

VERMILION CREDIT UNION LIMITED

VERMILION, ALBERTA

FINANCIAL STATEMENTS

FOR THE YEAR ENDED OCTOBER 31, 2019

INDEPENDENT AUDITORS' REPORT

To the Members of Vermilion Credit Union Limited

Opinion

We have audited the accompanying financial statements of Vermilion Credit Union Limited, which comprise the statement of financial position as at October 31, 2019 and the statements of net income and comprehensive income, changes in member equity, and cash flows for the year ended October 31, 2019, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

In our opinion, the financial statements present fairly, in all material respects, the financial position of Vermilion Credit Union Limited as at October 31, 2019 and its financial performance and cash flows for the year ended October 31, 2019 in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Credit Union in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report, but does not include the financial statements and our auditors' report thereon. The Annual Report is expected to be made available to us after the date of this auditors' report.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.



Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

In preparing the financial statements, management is responsible for assessing the Credit Union's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless management either intends to liquidate the Credit Union or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Credit Union's financial reporting process.

Auditors' Responsibility for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but it is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Credit Union's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Credit Union to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

METRIX GROUP LLP

Chartered Professional Accountants

Edmonton, Alberta

January 23, 2020



MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

To the Members of Vermilion Credit Union Limited:

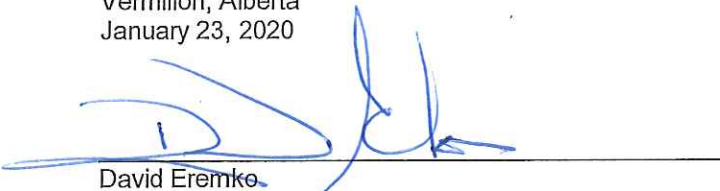
Management has the responsibility for preparing the accompanying financial statements and ensuring that all information in the annual report is consistent with these statements. This responsibility includes selecting appropriate accounting principles and making objective judgments and estimates in accordance with International Financial Reporting Standards and the requirement of the *Credit Union Act* (Alberta).

In discharging its responsibility for the integrity and fairness of the financial statements, as well as for the accounting systems from which they are derived, management maintains the necessary systems of internal controls designed to provide assurance that the transactions are authorized, assets are safeguarded and proper records are maintained.

The ultimate authority to members for the financial statements lies with the Board of Directors (the "Board"). The Board appoints an Audit and Risk Committee to review financial statements with management in detail and to report to the Board prior to its approval to publish the financial statements.

The Board appoints external auditors to audit the financial statements and to meet separately with both the Audit and Risk Committee, and management to review these findings. The external auditors report directly to the members. The external auditors have full and free access to the Audit and Risk Committee to discuss their audit, as well as their findings concerning the integrity of the Credit Union's financial reporting and the adequacy of its systems of internal controls.

Vermilion, Alberta
January 23, 2020



David Eremko
Chief Executive Officer

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VERMILION CREDIT UNION LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT OCTOBER 31, 2019

	<u>2019</u>	<u>2018</u>
ASSETS		
Cash and cash equivalents (Note 6)	\$ 24,012,208	\$ 22,373,194
Investments (Note 7)	14,648,327	6,304,361
Derivative assets (Note 20)	55,200	133,214
Income taxes recoverable	58,400	-
Member loans (Note 8)	165,424,646	153,534,179
Other assets	123,672	82,257
Deferred income tax asset (Note 9)	23,939	-
Property and equipment (Note 10)	1,215,019	1,261,017
Intangible assets (Note 11)	<u>4,712</u>	<u>40,193</u>
	<u>\$205,566,123</u>	<u>\$183,728,415</u>
LIABILITIES		
Accounts payable and accrued liabilities	\$ 254,271	\$ 251,847
Deferred income tax liability (Note 9)	-	33,626
Derivative liabilities (Note 20)	55,200	133,214
Income taxes payable	-	53,382
Member deposits (Note 13)	184,212,737	163,074,815
Allocation payable (Note 14)	<u>87,460</u>	<u>174,300</u>
	<u>184,609,668</u>	<u>163,721,184</u>
MEMBERS' EQUITY		
Allocation distributable (Note 14)	316,000	327,335
Member shares (Note 15)	7,887,637	7,598,471
Retained earnings	<u>12,752,818</u>	<u>12,081,425</u>
	<u>20,956,455</u>	<u>20,007,231</u>
	<u>\$205,566,123</u>	<u>\$183,728,415</u>

Commitments (Note 17)

ON BEHALF OF THE BOARD:


 _____ Director


 _____ Director

VERMILION CREDIT UNION LIMITED

STATEMENT OF NET INCOME AND COMPREHENSIVE INCOME

FOR THE YEAR ENDED OCTOBER 31, 2019

	<u>2019</u>	<u>2018</u>
INTEREST INCOME		
Member loans	\$ 6,373,533	\$ 5,666,395
Investments	<u>609,187</u>	<u>626,485</u>
	<u>6,982,720</u>	<u>6,292,880</u>
INTEREST EXPENSE		
Member deposits	2,334,918	1,625,195
Financing	<u>53</u>	<u>104</u>
	<u>2,334,971</u>	<u>1,625,299</u>
NET INTEREST INCOME BEFORE PROVISION FOR IMPAIRMENT CHARGES	4,647,749	4,667,581
NET INVESTMENT IMPAIRMENT CHARGES	<u>831</u>	<u>-</u>
NET LOAN IMPAIRMENT CHARGES (NOTE 8)	<u>(28,927)</u>	<u>(13,315)</u>
OFF BALANCE SHEET IMPAIRMENT CHARGES	<u>(8,739)</u>	<u>-</u>
NET INTEREST INCOME AFTER IMPAIRMENT CHARGES	4,684,584	4,680,896
OTHER INCOME	<u>770,324</u>	<u>848,627</u>
NET INTEREST AND OTHER INCOME	<u>5,454,908</u>	<u>5,529,523</u>
OPERATING EXPENSES (SCHEDULE I)		
Personnel	2,287,051	2,161,745
Occupancy	155,003	148,579
Security	190,199	180,981
Organization	104,217	103,183
General	<u>1,142,424</u>	<u>1,091,699</u>
	<u>3,878,894</u>	<u>3,686,187</u>
INCOME BEFORE PATRONAGE ALLOCATION AND INCOME TAXES	1,576,014	1,843,336
PATRONAGE ALLOCATION (NOTE 14)	<u>87,460</u>	<u>174,300</u>
INCOME BEFORE INCOME TAXES	<u>1,488,554</u>	<u>1,669,036</u>
INCOME TAXES (NOTE 9)		
Current	393,650	457,390
Deferred (recovery)	<u>12,762</u>	<u>(4,574)</u>
	<u>406,412</u>	<u>452,816</u>
NET INCOME AND COMPREHENSIVE INCOME	<u>\$ 1,082,142</u>	<u>\$ 1,216,220</u>

