exceptions applied in the conversion from pre-changeover Canadian GAAP to IFRS are as follows:

**Optional Exemptions**

***Business Combinations***

The Credit Union has elected not to retrospectively apply IFRS 3, Business Combinations, to business combinations that occurred prior to its Transition Date and such business combinations have not been restated.

***Compound Financial Instruments***

The Credit Union has elected not to retrospectively separate the liability and equity components of compound instruments for which the liability component is no longer outstanding at the date of transition to IFRS.

**Optional Exemptions**

***Pension Plans***

The Credit Union has elected not to apply the IFRS 1 optional exemption related to pensions. The Credit Union has therefore chosen to retrospectively apply the IFRS pension accounting standards. As a result of the retrospective application, the Credit Union has chosen to apply the corridor method and to recognize a portion of the actuarial gains / losses in net income on an annual basis. The actuarial gains and losses since inception were recognized in retained earnings on transition from pre-changeover Canadian GAAP. The actuarial valuations under pre-changeover Canadian GAAP and IFRS are consistent.

**Mandatory Exceptions**

***Derecognition of Financial Assets and Liabilities***

The Credit Union has applied the derecognition requirements in IAS 39, Financial Instruments; Recognition and Measurement, prospectively from the date of transition to IFRS. As a result any non-derivative financial assets or non-derivative financial liabilities derecognized prior to the date of transition to IFRS in accordance with pre-changeover Canadian GAAP have not been reviewed for compliance with IAS 39 derecognition requirements.

***Estimates***

The estimates previously made by the Credit Union under pre-changeover Canadian GAAP were not revised for the application of IFRS except where necessary to reflect any difference in accounting policy or where there was objective evidence that those estimates were in error. As a result the Credit Union has not used hindsight to revise estimates.

### Reconciliation of Equity and Comprehensive Income

In preparing these financial statements, management has amended certain accounting policies previously applied in the pre-changeover Canadian GAAP financial statements to comply with IFRS. The comparative figures for 2010 were restated to reflect these adjustments. The following reconciliations and explanatory notes provide a description of the effect of the transition from pre-changeover Canadian GAAP to IFRS on members' equity, net income and comprehensive income:

## 24. First time adoption of international financial reporting standards (continued)

### Consolidated Statement of Financial Position for the Year-Ended January 1, 2010 – Transition Date

| | Sub-note | Pre-Changeover Canadian GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and short term investments | | $ 5,815,653 | $ - | $ 5,815,653 |
| Investments | (i) | 26,164,259 | 197,894 | 26,362,153 |
| Derivative swap asset | | 501,270 | - | 501,270 |
| Deferred pension costs | (iv) | 1,985,600 | (697,500) | 1,288,100 |
| Prepaid expenses and other assets | | 1,864,340 | - | 1,864,340 |
| Income taxes recoverable | | 138,014 | - | 138,014 |
| Accrued interest receivable | (ii) | 641,132 | 254,354 | 895,486 |
| Loans to members | (ii) | 260,797,067 | (230,362) | 260,566,705 |
| Property and equipment | (iii) | 1,712,673 | 185,693 | 1,898,366 |
| Intangible assets | | 1,586,946 | - | 1,586,946 |
| Foreclosed asset | | 1,059,306 | - | 1,059,306 |
| Total assets | | $ 302,266,260 | $ (289,921) | $ 301,976,339 |
| **Liabilities** | | | | |
| Member deposits | | $ 271,122,711 | $ - | $ 271,122,711 |
| Term loans | | 11,000,000 | - | 11,000,000 |
| Payables and accruals | | 1,059,002 | - | 1,059,002 |
| Employee benefit plan obligation | | 102,089 | - | 102,089 |
| Deferred tax liability | (i)(iv) | 308,393 | (181,156) | 127,237 |
| Membership shares | | 71,714 | - | 71,714 |
| Total liabilities | | 283,663,909 | (181,156) | 283,482,753 |
| **Members' Equity** | | | | |
| Class A Series 1 shares | (v) | 2,508,030 | - | 2,508,030 |
| Class B Series 1 shares | (v) | 1,327,373 | - | 1,327,373 |
| Contributed surplus | | 1,315,305 | - | 1,315,305 |
| Retained earnings | (ii)(iii)(iv) | 13,461,056 | (274,007) | 13,187,049 |
| Accumulated other comprehensive income (loss) | (i) | (9,413) | 165,242 | 155,829 |
| Total members' equity | | 18,602,351 | (108,765) | 18,493,586 |
| **Total Liabilities and Members' Equity** | | $ 302,266,260 | $ (289,921) | $ 301,976,339 |

