Financial Statements of

NEWFOUNDLAND AND LABRADOR CREDIT UNION LIMITED

Year ended December 31, 2017

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INDEPENDENT AUDITOR'S REPORT

To the Members of Newfoundland and Labrador Credit Union Limited

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Comparative Information

The financial statements of Newfoundland and Labrador Credit Union Limited as at and for the year ended December 31, 2016 were audited by another auditor who expressed an unmodified opinion on those financial statements on January 28, 2017.

KPMG LLP

Chartered Professional Accountants

St. John's, Canada

January 27, 2018

NEWFOUNDLAND AND LABRADOR CREDIT UNION LIMITED

Statement of Financial Position

December 31, 2017, with comparative information for 2016

	2017	2016

Assets

	2017	2016
Cash and cash equivalents (note 5)	$ 9,378,134	$ 8,307,954
Investments (note 6)	52,553,612	65,866,033
Loans and mortgages receivable (note 7):		
Personal loans	88,841,959	82,722,941
Mortgage loans	360,952,882	355,603,483
Commercial loans and mortgages	40,808,854	36,397,932
	490,603,695	474,724,356
Less allowance for impaired loans and mortgages (note 8)	(1,044,559)	(867,907)
	489,559,136	473,856,449
Property and equipment (note 9)	18,043,198	18,587,524
Derivative financial instruments (note 16)	2,490,186	2,445,610
Other assets	2,006,921	2,511,525
	$ 574,031,187	$ 571,575,095

Liabilities and Retained Earnings Attributed to Members

	2017	2016
Liabilities:		
Members' deposits (note 10)	$ 546,384,153	$ 544,393,946
Accounts payable and accrued liabilities	1,020,358	1,105,151
Severance provisions	1,826,392	1,776,181
Derivative financial instruments (note 16)	2,490,186	2,445,610
	551,721,089	549,720,888
Retained earnings attributed to members	22,310,098	21,854,207
Commitments (note 14)		
	$ 574,031,187	$ 571,575,095

See accompanying notes to financial statements.

On behalf of the Board:

_______________ Director _______________ Director

NEWFOUNDLAND AND LABRADOR CREDIT UNION LIMITED

Statement of Comprehensive Income and Retained Earnings

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

	2017	2016
Revenue:		
Interest income (note 3)	$ 18,253,340	$ 18,865,291
Investment income	992,880	889,737
	19,246,220	19,755,028
Financial expenses:		
Interest on members' deposits (note 4)	5,668,949	5,971,163
Financial margin	13,577,271	13,783,865
Other income:		
Service charges	3,176,707	3,144,025
Other	204,434	297,203
Insurance commissions	855,421	812,176
Rental	209,368	185,649
	4,445,930	4,439,053
Financial margin and other income	18,023,201	18,222,918
Non interest expenses:		
Personnel	9,629,025	9,556,167
General business	3,728,909	3,927,291
Occupancy	1,525,341	1,558,637
Members' security	1,510,071	1,342,250
Depreciation	908,151	933,738
	17,301,497	17,318,083
Income before income taxes	721,704	904,835
Income taxes (note 11)	133,813	228,812
Comprehensive income for the year	587,891	676,023
Retained earnings, beginning of year	21,854,207	21,305,184
Dividends	(132,000)	(127,000)
Retained earnings, end of year	$ 22,310,098	$ 21,854,207

See accompanying notes to financial statements.