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

VERMILION CREDIT UNION LIMITED

STATEMENT OF CHANGES IN MEMBERS' EQUITY

FOR THE YEAR ENDED OCTOBER 31, 2019

	<u>Allocation Distributable</u>	<u>Member Shares</u>	<u>Retained Earnings</u>	<u>Total</u>
Balance, October 31, 2017	\$ 261,363	\$ 7,526,905	\$ 11,096,509	\$ 18,884,777
Net income	-	-	1,216,220	1,216,220
Dividends paid through issuance of member shares	(261,363)	250,884	10,479	-
Dividends accrued	327,335	-	(327,335)	-
Income tax recovery, dividends declared	-	-	85,552	85,552
Issuance of member shares	-	374,595	-	374,595
Redemption of member shares	-	(553,913)	-	(553,913)
Balance, October 31, 2018	327,335	7,598,471	12,081,425	20,007,231
Impact of adopting IFRS 9 as at November 1, 2018 (Note 22)	-	-	(190,143)	(190,143)
Balance, November 1, 2018	<u>327,335</u>	<u>7,598,471</u>	<u>11,891,282</u>	<u>19,817,088</u>
Net income	-	-	1,082,142	1,082,142
Dividends paid through issuance of member shares	(327,335)	312,146	15,189	-
Dividends accrued	316,000	-	(316,000)	-
Income tax recovery, dividends declared	-	-	80,205	80,205
Issuance of member shares	-	477,074	-	477,074
Redemption of member shares	-	(500,054)	-	(500,054)
Balance, October 31, 2019	<u>\$ 316,000</u>	<u>\$ 7,887,637</u>	<u>\$ 12,752,818</u>	<u>\$ 20,956,455</u>

VERMILION CREDIT UNION LIMITED

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED OCTOBER 31, 2019

	<u>2019</u>	<u>2018</u>
OPERATING ACTIVITIES		
Interest received from member loans	\$ 6,249,177	\$ 5,566,454
Interest received from investments	551,555	480,240
Dividends received	71,820	147,353
Other income received	770,324	848,627
Interest paid to members	(1,818,641)	(1,520,449)
Income taxes paid	(425,227)	(333,261)
Net operating expenses paid	(3,804,191)	(3,489,756)
Patronage allocation paid	(174,300)	(163,350)
Net change in member loans	(11,979,703)	(10,321,049)
Net change in investments	(8,361,175)	1,497,097
Net change in member deposits	<u>20,621,645</u>	<u>(3,851,214)</u>
	<u>1,701,284</u>	<u>(11,139,308)</u>
INVESTING ACTIVITIES		
Purchase of property and equipment	(39,237)	(43,278)
Proceeds on disposal of foreclosed property	<u>-</u>	<u>53,565</u>
	<u>(39,237)</u>	<u>10,287</u>
FINANCING ACTIVITIES		
Issue of member shares	789,220	625,479
Redemption of member shares	(500,054)	(553,913)
Dividends on common shares	(312,146)	(250,884)
Interest paid on financing	<u>(53)</u>	<u>(104)</u>
	<u>(23,033)</u>	<u>(179,422)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,639,014	(11,308,443)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>22,373,194</u>	<u>33,681,637</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 24,012,208</u>	<u>\$ 22,373,194</u>

VERMILION CREDIT UNION LIMITED
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED OCTOBER 31, 2019

1. NATURE OF OPERATIONS

Vermilion Credit Union Limited (the "Credit Union") is incorporated under the *Credit Union Act* of Alberta (the "Province") on March 18, 1943. The Credit Union operates Credit Union branches in the Town of Vermilion and Village of Mannville, which provides loans and deposit services to its members.

The Credit Union Deposit Guarantee Corporation (the "Corporation"), a provincial corporation, guarantees the repayment of all deposits with Alberta credit unions, including accrued interest. The *Credit Union Act* provides that the Province will ensure that the Corporation carries out this obligation.

The Credit Union's registered office is located at 5019 - 50 Avenue, Vermilion, Alberta, T9X 1A7.

2. BASIS OF PRESENTATION

(a) Statement of Compliance

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

Details of the Credit Union's accounting policies, including changes during the year, are included in Notes 3 and 22. As explained in Note 22, the Credit Union has adopted IFRS 9 *Financial Instruments* and IFRS 15 *Revenues from Contracts with Customers* with a date of initial application of November 1, 2018.

The financial statements were authorized for issue by the Board of Directors on January 23, 2020.

(b) Basis of Measurement

The financial statements have been prepared using the historical cost basis, except for derivative financial instruments and financial instruments classified as fair value through profit or loss, which has been measured at fair value. The methods to measure fair value are presented in Note 21.

(c) Use of Estimates and Judgments

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are described in Notes 3 and 4.

(d) Functional Currency

The financial statements are presented in Canadian dollars, which is the Credit Union's functional currency.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in the preparation of these financial statements are summarized below. These accounting policies have been applied consistently to all periods presented in these financial statements.

(a) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, ATM cash, foreign currency, operating accounts with Credit Union Central Alberta, items in transit and money market term deposits. These items are highly liquid on deposits with an original maturity of less than or equal to three months.

(b) Investments

Each Investment is classified into one of the categories described under financial instruments. The classification dictates the accounting treatment for the carrying value and changes in that value.