## 24. First time adoption of international financial reporting standards (continued)

### Consolidated Statement of Financial Position for the Year-Ended December 31, 2010

| | Sub-note | Pre-Changeover Canadian GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and short term investments | | $ 8,994,894 | $ - | $ 8,994,894 |
| Investments | *(i)* | 26,405,629 | 450,054 | 26,855,683 |
| Derivative swap asset | | 342,183 | - | 342,183 |
| Deferred pension costs | *(iv)* | 2,518,600 | (607,702) | 1,910,898 |
| Prepaid expenses and other assets | | 2,022,250 | - | 2,022,250 |
| Income taxes recoverable | | 132,319 | - | 132,319 |
| Accrued interest receivable | (ii) | 728,099 | 289,830 | 1,017,929 |
| Loans to members | (ii) | 273,933,668 | (251,732) | 273,681,936 |
| Property and equipment | (iii) | 2,126,372 | 181,309 | 2,307,681 |
| Intangible assets | | 1,366,730 | - | 1,366,730 |
| Total assets | | $ 318,570,744 | $ 61,759 | $ 318,632,503 |
| **Liabilities** | | | | |
| Member deposits | | $ 281,606,566 | $ - | $ 281,606,566 |
| Term loans | | 15,000,000 | - | 15,000,000 |
| Payables and accruals | | 2,214,158 | - | 2,214,158 |
| Employee benefit plan obligation | | 89,069 | - | 89,069 |
| Deferred tax liability | (i)(iv) | 399,590 | (77,743) | 321,847 |
| Membership shares | | 70,632 | - | 70,632 |
| Total liabilities | | 299,380,015 | (77,743) | 299,302,272 |
| **Members' Equity** | | | | |
| Class A Series 1 shares | (v) | 2,508,030 | - | 2,508,030 |
| Class B Series 1 shares | (v) | 1,266,667 | - | 1,266,667 |
| Contributed surplus | | 1,315,305 | - | 1,315,305 |
| Retained earnings | (ii)(iii)(iv) | 14,100,727 | (236,293) | 13,864,434 |
| Accumulated other comprehensive income | (i) | - | 375,795 | 375,795 |
| Total members' equity | | 19,190,729 | 139,502 | 19,330,231 |
| **Total Liabilities and Members' Equity** | | $ 318,570,744 | $ 61,759 | $ 318,632,503 |

### 24. First time adoption of international financial reporting standards (continued)

**Consolidated Statement of Comprehensive Income for the Year Ended December 31, 2010**

| | Sub-note | Pre-Changeover Canadian GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| Interest Revenue | | | | |
| Interest – personal loans | (ii) | $ 3,588,776 | $ 15,292 | $ 3,604,068 |
| Interest – personal mortgages | (ii) | 5,440,496 | 23,220 | 5,463,716 |
| Interest – business loans and mortgage | (ii) | 4,147,588 | 18,123 | 4,165,711 |
| Investment income | | 425,661 | - | 425,661 |
| | | 13,602,521 | 56,635 | 13,659,156 |
| Interest expense | | | | |
| Interest on members' deposits | | 5,559,387 | - | 5,559,387 |
| Interest on borrowing | | 156,766 | - | 156,766 |
| Impairment losses on member loans | (ii) | 606,536 | 42,529 | 649,065 |
| | | 6,322,689 | 42,529 | 6,365,218 |
| Financial margin | | 7,279,832 | 14,106 | 7,293,938 |
| Other revenue | | 3,215,842 | - | 3,215,842 |
| | | 10,495,674 | 14,106 | 10,509,780 |
| Other expenses | | | | |
| Depreciation of property and equipment | (iii) | 464,922 | 4,382 | 469,304 |
| Amortization of intangibles | | 215,787 | - | 215,787 |
| Automated networks | | 993,854 | - | 993,854 |
| General and administration | | 1,503,630 | - | 1,503,630 |
| Insurance | | 431,454 | - | 431,454 |
| Loan costs | | 84,712 | - | 84,712 |
| Occupancy | | 676,759 | - | 676,759 |
| Salaries, wages and benefits | (iv) | 5,252,740 | (89,798) | 5,162,942 |
| | | 9,623,858 | (85,416) | 9,538,442 |
| Distributions to members | | | | |
| Dividends on Class A, Series 1 Shares | (v) | 86,528 | (86,528) | - |
| Dividends on Class B, Series 2 Shares | (v) | 25,333 | (25,333) | - |
| | | 111,861 | (111,861) | - |
| Income before income taxes | | 759,955 | 211,383 | 971,338 |
| Provision for income taxes | | | | |
| Current income tax | | 29,088 | (41,606) | (12,518) |
| Deferred income tax | (iv) | 91,199 | 103,411 | 194,610 |
| Net income for the year | | $ 639,668 | $ 149,578 | $ 789,246 |

**Consolidated Statement of Cash Flows for the year-ended December 31, 2010**

The transition to IFRS had no impact on total financing activities on the statement of cash flows. The change in net income for year-ended December 31, 2010 has been offset by adjustments to operating and investing activities.

### 24. First time adoption of international financial reporting standards (continued)

**Explanations for the Adjustments are as follows**

*(i) Investments*

Under pre-changeover Canadian GAAP the Credit Union classified all investments as available-for-sale. The Credit Union maintained this classification on the transition to IFRS. Pre-changeover Canadian GAAP permits investments classified as available-for-sale that are not quoted in an active market to be measured at cost. IFRS only permits such investments to be measured at cost if they are not quoted in an active market and fair value cannot be reliably determined. As a result certain available-for-sale investments that were previously measured at cost are now measured at fair value. The fair value adjustment, at January 1, 2010 of $197,894 was made to the value of the ABCP LP Investment while accumulated other comprehensive income recorded an increase of $165,242 net of tax of $32,652.