NEWFOUNDLAND AND LABRADOR CREDIT UNION LIMITED

Statement of Cash Flows

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

	2017	2016
Cash provided by (used in):		
Operations:		
Comprehensive income for the year	$ 587,891	$ 676,023
Items not involving cash:		
Depreciation	908,151	933,738
Provision for impaired loans and mortgages	176,652	254,210
Financial margin	(13,577,271)	(13,783,865)
Current income taxes	113,652	205,142
Increase in severance provision	50,211	13,211
Deferred income tax expense	(55,825)	23,670
	(11,796,539)	(11,677,871)
Changes in operating assets / liabilities:		
Change in accounts payable and accrued liabilities	(89,792)	(204,906)
Change in members' deposits	2,156,103	(262,517)
Change in loans and mortgages receivable	(15,320,494)	2,358,032
Change in other assets	651,929	219,656
Interest received	18,820,443	19,726,175
Interest paid	(5,703,662)	(5,954,762)
Income taxes paid	(205,152)	(422,141)
	(11,487,164)	3,781,666
Investing activities:		
Decrease (increase) in investments	13,180,251	(6,142,627)
Purchase of property and equipment	(363,825)	(413,242)
	12,816,426	(6,555,869)
Financing activities:		
Dividends paid on membership shares	(127,000)	(124,000)
Decrease in membership share capital	(132,082)	(124,109)
	(259,082)	(248,109)
Net increase (decrease) in cash and cash equivalents	1,070,180	(3,022,312)
Cash and cash equivalents, beginning of year	8,307,954	11,330,266
Cash and cash equivalents, end of year	$ 9,378,134	$ 8,307,954

See accompanying notes to financial statements.

Newfoundland and Labrador Credit Union Limited (NLCU) is incorporated under the Credit Union Act of Newfoundland and Labrador (the "Act") and is a member of the Credit Union Deposit Guarantee Corporation of Newfoundland and Labrador. NLCU commenced operations in 1957. It currently operates twelve branches that offer a full range of financial services to the people of Newfoundland and Labrador. The registered office of NLCU is at 240 Water Street, St. John's, Newfoundland and Labrador.

1. Basis of preparation and statement of compliance:

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

These financial statements have been approved and authorized for issue by the Board of Directors on January 27, 2018.

Basis of preparation

These financial statements are presented in Canadian dollars which is NLCU's functional currency. They are prepared on the historical cost basis except for available-for-sale investments, and derivative financial instruments, which are stated at their fair value.

Use of significant accounting judgments, estimates and assumptions

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

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

Estimates and judgments made by management in the application of IFRS have a significant effect on these financial statements. Areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to NLCU's financial statements are as follows:

1. Basis of preparation and statement of compliance (continued):

(a) Fair value of financial instruments

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

(b) Impairment losses on loans and mortgages

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

Loans and mortgages have been assessed individually for impairment. The impairment loss on loans and mortgages is disclosed in more detail in Note 8.

(c) Economic lives of property and equipment

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

(d) Syndicated loans

NLCU has entered into syndication agreements with various other credit unions to limit exposure to certain commercial loans.

Management is required to use judgment in the determination under IAS 36 if the loans meet the criteria for derecognition.

1. Basis of preparation and statement of compliance (continued):

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

New standards and interpretations not yet adopted

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

(a) Financial instruments

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

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

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

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

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

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

1. Basis of preparation and statement of compliance (continued):

(b) Revenue from Contracts with Customers

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

The core principle of IFRS 15 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

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

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

IFRS 15 is applicable for annual periods beginning on or after January 1, 2018, with earlier application permitted. Management does not believe there will be any material impact on the adoption of IFRS 15.

(c) Leases

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

2. Significant accounting policies:

The following significant accounting policies have been applied consistently by NLCU to all periods presented in these financial statements without exception.

(a) Financial instruments:

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

Classification

Cash and cash equivalents	Loans and receivables
Investments:	
Equity investments	Available-for-sale
Liquidity reserve	Loans and receivables
Loans and mortgages	Loans and receivables
Other assets:	
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Members' deposits	Other liabilities
Other liabilities	Other liabilities
Derivative financial instruments	Fair value through profit or loss

Membership shares and surplus shares and incentive shares

In accordance with IFRIC 2, NLCU's membership shares, surplus shares, and incentive shares are presented in the statement of financial position as financial liabilities. These liabilities qualify as equity for regulatory purposes, notwithstanding their financial statement classification. Discretionary dividends on these shares will be recorded as a reduction in retained earnings, if and when declared.

Fair value through profit or loss ("FVTPL")

Financial assets and financial liabilities are classified as FVTPL when the financial asset or financial liability is held for trading or it is designated as FVTPL, if certain criteria are met.

Financial assets and financial liabilities at FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognized in comprehensive income. NLCU's financial instruments designated as FVTPL consist of derivative financial instruments.

2. Significant accounting policies (continued):

(a) Financial instruments (continued):

Available-for-sale financial assets

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

Shares in Central 1, League Data, and Concentra Financial held by NLCU are not traded in an active market and are classified as available-for-sale. Available-for-sale equity investments with a fair value that cannot be reliably measured are measured at cost less any identified impairment losses at the end of each reporting period.