(c) Member Loans

Member loans are measured initially at fair value plus transaction costs, and subsequently at amortized cost using the effective interest rate method, less any impairment losses. All loans are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

(d) Financial Instruments - Applicable Before November 1, 2018

All financial instruments are initially recognized on the statement of financial position at fair value through acquisition. Measurement in subsequent periods depends on whether the financial instrument has been classified as fair value through profit and loss, available for sale, held-to-maturity, loans and receivables or other financial liabilities. During the year there has been no reclassification of financial instruments.

(i) *Financial assets*

The Credit Union designates financial assets as follows: fair value through profit or loss, loans and receivables, held-to-maturity investments and available for sale financial assets. Management determines the classification of its financial instruments at initial recognition.

(ii) *Fair value through profit or loss*

Fair value through profit or loss financial assets are measured at fair value with unrealized gains and losses recognized through the statement of net income and comprehensive income. The Credit Union's fair value through profit or loss financial assets include cash and cash equivalents and derivatives.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Financial Instruments - Applicable Before November 1, 2018 (continued)

(iii) **Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Member loans, accrued interest and other receivables are designated as loans and receivables. Loans and receivables are initially recognized at fair value - which is the cash consideration to originate or purchase the loan net of any transaction costs - and measured subsequently at amortized cost using the effective interest rate method.

(iv) **Held-to-maturity**

Held-to-maturity financial assets are non-derivative assets with fixed or determinable payments and fixed maturity dates that the Credit Union has the positive intention and ability to hold until its maturity date, and which are not designated as a fair value through profit or loss or as available for sale. The Credit Union's held-to-maturity investments includes its term deposits with Central, Concentra Financial and other credit unions. Held-to-maturity financial assets are subsequently measured at amortized cost using the effective interest method less any impairment, with revenue recognized on an effective yield basis.

(v) **Available-for-sale financial assets**

Available for sale ("AFS") investments are financial assets that are intended to be held for an indefinite period of time and are not classified as loans and receivables. The Credit Union's AFS investments includes its shares in Central, Concentra Financial and Cornerstone Co-operative. AFS financial assets are initially recognized at fair value plus transaction costs and measured subsequently at fair value with gains and losses being recognized in the statement of comprehensive income, except for impairment losses, until the financial asset is derecognized. The Credit Union does not have an accumulated balance of other comprehensive income.

If an AFS asset is determined to be impaired, the cumulative gain or loss previously recognized in the statement of comprehensive income is recognized in the statement of net income. However, interest is calculated using the effective interest rate method, and dividends on AFS equity instruments are recognized in the statement of net income as investment income when the right to receive payment is established.

(vi) **Financial liabilities**

The Credit Union designates member deposits, and accounts payable and accrued liabilities as other financial liabilities. Other financial liabilities are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method.

(vii) **Impairment of financial assets**

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

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

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(viii) Derecognition of financial instruments

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

(e) Financial Instruments - Applicable After November 1, 2018

(i) Financial assets

Recognition and initial measurement

The Credit Union recognizes financial assets when it becomes party to the contractual provisions of the instrument. Financial assets are measured initially at their fair value plus, in the case of financial assets not subsequently measured at fair value through profit or loss, transaction costs that are directly attributable to their acquisition. Transaction costs attributable to the acquisition of financial assets subsequently measured at fair value through profit or loss are expensed in net income and comprehensive income when incurred.

Classification and subsequent measurement

On initial recognition, financial assets are recorded at fair value and subsequently classified as measured at amortized cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL).

Financial instruments are classified as follows:

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding.

A financial asset is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity instrument that is not held for trading, the Credit Union may irrevocably elect to present subsequent changes in FVOCI. This election is made on an investment by-investment basis. All other financial assets are classified as measured at FVTPL.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Financial Instruments - Applicable After November 1, 2018 (continued)

(i) *Financial assets (continued)*

Classification and subsequent measurement (continued)

For financial assets designated as measured at FVTPL, changes in fair value are recognized in the statement of net income and comprehensive income. For financial assets classified as measured at FVOCI or an irrevocable election has been made, changes in fair value are recognized in the statement of net income and comprehensive income. For financial assets and other financial liabilities measured at amortized cost, interest income and interest expense are calculated using the effective interest method and is recognized in the statement of net income and comprehensive income.

Business model assessment

The Credit Union assesses the objective of its business model for holding a financial asset at a level of aggregation which best reflects the way the business is managed and information is provided to management. Information considered in this assessment includes stated policies and objectives and how performance of the portfolio is evaluated.

Contractual cash flow assessment

The cash flows of financial assets are assessed as to whether they are solely payments of principal and interest on the basis of their contractual terms. For this purpose, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money, the credit risk associated with the principal amount outstanding, and other basic lending risks and costs. In performing this assessment, the Credit Union considers factors that would alter the timing and amount of cash flows such as prepayment and extension features, terms that might limit the Credit Union's claim to cash flows, and any features that modify consideration for the time value of money.

Reclassifications

The Credit Union reclassifies financial assets only when its business model for managing those financial assets has changed. Reclassifications are applied prospectively from the reclassification date and any previously recognized gains, losses or interest are not restated.

Impairment

The Credit Union recognizes a loss allowance for the expected credit losses associated with its financial assets, other than debt instruments measured at fair value through profit or loss and equity investments. Expected credit losses are measured to reflect a probability-weighted amount, the time value of money, and reasonable and supportable information regarding past events, current conditions and forecasts of future economic conditions.

The date the Credit Union commits to purchasing a financial asset is considered the date of initial recognition for the purpose of applying the Credit Union's accounting policies for impairment of financial assets.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Financial Instruments - Applicable After November 1, 2018 (continued)

(i) *Financial assets (continued)*

Impairment (continued)

For members' loans receivable and accrued interest the Credit Union records a loss allowance equal to the expected credit losses resulting from default events that are possible within the next 12-month period, unless there has been a significant increase in credit risk since initial recognition. For those financial assets for which the Credit Union assessed that a significant increase in credit risk has occurred, the Credit Union records a loss allowance equal to the expected credit losses resulting from all possible default events over the assets' contractual lifetime.