During 2010, there was an additional gain recorded to increase the value of the ABCP LP by $252,160, while accumulated other comprehensive income was increased by $210,553, net of tax of $41,607. The increase in the investment from the Canadian GAAP value to the IFRS value in 2010 includes the sum of the two amounts or $450,054 increase while accumulated comprehensive other income increased $375,795 net of tax of $74,259.

*(ii) Loans*

Under pre-changeover Canadian GAAP the Credit Union provided for impaired member loans on a specific loan basis along with a general provision. Under IFRS, the Credit Union first assesses whether objective evidence of impairment exists individually for loans that are individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed loan, whether significant or not, the loan is included in a group of loans with similar credit risk characteristics and that group of loans is collectively assessed for impairment. The expected future cash outflows for a group of loans with similar credit risk characteristics are estimated based on historical loss experience.

At January 1, 2010, the loan impairment provision was increased by $230,362, accrued interest was increased by $254,354 to include non-accrual interest on impaired loans previously excluded, and an increase in retained earnings was recorded for $23,992.

In 2010, additional accrued interest receivable was recorded of $35,476, the allowance for doubtful accounts was increased by an additional $21,370 and the provision for loan losses was increased by $42,529 as result of changes in the loan loss methodology. Interest revenue increased $56,635.

*(iii) Property and equipment*

Under IFRS the Credit Union elected to take the deemed cost exemption and adjust the value of land and building at its Trunk Road location to fair value based on an appraisal obtained. As a result of the election, the land value increased by $98,037 and the building value increased by $87,655 for a total increase of $185,692 with an offsetting entry to increase retained earnings by $185,692. Amortization on the building was recomputed in 2010 using the revised net book value and as a result depreciation expense increased by $4,382 and accumulated amortization increased by $4,382. The net effect in 2010 was an increase in net book value of property and equipment of $181,310.

### 24. First time adoption of international financial reporting standards (continued)

*(iv) Pension accounting*

Under pre-changeover Canadian GAAP any unrealized gains or losses were included as part of the deferred pension asset/liability. On transition, the net impact of past gains and losses recognized through retained earnings was a reduction of $697,500 and a reduction in the deferred pension asset, included in other assets on the Consolidated Statement of Financial Position, of $697,500.

The credit union has elected to apply the corridor approach (for each of its pension plans) to recognize a portion of its actuarial gains and losses as income or expense if the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded the greater of:

(a) 10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and
(b) 10% of the fair value of any plan assets at that date.

The limits have been calculated and applied separately for each defined benefit plan. For 2010, actuarial losses recognized in net income according to the corridor approach were $72,700.

*(v) Members' Shares*

Under pre-changeover Canadian GAAP, the credit union recognized all members' shares, including all membership shares, investment shares and patronage shares, as other financial liabilities. They were initially measured at fair value, including direct and incremental transaction costs and are subsequently measured at amortized cost. Under IFRS, the member shares are classified as equity only to the extent that they do not meet the definition of a financial liability or financial asset.

As a result of the above accounting, the pre-changeover Canadian GAAP member share liability was recalculated and reclassified at January 1, 2010 and December 31, 2010. Member shares recognized as a liability decreased by $3,835,403 at January 1, 2010 (December 31, 2010 - $3,774,697) and member shares recognized as equity increased by $3,835,403 at January 1, 2010 (December 31, 2010 - $3,774,697). For 2010, distributions to members in the amount of $111,861 were moved from the income statement to the Consolidated Statements of Changes in Members' Equity.

### 25. Executive compensation

Effective October 1, 2010, the Act requires disclosure of the five highest paid officers and employees where remuneration paid during the year exceeded $150,000. For 2011, the following remuneration requires disclosure:

Mr. Gregory Peres, Chief Executive Officer (CEO), earned total remuneration in the year of $158,938 (2010: $174,917); $145,635 (2010: $138,471) for salary, $7,989 (2010: $31,003) for variable compensation, and $5,314 (2010: $5,443) for taxable benefits.

On an annual basis, the Board reviews the CEO compensation and considers market expectations for similar roles in comparable organizations. Variable compensation is based on corporate performance against strategic metrics established at the beginning of each year.

### 26. Prior period adjustment

The Credit Union carried items on its bank reconciliation in the amount of $118,070, from 2009 and prior years that were adjustments to the cash balance that were determined not to be collectible. Management conducted a thorough investigation of the reconciling items and was unable to validate their collectability. As a result, the opening retained earnings at January 1, 2010 and the opening cash balance were restated to reflect the write off of the uncollectible amounts. Since this is considered to be an error in a prior period, a retrospective adjustment is required.

The effective tax rate in 2009 per the audited financial statements was 20.15% so this rate was applied to estimate the income tax effect of the adjustment.

As a result of the retrospective adjustment, opening retained earnings in 2010 was reduced by $94,280, income taxes recoverable increased by $23,790 and cash decreased $118,070 in the 2010 comparative column.