Loans and receivables

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

Interest income is recognized by applying the effective interest rate.

Effective interest method

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

2. Significant accounting policies (continued):

(a) Financial instruments (continued):

Impairment of financial assets and allowance for impaired loans

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

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

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

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

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

2. Significant accounting policies (continued):

(a) Financial instruments (continued):

Derecognition of financial assets

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

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

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

Other liabilities

Other liabilities are initially recorded at fair value and subsequently measured at amortized cost using the effective interest method.

Derecognition of financial liabilities

NLCU derecognizes financial liabilities when, and only when, NLCU's obligations are discharged, cancelled or expire.

Embedded derivatives

Derivatives embedded in non-derivative host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value through comprehensive income.

(b) Cash and cash equivalents:

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

2. Significant accounting policies (continued):

(c) Property and equipment:

Property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses. When parts of a capital asset have different useful lives, they are accounted for as separate assets.

Depreciation is recognized in profit or loss on a straight-line basis over the respective assets' estimated useful lives with the exception of depreciation of paved areas and furniture and equipment, which is recognized using the declining balance method.

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

(d) Leases:

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

Rental income from operating leases is recognized on a straight-line basis over the term of the related lease.

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

2. Significant accounting policies (continued):

(e) Employee benefits:

a) Short-term employee benefits

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

b) Severance provisions

Severance provisions are calculated based on management's best estimate of expected payment for years of service and current salary levels discounted from the expected payment date. The right to be paid severance pay vests with employees with twenty years of continual service with NLCU. Severance is payable when the employee ceases employment with NLCU. The severance provision is unfunded.

(f) Revenue recognition:

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

(g) Income taxes:

Income tax expense comprises current and deferred tax.

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

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

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

2. Significant accounting policies (continued):

(h) Foreign currency translation:

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

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

Translation gains and losses are recognized immediately in comprehensive income and are included in the 'other income' line item in the Statement of Comprehensive Income and Retained Earnings.

3. Financial revenue - members' loans and mortgages:

	2017	2016
Personal loans	$ 4,833,748	$ 4,766,392
Residential mortgages	11,740,897	12,553,598
Commercial loans and mortgages	1,678,695	1,545,301
	$ 18,253,340	$ 18,865,291

4. Interest on members' deposits:

	2017	2016
Personal chequing accounts	$ 13,740	$ 8,577
Savings accounts	463,236	540,401
Term deposits	2,542,648	2,662,220
Registered savings accounts	1,702,296	1,811,782
Tax free savings accounts	542,221	500,031
Index - linked deposits	391,567	448,152
Other	13,241	-
	$ 5,668,949	$ 5,971,163

5. Cash and cash equivalents:

	2017	2016
Cash on hand	$ 3,885,062	$ 4,043,470
Cash held with Credit Union Central	3,918,816	2,920,897
Cash held with other chartered banks	1,574,256	1,343,587
	$ 9,378,134	$ 8,307,954

NLCU has available lines of credit with Central 1 in the amounts of $9,900,000 (CDN) and $300,000 (USD). As at December 31, 2017, there were no drawings on these facilities (2016 - nil). There is also a $3,000,000 (CDN) credit facility with Atlantic Central available to NLCU which was not drawn on at year end (2016 - nil).

6. Investments:

The following table provides information on the investments held by NLCU.

	2017	2016
Loans and receivables		
Mandatory liquidity reserve deposits	$ 32,832,750	$ 33,082,250
Central 1 deposit note	10,000,000	32,001,635
Consumer loan pool	4,327,737	-
Syndicated loan	3,851,891	-
Other deposits	891,256	-
Available-for-sale		
Equity investments	457,107	457,107
	52,360,741	65,540,992
Accrued interest	192,871	325,041
	$ 52,553,612	$ 65,866,033
Fair value	$ 52,553,612	$ 65,866,033

Mandatory liquidity deposits are fixed rate notes with maturity dates ranging between 2018 and 2022 and earn a weighted average interest rate of 1.2%.

6. Investments (continued):

The Central 1 deposit note matures in 2018 and earns interest at a rate of 1.74%.

The syndicated loans have maturity dates between 2019 and 2021 and earn a fixed rate weighted average interest rate of 3.99%.