The Credit Union applies the simplified approach for other receivables. Using the simplified approach, the Credit Union records a loss allowance equal to the expected credit losses resulting from all possible default events over the assets' contractual lifetime.

The Credit Union assesses whether a financial asset is credit-impaired at the reporting date. Regular indicators that a financial asset is credit-impaired include significant financial difficulties as evidenced through borrowing patterns or observed balances in other accounts, breaches of borrowing contracts such as default events or breaches of borrowing covenants and requests to restructure loan payment schedules. For financial assets assessed as credit-impaired at the reporting date, the Credit Union continues to recognize a loss allowance equal to lifetime expected credit losses.

Loss allowances for expected credit losses are presented in the consolidated statement of financial position as follows:

- For financial assets measured at amortized cost, as a deduction from the gross carrying amount of the financial assets;
- For loan commitments and financial guarantee contracts, as a provision;
- For facilities with both a drawn and undrawn component where the Credit Union cannot separately identify expected credit losses between the two components, as a deduction from the carrying amount of the drawn component. Any excess of the loss allowance over the carrying amount of the drawn component is presented as a provision; and
- Financial assets are written off when the Credit Union has no reasonable expectations of recovering all or any portion thereof.

Derecognition of financial assets

The Credit Union derecognizes a financial asset when its contractual rights to the cash flows from the financial asset expire, or the financial asset has been transferred under particular circumstances.

For this purpose, a financial asset is transferred if the Credit Union either:

- Transfers the right to receive the contractual cash flows of the financial asset, or;
- Retains the right to receive the contractual cash flows of the financial asset, but assumes an obligation to pay received cash flows in full to one or more third parties without material delay and is prohibited from further selling or transferring the financial asset.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Financial Instruments - Applicable After November 1, 2018 (continued)

(i) *Financial assets (continued)*

Derecognition of financial assets (continued)

Transferred financial assets are evaluated to determine the extent to which the Credit Union retains the risks and rewards of ownership. When the Credit Union neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, it evaluates whether it has retained control of the financial asset.

Modification of financial assets

The Credit Union assesses the modification of terms of a financial asset to evaluate whether its contractual rights to the cash flows from that asset have expired in accordance with the Credit Union's derecognition policy.

When the modifications do not result in derecognition of the financial asset, the gross carrying amount of the financial asset is recalculated with any difference between the previous carrying amount and the new carrying amount recognized in profit or loss. The new gross carrying amount is recalculated as the present value of the modified contractual cash flows discounted at the asset's original effective interest rate.

For the purpose of applying the impairment requirements, at each reporting date subsequent to the modification, the Credit Union continues to assess whether there has been a significant increase in credit risk on the modified financial assets from the date of initial recognition.

(ii) *Financial liabilities*

Recognition and initial measurement

The Credit Union recognizes a financial liability when it becomes party to the contractual provisions of the instrument. At initial recognition, the Credit Union measures financial liabilities at their fair value plus transaction costs that are directly attributable to their issuance, with the exception of financial liabilities subsequently measured at fair value through profit or loss for which transaction costs are immediately recorded in net income and comprehensive income.

Classification and subsequent measurement

Subsequent to initial recognition, financial liabilities are measured at amortized cost or fair value through profit or loss. When the transfer of a financial asset does not qualify for derecognition because the Credit Union has retained substantially all of the risks and rewards of ownership, a liability is recognized for the consideration received. Subsequently, any expense incurred on the financial liability is recognized in net income and comprehensive income.

All financial liabilities are measured at amortized cost using the effective interest method. Financial liabilities measured at amortized cost include member deposits and accrued interest, trade payables and accrued liabilities and securitization debt.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) *Financial assets (continued)*

Classification and subsequent measurement (continued)

The classification of a financial instrument or component as a financial liability or equity instrument determines where gains or losses are recognized. Interest, dividends, gains and losses relating to financial liabilities are recognized in the statement of net income and comprehensive income while distributions to members of instruments classified as members' equity are recognized in members' equity.

Financial liabilities are not reclassified subsequent to initial recognition.

Derecognition of financial liabilities

The Credit Union derecognizes a financial liability only when its contractual obligations are discharged, cancelled or expire.

(f) Derivatives and Hedge Accounting

The Credit Union uses option contract derivatives to manage its exposure to Canadian equity indices. Derivatives are initially recognized at fair value at the date that the derivative contract is entered into and subsequently measured at fair value with changes in fair value recognized through profit and loss immediately, unless the derivative is designated in a qualifying hedging relationship.

The Credit Union designates certain derivatives as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Credit Union formally documents the relationship between the hedging instrument and hedged item, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. Premiums paid to enter into these hedges are recorded in member deposits and are amortized over the contract life.

The Credit Union uses option contract derivatives to manage its exposure to Canadian equity indices. Derivatives are initially recognized at fair value at the date that the derivative contract is entered into and subsequently measured at fair value with changes in fair value recognized through profit and loss immediately, unless the derivative is designated in a qualifying hedging relationship.

The Credit Union designates certain derivatives as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Credit Union formally documents the relationship between the hedging instrument and hedged item, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. Premiums paid to enter into these hedges are recorded in member deposits and are amortized over the contract life.

(g) Assets Held For Sale

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

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

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Impairment of Non-Financial Assets

Non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying value may not be recoverable. The recoverable amount is determined as the higher of an asset's fair value less costs to sell and its value in use. 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.

(i) Property and Equipment

Land is measured at cost. Other items of property and equipment are measured at cost less accumulated depreciation and impairment losses. Land is not depreciated. Depreciation of other items of property and equipment are calculated over their estimated useful life at the following annual rates and methods:

Building	2%	Straight-line
Parking lot	6.75%	Straight-line
Furniture and equipment	20%	Straight-line
Information technology	33%	Straight-line

Depreciation is recorded in the initial month of acquisition; no depreciation is recorded in the month of disposal. Depreciation methods, useful lives and residual values are reviewed annually and adjusted if necessary. Gains and losses on the disposal of property and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognized in net income with Other Income.

Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

(j) Intangible Assets

Intangible assets consist of computer software which are not integral to the computer hardware owned by the Credit Union. Software is initially recorded at cost and subsequently measured at cost less accumulated depreciation and any accumulated impairment (losses). Software is depreciated on a straight-line basis over its estimated useful life of 10 years.