Central 1 Credit Union - liquidity reserve deposit

As a condition required under Newfoundland and Labrador Regulations 56/09 Credit Union Regulation 2009 Section 19, NLCU is required to maintain on deposit with Central 1 an amount equal to 6% of NLCU's total liabilities as at each month end. At maturity, these deposits are reinvested at market rates for various terms as determined by management. The deposit can be withdrawn only if there is a sufficient reduction in NLCU's liabilities or upon withdrawal of membership from Central 1.

Interest on mandatory reserve deposits and other deposits generated an average annual return of 1.8% (2016 - 1.42%).

Equity investments

Equity investment shares are issued and redeemable at par value. As there is no active market for these shares, fair value is not reliably determinable as future cash flows cannot be reasonably predicted with a standard valuation technique. Therefore these equity investments are carried at cost.

7. Loans to members:

Personal and commercial mortgages are repayable in monthly blended principal and interest installments over a maximum term of seven years up to the maximum amortization period as prescribed by Provincial law. Mortgages are secured by residential and commercial properties as noted below. Mortgages earn a weighted average interest rate of 3.2% (2016 - 3.43%). Many of the loans are insured.

7. Loans to members (continued):

Personal loans, including line of credit loans, are repayable in monthly blended principal and interest installments over a period acceptable by Provincial law, except for line of credit loans, which are repayable on a revolving credit basis and require minimum monthly payments. All loans, except for mortgage loans, are open and, at the option of the borrower, may be repaid at any time without notice. Types of collateral generally obtained by NLCU include, but are not limited to, the following: member's personal property such as vehicles; cash and marketable securities; mortgage charges; fixed, floating or specific general security agreements; and personal guarantees. Personal loans earn a weighted average interest rate of 5.5% (2016 - 5.31%).

As of December 31, 2017 NLCU had $73,445,805 in approved lines of credit that had not been disbursed.

Commercial loans are repayable in periodic blended principal and interest installments and earn a weighted average interest rate of 5.22% (2016 - 4.71%).

Security held on a portfolio basis is as follows:

	2017	2016
Insured mortgages	$ 226,714,032	$ 240,878,675
Uninsured mortgages	155,028,897	132,209,590
Secured loans	69,312,068	65,859,644
Unsecured loans	39,548,698	35,776,447
	$ 490,603,695	$ 474,724,356

8. Allowance for impaired loans and mortgages:

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

	Personal	Mortgages	Commercial	2017 Total	2016 Total
Balance, beginning of year	$ 795,797	$ 13,747	$ 58,363	$ 867,907	$ 900,509
Loans written-off as uncollectible	(147,062)	(2,559)	-	(149,621)	(286,812)
Provision for (recovery of) impaired loans and mortgages	337,471	(11,188)	(10)	326,273	254,210
Balance, end of year	$ 986,206	$ -	$ 58,353	$ 1,044,559	$ 867,907

Credit quality of member loans is summarized as follows:

	Personal	Mortgages	Commercial	2017 Total
Neither past due (1) nor impaired	$ 87,627,850	$ 358,176,574	$ 26,873,628	$ 472,678,052
Past due but not impaired				
31 to 90 days	207,383	1,467,835	67	1,675,285
91 and greater	20,520	1,308,473	13,876,806	15,205,799
Impaired	986,206	-	58,353	1,044,559
	88,841,959	360,952,882	40,808,854	490,603,695
Less: specific allowances	(986,206)	-	(58,353)	(1,044,559)
	$ 87,855,753	$ 360,952,882	$ 40,750,501	$ 489,559,136

8. Allowance for impaired loans and mortgages (continued):

	Personal	Mortgages	Commercial	2016 Total
Neither past due (1) nor impaired	$ 81,874,138	$ 352,886,586	$ 36,339,569	$ 471,100,293
Past due but not impaired				
31 to 90 days	34,260	1,436,897	-	1,471,157
91 and greater	18,746	1,266,253	-	1,284,999
Impaired	795,797	13,747	58,363	867,907
	82,722,941	355,603,483	36,397,932	474,724,356
Less: specific allowances	(795,797)	(13,747)	(58,363)	(867,907)
	$ 81,927,144	$ 355,589,736	$ 36,339,569	$ 473,856,449

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

9. Property and equipment:

	Land	Buildings	Roof and Air Conditioning	Paved Areas	Leasehold Improvements	Furniture and equipment	Computer terminals	Automated banking machines	Automobile	Personal computers and software	Total 2017
Rate		50 years	25 years	8%	5 years	20%	5 years	5 years	5 years	3 years	
Cost											
Balance, beginning of year	$ 3,951,343	$ 15,420,340	$ 2,413,903	$ 778,771	$ 1,741,429	$ 6,406,666	$ 620,478	$ 2,056,960	$ 52,755	$ 1,917,473	$ 35,360,118
Additions	-	13,872	-	(3,254)	-	53,424	-	211,866	-	87,917	363,825
Balance, end of year	3,951,343	15,434,212	2,413,903	775,517	1,741,429	6,460,090	620,478	2,268,826	52,755	2,005,390	35,723,943
Accumulated depreciation											
Balance, beginning of year	-	4,274,791	573,662	356,494	1,735,933	5,471,056	561,354	1,927,575	10,552	1,861,177	16,772,594
Depreciation expense	-	382,557	99,179	33,522	3,167	197,806	24,423	81,659	10,550	75,288	908,151
Balance, end of year	-	4,657,348	672,841	390,016	1,739,100	5,668,862	585,777	2,009,234	21,102	1,936,465	17,680,745
Net Book Value	$ 3,951,343	$ 10,776,864	$ 1,741,062	$ 385,501	$ 2,329	$ 791,228	$ 34,701	$ 259,592	$ 31,653	$ 68,925	$ 18,043,198

9. Property and equipment (continued):

	Land	Buildings	Roof and Air Conditioning	Paved Areas	Leasehold Improvements	Furniture and equipment	Computer terminals	Automated banking machines	Automobile	Personal computers and software	Total 2016
Rate		50 years	25 years	8%	5 years	20%	5 years	5 years	5 years	3 years	
Cost											
Balance, beginning of year	$ 3,951,343	$ 15,247,187	$ 2,413,903	$ 682,265	$ 1,739,071	$ 6,350,351	$ 620,478	$ 2,055,804	$ 53,708	$ 1,886,474	$ 35,000,584
Additions	-	173,153	-	96,506	2,358	56,315	-	1,156	52,755	30,999	413,242
Disposals	-	-	-	-	-	-	-	-	(53,708)	-	(53,708)
Balance, end of year	3,951,343	15,420,340	2,413,903	778,771	1,741,429	6,406,666	620,478	2,056,960	52,755	1,917,473	35,360,118
Accumulated depreciation											
Balance, beginning of year	-	3,892,775	474,485	319,774	1,722,078	5,237,141	540,932	1,860,672	53,708	1,790,999	15,892,564
Depreciation expense	-	382,016	99,177	36,720	13,855	233,915	20,422	66,903	10,552	70,178	933,738
Disposals	-	-	-	-	-	-	-	-	(53,708)	-	(53,708)
Balance, end of year	-	4,274,791	573,662	356,494	1,735,933	5,471,056	561,354	1,927,575	10,552	1,861,177	16,772,594
Net Book Value	$ 3,951,343	$ 11,145,549	$ 1,840,241	$ 422,277	$ 5,496	$ 935,610	$ 59,124	$ 129,385	$ 42,203	$ 56,296	$ 18,587,524

10. Members' deposits:

	2017	2016
Personal and commercial chequing accounts	$ 108,389,531	$ 103,697,202
Savings accounts	112,816,641	111,724,924
Term deposits	129,655,104	139,054,324
Registered retirement savings plans	101,165,780	104,843,881
Registered retirement income funds	31,034,227	27,746,905
Tax free savings accounts	57,016,080	50,887,838
Share accounts	6,306,790	6,438,872
	$ 546,384,153	$ 544,393,946

Chequing accounts

Commercial and personal chequing accounts are due on demand and pay an average interest rate of 0.01% (2016 - 0.02%).

Savings accounts are due on demand and pay an average interest rate of 0.46% (2016 - 0.38%).

Term deposits

Term deposits are for periods of 30 days to seven years and generally may not be withdrawn prior to maturity. During the year ended 2017, they paid an average interest rate of 1.96% (2016 - 1.92%).