The useful lives of the intangible assets are reviewed on an annual basis and the useful life is altered if estimates have changed significantly. Gains or losses on the disposal of intangible assets are determined as the difference between the net disposal proceeds and the carrying amount of the asset, and are recognized in net income within Other Income.

(k) Income Taxes

Tax expense for the period is comprised of current and deferred income taxes.

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

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Income Taxes (continued)

Deferred income taxes are provided for using the liability method. Under this method, temporary differences are recorded using tax rates that have been enacted or substantively enacted by the statement of financial position date and are expected to apply when the corresponding taxes will be paid or refunded. Temporary differences are comprised primarily of differences between the carrying amounts and the income tax basis of the Credit Union's member loans, property and equipment and intangible assets. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

(l) Dividends

Dividends are accounted for when they have been approved by the Board of Directors.

(m) Member Shares

Member shares issued by the Credit Union are classified as equity only to the extent that they do not meet the definition of a financial liability.

Common and surplus shares are accounted for in accordance with *IFRIC 2 - Members' Shares in Co-operative Entities and Similar Instruments* ("IFRIC 2"). Common and surplus shares that are available for redemption are classified as a liability. In accordance with IFRIC 2, dividends to holders of equity instruments are recognized directly in equity, net of income tax benefits. Interest, dividends and other returns relating to financial instruments classified as financial liabilities are expenses, regardless of whether those amounts paid are legally characterized as dividends, interest or otherwise.

(n) Revenue Recognition

Interest income is recognized on the statement of income and comprehensive income for all financial assets measured at amortized cost using the effective interest rate method. The effective interest rate method is the rate that discounts estimated future cash flows through the expected life of the financial instrument back to the net carrying amount of the financial asset. The application of the method has the effect of recognizing revenue of the financial instrument evenly in proportion to the amount outstanding over the period to maturity or repayment. The amortized cost of a financial asset or financial liability is the amount at which the instrument is measured on initial recognition minus principal repayments, plus or minus any cumulative amortization using the effective interest method of any difference between the initial amount and maturity amount and adjusted for any expected credit loss allowance. The gross carrying amount of a financial asset is the amortized cost of a financial asset before adjusting for any expected credit losses.

Other income is recognized in the fiscal period in which the related service is provided, which includes fees, service charges and commission income.

(o) Foreign Currency Translation

Transaction amounts denominated in foreign currencies are translated into their Canadian dollar equivalents at exchange rates prevailing at the transaction dates. Carrying values of monetary assets and liabilities reflect exchange rates at the statement of financial position date. Translation gains and losses are included in other income.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

4. USE OF ESTIMATES AND KEY JUDGMENTS

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses during the reporting year. Accordingly, actual results could differ from those estimates. Estimates and underlying assumptions are reviewed on an ongoing basis based on management's best knowledge of current events and actions that the Credit Union may undertake in the future. Revisions to accounting estimates are recognized in the year in which the estimate is revised if it affects only that period or in the period of revision and future periods if the revision affects both current and future years.

The principal areas involving a higher degree of judgment or complexity and/or areas which require significant estimates are described below:

(a) Allowance for Impaired Loans - Applicable Before November 1, 2018

The specific allowance component of the total allowance for impairment applies to financial assets evaluated individually for impairment. In particular, management judgment is required in the estimate of the amount and timing of the future cash flows the Credit Union expects to receive from these specific loans. These estimates are based on a number of factors, including the net realizable value of any underlying collateral.

For the purpose of the collective allowance component of loan impairment, financial assets are grouped on the basis of the Credit Union's internal system that considers credit risk, characteristics such as asset type, industry, geographical location, collateral, delinquency status and other relevant economic factors. Future cash flows on the group of financial assets, that are collectively evaluated for impairment, are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical credit loss experience is adjusted on the basis of current observable data. The purpose of the adjustment is to reflect the effects of current conditions on which the historical credit loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year. This includes for example changes in unemployment rates, inflation, borrowing rates, consumer fuel prices, vehicle auction values or other factors that are indicative of incurred losses in the group and their magnitude.

(b) Expected Credit Loss Allowance - Applicable After November 1, 2018

The Credit Union measures loss allowances at an amount equal to lifetime expected credit loss (ECL). In particular, management judgement is required in the estimate of whether credit risk of a specific impaired loan has increased significantly, inputs into the ECL quantitative model and in the use of forward-looking information.

The Credit Union assesses whether credit risk on a financial asset has increased significantly considering reasonable and supportable information since initial recognition in order to determine whether a 12 month ECL or lifetime ECL should be recognized. When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Credit Union considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Credit Union's historical experience and expert credit assessment.

See the impairment of loans and advances under the significant accounting policies contained in Note 3 for further discussion of allowance for credit losses.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

4. USE OF ESTIMATES AND KEY JUDGMENTS (CONTINUED)

(c) 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. These techniques are significantly affected by the assumptions used, including discount rates and estimates of future cash flows. In that regard, the derived fair value estimates cannot always be substantiated by comparison with independent markets and, in many cases, may not be capable of being realized immediately. The methods and assumptions applied, and the valuation techniques used, are disclosed in Note 21.

(d) Property and Equipment

Depreciation methods, useful lives and residual values require estimation and are reviewed annually and adjusted if appropriate.

(e) Income Taxes

Management exercises judgment in estimating the provision for income taxes. The Credit Union is subject to income tax laws in the federal and provincial jurisdictions where it operates. Various tax laws are potentially subject to different interpretations by the Credit Union and the relevant tax authority. To the extent that the Credit Union's interpretations differ from those of tax authorities or the timing of realization is not as expected, the provision for income taxes may increase or decrease in future periods to reflect actual experience.

Significant management judgment is also required to determine the deferred tax balances. Management is required to determine the amount of deferred tax assets and liabilities that can be recognized, based on their best estimate of the likely timing that the temporary difference will be realized, and of the likelihood that taxable profits will exist in the future.

5. STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

At October 31, 2019 a number of standards, interpretations and amendments have been issued by the IASB, which are not yet effective for these financial statements. Those which could have an impact on the Credit Union's financial statements are discussed below:

(a) IFRS 16 Leases

IFRS 16 Leases specifies that all leases with the exception of very short term and small items may be required to be recognized on the statement of financial position. The effective date from IFRS 16 is for fiscal periods beginning on or after January 1, 2019. The Credit Union will assess what impact the application of IFRS 16 will have on amounts reported on the financial statements.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

6. CASH AND CASH EQUIVALENTS

The Credit Union's cash and cash equivalents consist of cash on hand, ATM cash, foreign exchange cash, operating accounts with Credit Union Central Alberta ("Central"), items in transit and money market term deposits. The average yield on the operating accounts with Central at October 31, 2019 0.25% (2018 - 0.25%).

Included in cash and cash equivalents is \$887,170 (2018 - \$441,735) denominated in US dollars.

A total of \$18,075,000 (2018 - \$19,350,000) are held in terms with an original maturity of less than or equal to three months. These terms have interest rates ranging from 1.65% to 2.55%.

7. INVESTMENTS

	<u>2019</u>	<u>2018</u>
Measured at Amortized Cost		
Central - term deposits	\$ 11,545,766	\$ 261,340
Other term deposits	1,000,000	3,920,000
Accrued interest	<u>55,715</u>	<u>69,903</u>
	<u>12,601,481</u>	<u>4,251,243</u>
Measured at Fair Value Through Profit and Loss		
Credit Union Central - Shares	2,000,000	2,000,000
Concentra Financial - Shares	49,867	49,867
Cornerstone Co-operative - Equity	<u>-</u>	<u>3,251</u>
	<u>2,049,867</u>	<u>2,053,118</u>
Allowance for impairment	<u>(3,021)</u>	<u>-</u>
	<u>\$ 14,648,327</u>	<u>\$ 6,304,361</u>

All term deposits mature within one year with interest rates ranging from 1.65% to 2.55%. As required by the *Credit Union Act*, the Credit Union holds investments in Central to maintain its statutory liquidity requirements.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

8. MEMBER LOANS

	<u>Principal Performing</u>	<u>Principal Impaired</u>	<u>Allowance for Impaired Loans</u>	<u>2019 Net</u>
Consumer	\$ 7,787,203	\$ 11,678	\$ (110,426)	\$ 7,688,455
Residential mortgages	64,483,278	263,905	(102,454)	64,644,729
Commercial	37,734,996	-	(49,208)	37,685,788
Agricultural	54,579,226	-	(49,228)	54,529,998
	<u>164,584,703</u>	<u>275,583</u>	<u>(311,316)</u>	<u>164,548,970</u>
Accrued interest	<u>875,676</u>	<u>-</u>	<u>-</u>	<u>875,676</u>
	<u>\$ 165,460,379</u>	<u>\$ 275,583</u>	<u>\$ (311,316)</u>	<u>\$ 165,424,646</u>
	<u>Recorded Loan</u>	<u>Individual Allowance</u>	<u>Collective Allowance</u>	<u>2018 Net</u>
Consumer	\$ 13,926,169	\$ 7,137	\$ 3,001	\$ 13,916,031
Residential mortgages	59,848,490	-	25,591	59,822,899
Commercial	30,533,755	-	13,807	30,519,948
Agricultural	48,572,169	-	48,188	48,523,981
	<u>152,880,583</u>	<u>7,137</u>	<u>90,587</u>	<u>152,782,859</u>
Accrued interest	<u>751,320</u>	<u>-</u>	<u>-</u>	<u>751,320</u>
	<u>\$ 153,631,903</u>	<u>\$ 7,137</u>	<u>\$ 90,587</u>	<u>\$ 153,534,179</u>

Loans Past Due but Not Impaired

A loan is considered past due when a counterparty has not made a payment by the contractual due date. The table that follows presents the carrying value of loans at year-end that are past due but not classified as impaired because they are either (i) less than 90 days past due unless there is information to the contrary that an impairment event has occurred or (ii) fully secured and collection efforts are reasonably expected to result in full repayment.

	<u>30 to 59 days</u>	<u>60 to 89 days</u>	<u>Over 90 days</u>	<u>2019 Total</u>
Consumer	\$ -	\$ 3,012	\$ 1,005	\$ 4,017
Residential mortgages	550,105	-	-	550,105
Commercial	-	227,957	-	227,957
Total	<u>\$ 550,105</u>	<u>\$ 230,969</u>	<u>\$ 1,005</u>	<u>\$ 782,079</u>
	<u>30 to 59 days</u>	<u>60 to 89 days</u>	<u>Over 90 days</u>	<u>2018 Total</u>
Consumer	\$ 536	\$ 8,512	\$ 26,525	\$ 35,573
Residential mortgages	206,449	131,537	387,237	725,223
Total	<u>\$ 206,985</u>	<u>\$ 140,049</u>	<u>\$ 413,762</u>	<u>\$ 760,796</u>

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

8. MEMBER LOANS (continued)

Credit Quality of Loans

The Credit Union holds collateral against loans to customers in the form of interests over property, other securities over assets, and guarantees. It is not practical to value all collateral as at the balance sheet date due to the variety of assets and conditions. The Credit Union has policies in place to monitor the existence of undesirable concentration in the collateral supporting its credit exposure. In management's estimation, the fair value of the collateral is sufficient to offset the risk of loss on the loans past due but not impaired.