Registered retirement plans

NLCU has engaged a third party to act as the trustee for the registered retirement plans offered to members. Under an agreement with the third party, members' contributions to these plans, as well as income earned on them, are deposited in NLCU. On withdrawal, payment of the plan proceeds is made to the members, or the parties designated by them, by NLCU, on behalf of the trustee. Registered retirement savings plans have terms of 6 months to 7 years or are due on demand. During the year ended 2017, they paid an average interest rate of 1.46% (2016 - 1.37%). Retirement income funds have terms of 6 months to 5 years or are due on demand. During the year ended 2017, they paid an average interest rate of 1.85% (2016 - 1.76%).

Tax free savings account

Tax free savings accounts have terms of 6 months to seven years or are due on demand. During the year they paid an average interest rate of 1.13% (2016 - 1.07%).

10. Members' deposits (continued):

Share accounts

Member equity shares consist of 20 shares at a par value of five dollars ($5.00) per share. The holders of member equity shares have all of the rights and privileges and are subject to the restrictions of a member. Currently, there are 16,544 (2016 - 16,482) fully paid equity share accounts with an aggregate value of $2,764,195 (2016 - $2,664,982). Member equity shares are voting shares and are redeemable at the option of the member upon closing all accounts.

Surplus shares may be issued in an unlimited number at par value of five dollars ($5.00) per share. The holders of surplus shares have all of the rights and privileges and are subject to the restrictions applicable to members, as outlined in the Credit Union Act and Regulations and in the By-laws of NLCU. Currently, there are 2,269 (2016 - 2,178) fully paid surplus share accounts with an aggregate value of $11,345 (2016 - $10,890).

Incentive shares may be issued by NLCU to a maximum number of ten thousand shares as approved by the Regulator in accordance with the Credit Union Act and Regulations and in the By-laws of NLCU. Currently, there are 758 (2016 - 790) share accounts outstanding with an aggregate value of $3,531,250 (2016 - $3,763,000). Incentive shares are voting shares and are redeemable at par at the option of the member upon giving 90 days notice.

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

Dividends

Dividends on shares may be declared by the Board of Directors, subject to availability of sufficient earnings to meet the regulatory requirements of the Act as described in Note 12.

The Board of Directors declared a dividend of $132,000 as of December 31, 2017 (2016 - $127,000).

11. Income taxes:

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory tax rates of 30.0% (2016 - 29.1%) to the income before income taxes. The reasons for the differences and related tax effects are as follows:

	2017	2016
Income before income taxes	$ 721,704	$ 904,835

	2017	2016
Income taxes on income before income taxes, at above basic rate	$ 216,511	$ 263,307
Increase (decrease) in taxes resulting from:		
Effect of non-deductible expenses	10,766	13,101
Other	(37,639)	(71,266)
Deferred income tax recovery	(55,825)	23,670
	$ 133,813	$ 228,812

Temporary differences, which give rise to the deferred income tax asset, are as follows:

	2017	2016
Deferred income tax assets (liabilities)		
Capital assets and other	$ (358,650)	$ (383,424)
Severance	547,917	516,866
Deferred income tax asset	$ 189,267	$ 133,442

12. Capital adequacy:

Capital management

The Board approves annually the capital management policy and the annual business plan. This policy outlines NLCU's overall objectives and guidelines to ensure that NLCU has the required quantity, quality and appropriate composition of capital needed to address the inherent risks of NLCU and to support the current and future operating plans.

12. Capital adequacy (continued):

The Credit Union Act 2009 requires credit unions to maintain a minimum capital adequacy reserve (consists of share capital and retained earnings) of 5% of total assets. Alternatively, credit unions are able to use a 10.5% risk weighted model. Additionally, retained earnings cannot be less than 3% of NLCU's total assets and common equity cannot be less than 7% of risk weighted assets.

NLCU is in compliance with its policies and those of the Act regarding regulatory capital as at December 31 as outlined in the following table.