Reconciliation of allowance for expected credit loss

	12- Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	<u>2019</u>
Balance at November 1, 2018 per IAS 39 \$	-	\$ -	\$ -	\$ 97,724
Adjustment on initial application of IFRS 9	-	-	-	<u>258,280</u>
Balance at November 1, 2018 per IFRS 9	189,964	143,339	22,701	356,004
Charges (recovery) of loan impairment	(8,955)	(29,360)	651	(37,664)
Loans written off	-	(6,312)	(712)	<u>(7,024)</u>
Balance, end of year	<u>\$ 181,009</u>	<u>\$ 107,667</u>	<u>\$ 22,640</u>	<u>\$ 311,316</u>

Details of the changes in the allowance for loan impairment are as follows:

	<u>2018</u>
Balance, beginning of year	\$ 130,943
Provision for loan impairment	(13,315)
Loans written off during the year	<u>(19,904)</u>
Balance, end of year	<u>\$ 97,724</u>

Allowance for expected credit loss by portfolio

	12- Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	<u>2019</u>
Consumer	\$ 62,377	\$ 37,197	\$ 10,852	\$ 110,426
Residential mortgages	35,780	54,886	11,788	102,454
Commercial	41,417	7,790	-	49,207
Agriculture	<u>41,435</u>	<u>7,794</u>	-	<u>49,229</u>
Balance, end of year	<u>\$ 181,009</u>	<u>\$ 107,667</u>	<u>\$ 22,640</u>	<u>\$ 311,316</u>

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

8. MEMBER LOANS (continued)

Concentration of Risk

The Credit Union has an exposure to groupings of individual loans which concentrate risk and create exposure to particular segments.

There was no member or related groups of members for which loans exceed 3% of total assets at October 31, 2019.

The majority of loans to members are with members located in and around Vermilion, Alberta. A significant portion of the Credit Union's loan portfolio is secured by residential, commercial and agricultural property in and around Vermilion, Alberta. Therefore, the Credit Union is exposed to the risks in reduction of the loan to valuation ratio coverage should the oil and gas economy and property market be subject to decline. The risk of loss from loans undertaken is primarily reduced by the nature and quality of the security taken.

9. INCOME TAXES

Income Tax Expense

Reasons for the difference between income tax expense for the year and the expected income taxes based on the statutory rate of 27.00% (2018 - 26.99%) are as follows:

	<u>2019</u>	<u>2018</u>
Net income before income taxes	<u>\$ 1,488,554</u>	<u>\$ 1,669,036</u>
Computed income tax expense	\$ 401,910	\$ 450,473
Adjustments for income tax treatment of allowance for loan impairment, property and equipment and intangible assets	3,217	380
Non-deductible expenses and other	<u>1,285</u>	<u>1,963</u>
Total provision for income taxes	<u>\$ 406,412</u>	<u>\$ 452,816</u>

Deferred Income Taxes

The deferred income tax liability (asset) is comprised of temporary taxable (deductible) differences between the tax bases and carrying values in the following accounts:

	<u>2019</u>	<u>2018</u>
Property and equipment	\$ 50,995	\$ 47,425
Intangible assets	1,272	10,852
Allowance for loan impairment	(75,390)	(24,651)
Allowance for investment impairment	<u>(816)</u>	<u>-</u>
	<u>\$ (23,939)</u>	<u>\$ 33,626</u>

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

10. PROPERTY AND EQUIPMENT

	<u>Land</u>	<u>Building</u>	<u>Parking Lot</u>	<u>Furniture and Equipment</u>	<u>Information Technology</u>	<u>Total</u>
COST:						
Balance at October 31, 2018	\$ 229,800	\$ 1,527,259	\$ 82,080	\$ 294,211	\$ 91,192	\$ 2,224,542
Additions	-	-	-	16,436	22,801	39,237
Disposals	-	-	-	-	(19,175)	(19,175)
Transfers	-	-	-	-	5,499	5,499
Balance at October 31, 2019	<u>\$ 229,800</u>	<u>\$ 1,527,259</u>	<u>\$ 82,080</u>	<u>\$ 310,647</u>	<u>\$ 100,317</u>	<u>\$ 2,250,103</u>
ACCUMULATED DEPRECIATION:						
Balance at October 31, 2018	\$ -	\$ 633,113	\$ 46,011	\$ 230,150	\$ 54,251	\$ 963,525
Depreciation expense	-	31,001	5,540	28,751	24,571	89,863
Disposals	-	-	-	-	(19,175)	(19,175)
Transfers	-	-	-	-	871	871
Balance at October 31, 2019	<u>\$ -</u>	<u>\$ 664,114</u>	<u>\$ 51,551</u>	<u>\$ 258,901</u>	<u>\$ 60,518</u>	<u>\$ 1,035,084</u>
NET BOOK VALUE:						
October 31, 2018	<u>\$ 229,800</u>	<u>\$ 894,146</u>	<u>\$ 36,069</u>	<u>\$ 64,061</u>	<u>\$ 36,941</u>	<u>\$ 1,261,017</u>
October 31, 2019	<u>\$ 229,800</u>	<u>\$ 863,145</u>	<u>\$ 30,529</u>	<u>\$ 51,746</u>	<u>\$ 39,799</u>	<u>\$ 1,215,019</u>

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

11. INTANGIBLE ASSETS

COST:

Balance at October 31, 2018	\$ 511,437
Transfers	<u>(5,499)</u>

Balance at October 31, 2019	<u>\$ 505,938</u>
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ACCUMULATED DEPRECIATION:

Balance at October 31, 2018	\$ 471,244
Depreciation expense	30,853
Transfers	<u>(871)</u>

Balance at October 31, 2019	<u>\$ 501,226</u>
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NET BOOK VALUE:

October 31, 2018	<u>\$ 40,193</u>
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October 31, 2019	<u>\$ 4,712</u>
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12. OPERATING DEMAND LOAN

The Credit Union has an approved \$5,850,000 revolving operating demand facility with Credit Union Central Alberta Limited ("Central") which is secured by a general assignment of book debts, investments and deposits held at Central. Interest is payable at Central's prime rate less 0.5%. No amount was drawn at October 31, 2019.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

13. MEMBER DEPOSITS

	<u>2019</u>	<u>2018</u>
Demand deposits	\$ 89,862,213	\$ 93,584,733
Term deposits	63,519,887	42,869,386
Registered Retirement Savings Plans (RRSPs)	14,010,511	13,350,772
Tax-Free Savings Accounts (TFSA's)	12,019,818	9,361,068
Registered Retirement Income Funds (RRIFs)	<u>3,717,896</u>	<u>3,342,721</u>
	183,130,325	162,508,680
Accrued interest payable	<u>1,082,412</u>	<u>566,135</u>
	<u>\$184,212,737</u>	<u>\$163,074,815</u>

The repayment of all member deposits, including accrued interest, is guaranteed by Credit Union Deposit Guarantee Corporation for which the Credit Union pays a deposit guarantee assessment fee.