	2017	2016
Retained earnings	$ 22,310,098	$ 21,854,207
Members' shares	6,306,790	6,438,872
Deferred tax asset	(189,267)	(133,442)
	$ 28,427,621	$ 28,159,637
Risk weighted assets	$ 172,082,108	$ 164,579,268
Risk weighted capital ratio		
Actual	16.52 %	17.11 %
Regulatory requirement	10.50 %	10.50 %
Common equity capital ratio		
Actual	12.97 %	13.28 %
Regulatory requirement	7.00 %	7.00 %
Retained earnings as a percentage of assets		
Actual	3.89 %	3.82 %
Regulatory requirement	3.00 %	3.00 %

13. Related party transactions:

At December 31, 2017, the aggregate value of personal and mortgage loans outstanding to directors, designated employees and all related parties totaled $1,773,567 (2016 - $2,300,569). The maximum balances of these loans during the year was $2,220,051 (2016 - $2,790,935). The aggregate value of deposits outstanding to directors, designated employees and all related parties totaled $5,481,487 (2016 - $5,455,160).

The interest rates charged on balances outstanding from directors and all related parties are the same as those charged in an arm's length transaction. Loans to designated employees are granted at a discount rate, consistent with industry practices and in accordance with board approved policy. Loan and mortgage balances with directors, designated employees and all related parties are secured as per NLCU's lending policies.

There was no allowance for impaired loans required in respect of these loans as at December 31, 2017 and December 31, 2016.

Key management personnel received salaries and other short-term employee benefits during the year of $3,794,428 (2016 - $3,793,221).

At December 31, 2017, directors received expense reimbursement of $17,530 (2016 - $30,903) and remuneration of $37,160 (2016 - $48,936) for serving NLCU.

14. Commitments:

Under present lease agreements for rental space NLCU is committed to the following expenditures:

2018	$	159,670
2019		65,720
2020		34,190
2021		28,773
	$	288,353

15. Fair value of financial instruments:

NLCU's financial instruments are calculated using the valuation methods and assumptions described below. The fair values do not reflect the value of assets/liabilities that are not considered financial instruments, such as prepaids, property and equipment, deferred tax asset and accrued severance liability.

15. Fair value of financial instruments (continued):

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

Fair value hierarchy

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

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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

Shares in Central 1, League Data, and Concentra are measured at cost less any identified impairment losses at the end of each reporting period. These shares are subject to an annual rebalancing mechanism and are issued and redeemable at par value. As there is no active market for these shares, fair value is not reliably determinable as future cash flows cannot be reasonably predicted with a standard valuation technique. Therefore these equity investments are carried at cost.

NLCU holds derivative financial instruments including embedded derivatives classified as FVTPL. These are classified as Level 2 financial instruments. Their fair value is determined by option pricing models that take into account changes in respective equity indices.

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

Additionally, there are no financial instruments classified in Level 1 or 3.

Interest rate sensitivity is the main reason for changes in fair values of NLCU's financial instruments with the exception of derivative assets and liabilities and equity instruments classified as available for sale.

15. Fair value of financial instruments (continued):

The fair value of cash and cash equivalents, interest receivable, accounts payables and accrued liabilities, loans to members due on demand, deposits from members due on demand and member share accounts redeemable on demand approximate their carrying amount due to short term to maturity.

The fair value of deposits with Central 1 is approximated by its carrying amounts due to the short - term maturity and repricing of the investments at market rates of return.

	Carrying amount	Fair value	2017 fair value difference
Financial assets			
Loans to members	$ 489,559,136	$ 487,640,081	$ (1,919,055)
Cash resources	9,378,134	9,378,134	-
Investments	52,553,612	52,553,612	-
Financial liabilities			
Members' deposits	$ 546,384,153	$ 544,610,848	$ (1,773,305)
Accounts payable and accrued liabilities	1,020,358	1,020,358	-

The above estimates were determined by management using the assumptions outlined below. Fair values are an estimate based on current market conditions and may not be reliable due to the use of assumptions.

Interest rate sensitivity is the main reason for changes in fair values of NLCU's financial instruments. The carrying value is not adjusted to reflect fair value, as it is the NLCU's intention to realize their value over time.

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

The fair values of, cash resources and accounts payables and accrued liabilities are the same as their carrying amount due to their short-term nature.

The fair values of loans to members, and members' deposits are determined by two methods. Variable rate loans to members and demand deposit members' accounts are estimated to be at fair value, as the interest rates of these financial instruments vary with market interest rates. Fixed rate loans to members, and fixed term deposit members' deposits fair value is determined by discounting the expected future cash flows of these financial instruments at current market rates for products with similar terms and credit risks. The expected fair value of these loans to members, direct financing lease, fixed term deposits may differ with changes in interest rates.

16. Nature and extent of risks arising from financial instruments:

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

Credit risk

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

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

NLCU uses a lending approach with standard underwriting parameters for each category of loans. These parameters are used to assist NLCU in assessing the borrower's ability to repay.

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

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

Liquidity risk

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

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

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

16. Nature and extent of risks arising from financial instruments (continued):

	2017	2016
Cash and cash equivalents	$ 9,378,134	$ 8,307,954
Central 1 (matures February 2017, redeemable)	-	2,000,000
Central 1 (matures March 2017, redeemable)	-	2,000,000
Central 1 (matures March 2017)	-	3,000,000
Central 1 (Matures December 2018)	10,000,000	-
Concentra (matures April 2017)	-	10,000,000
Concentra (matures September 2017)	-	3,000,000
Liquidity reserve deposit	32,832,750	33,082,250
Total assets held for liquidity	$ 52,210,884	$ 61,390,204

Contractual maturities of financial liabilities are shown under interest rate risk. NLCU has no material commitments for capital expenditures and there is no need for such expenditures in the normal course of business.

Market risk

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

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

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

Interest rate risk

Interest rate risk refers to the potential impact of changes in interest rates on NLCU's earnings. It is the policy of NLCU to keep exposure to interest rate fluctuations within limits set by the Board and regulations by matching, when possible, the maturity of interest bearing liabilities and assets and pricing interest rate assets consistent with the basis used for liabilities.

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

16. Nature and extent of risks arising from financial instruments (continued):

2017	Investments	Loans and advances to members	Deposits from members
On Demand	$ -	$ 96,981,146	$ 120,231,423
Less than three months	4,091,603	22,445,965	32,386,343
Three months to a year	13,764,041	87,163,601	99,680,594
One to five years	34,240,861	281,995,136	161,065,847
Non-rated sensitive	457,107	2,017,847	133,019,946
Effective interest rate	1.52 %	3.75 %	1.00 %
Total	$ 52,553,612	$ 490,603,695	$ 546,384,153

2016	Investments	Loans and advances to members	Deposits from members
On Demand	$ -	$ 93,416,517	$ 115,438,959
Less than three months	8,895,008	19,300,699	34,749,323
Three months to a year	15,101,188	96,594,802	101,216,410
One to five years	41,412,730	263,294,959	165,564,745
Non-rate sensitive	457,107	2,117,379	127,424,509
Effective interest rate	1.42 %	3.81 %	1.07 %
Total	$ 65,866,033	$ 474,724,356	$ 544,393,946

At December 31, 2017, if interest rates at that date had been 100 (2016 - 100) basis points lower with all other variables held constant, after-tax net income for the year would have been approximately $179,026 (2016 - $151,323) lower, arising mainly as a result of lower interest revenue on variable loans and mortgages, and lower interest revenue on liquidity investments. If interest rates had been 100 (2016 - 100) basis points higher, with all other variables held constant, after-tax net income would have been approximately $178,763 (2016 - $212,968) higher, arising mainly as a result of higher interest revenue on variable loans and mortgages, and higher interest on liquidity investments.

Market price risk

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

16. Nature and extent of risks arising from financial instruments (continued):

Index-linked deposits

At December 31, 2017, NLCU has issued $30,955,244 (2016 - $33,037,494) of index-linked term deposits (registered and non-registered deposits) to its members. These term deposits have maturities of three and five years and pay interest to the depositors at the end of the term based on the performance of various Toronto Stock Exchange ("TSX") indices.

The interest feature of these term deposits have been accounted for by an embedded derivative liability of fair value separate from the host deposit. The purpose of these agreements is to provide a hedge against market fluctuations.

NLCU has entered into derivative agreements with Central 1 to offset the exposure to these indices associated with these products. NLCU pays Central 1 a fixed amount on the face value of these term deposit products. At the end of the respective terms, NLCU receives payments from the counterparty, Central 1, equal to the amount that will be paid to the depositors based on the performance of various TSX indices.

These agreements have a fair value that varies based on the particular contract and changes in linked indices. The fair value of these agreements is $2,490,186 (2016 - $2,445,610) at year end.