Concentra Financial Services Association is the trustee of the RRSPs, RRIFs, and TFSA's offered to members. Under an agreement with Concentra, member contributions to the plans, as well as income earned, are deposited in the Credit Union.

Concentration of Risk

The Credit Union has exposure to groupings of individual deposits which concentrate risk and create exposure to particular segments. The majority of member deposits are with members located in and around Vermilion, Alberta.

There was one member whose deposits amounted to 7.64% of total assets. No other member or related groups of members for which deposits exceed 3% of total assets at October 31, 2019.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

14. ALLOCATION DISTRIBUTABLE

The Board of Directors' intention is to pay a dividend on common shares equal to the average five-year term deposit rate for that fiscal year plus 1.5%. Their objective is to return approximately 30% of the Credit Union's profits to the membership each year by way of dividends on common shares (paid in member shares) and patronage rebates (paid in cash).

	<u>2019</u>	<u>2018</u>
Income before patronage allocation and income taxes	<u>\$ 1,576,014</u>	<u>\$ 1,843,336</u>
Less: Income taxes	406,412	452,816
Income tax recovery, dividends declared	<u>(80,205)</u>	<u>(85,552)</u>
	<u>326,207</u>	<u>367,264</u>
Income after income taxes and before patronage allocation	<u>\$ 1,249,807</u>	<u>\$ 1,476,072</u>
Patronage allocation distributable:		
Dividend on common shares	\$ 316,000	\$ 327,335
Patronage rebate	<u>87,460</u>	<u>174,300</u>
	<u>\$ 403,460</u>	<u>\$ 501,635</u>

15. MEMBER SHARES

Authorized

The *Credit Union Act* of Alberta identifies a class of equity shares, known as common shares, having the following characteristics:

- i) an unlimited number may be issued;
- ii) a par value of \$1, but fractional shares may be issued;
- iii) transferable only in restricted circumstances;
- iv) non-assessable; and
- v) redemption of common shares is at par value and is at the discretion of the Credit Union, subject to the restrictions contained in the *Credit Union Act* and *Regulations*, including limitations to 10% of outstanding balances.

Credit Union policy requires all members to make a minimum investment based upon the following criteria:

Regular member account	\$25
Children's member account (under 16 years)	\$5
Trust account	
- Beneficiary	\$5
- Trustees	\$25
Business account	\$25
Not-for-profit organization	NIL
Members are allowed to hold a maximum of	Unlimited

The Corporation does not guarantee common shares which represent "at risk" capital.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

16. RELATED PARTY TRANSACTIONS

(a) Member Loans

Directors and management of the Credit Union have loans totaling \$5,785,508 (2018 - \$5,807,042) which is 3.52% (2018 - 3.80%) of total loans. The aggregate value of loans disbursed to directors and management is \$1,977,866 (2018 - \$1,177,376). The aggregate value of unadvanced loans to directors and management is \$567,527 (2018 - \$152,251). The Credit Union, in accordance with its policy, grants loans to its management and staff at rates from 0% to 2% below member rates. Directors pay regular member rates on loans. All loans are in good standing. Interest and other revenue earned on these related party loans is \$158,045 (2018 - \$183,303).

(b) Member Deposits

Directors and management of the Credit Union have deposits totaling \$2,988,492 (2018 - \$2,861,322) which is 1.63% (2018 - 1.76%) of total deposits. Interest paid on these related party member deposits was \$37,594 (2018 - \$28,310).

(c) Directors' Fees

Directors' remuneration was \$29,075 (2018 - \$19,550) and expenses reimbursed to Directors were \$19,790 (2018 - \$20,964). Remuneration paid to Directors ranges from \$450 to \$4,750 with an average of \$3,231. The Credit Union retained nine (2018 - nine) directors for the year.

(d) Compensation of Key Management Personnel

Key management personnel are defined under the standards as persons having authority and responsibility for planning, directing, and controlling the activities of the Credit Union, directly or indirectly. The key management personnel of the Credit Union includes executive management.

	<u>2019</u>	<u>2018</u>
Salaries and short-term benefits	<u>\$ 981,357</u>	<u>\$ 745,559</u>

There was no compensation for post employment benefits, long-term benefits, termination benefits or share-based compensation during 2019 or 2018. The Credit Union management is comprised of eight (2018 - six) employees for the year.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

17. COMMITMENTS

(a) Retail Banking Services Agreement

The Credit Union recently entered into an amended *eroWORKS* Retail Banking Services Agreement with Celero Solutions Inc. The Agreement is effective for a ten year term commenced on January 1, 2016. Under the terms of this Agreement the Credit Union is committed to annual operating fees of approximately \$150,000.

(b) Deposit Agreements

The Credit Union has \$792,737 (2018 - \$1,519,034) of index-linked deposits outstanding to its members at October 31, 2019. These deposits mature between 2020 and 2024 and pay bonus interest to the depositors, at the end of the term, based upon the performance of the related index. The Credit Union has entered into deposit agreements with Central to offset the exposure on these deposits related to the performance of the underlying index. Consequently, at the end of the term, the Credit Union will receive payments from Central which will offset the amounts that will be paid to the depositors based on the performance of the underlying index.

The deposit agreements with Central are recorded in member deposits at cost less accumulated depreciation at October 31, 2019 of \$32,994 (2018 - \$28,126). Depreciation is calculated on a straight-line basis over the term of the deposits and amounted to \$22,448 (2018 - \$31,185).

(c) Credit Commitments

In the normal course of business, the Credit Union enters into various commitments to meet the credit requirements of its members. These credit arrangements are subject to the Credit Union's normal credit standards and collateral may be obtained where appropriate. The contract amounts for these commitments as set out below represent the maximum exposure to the Credit Union should the contracts be fully drawn and any collateral held proves to be of no value. As many of these arrangements will expire or terminate without being drawn upon, the contract amounts do not necessarily represent the future cash requirements. Such commitments, which are not included on the statement of financial position, include:

Commitments to extend credit which represent undertakings to make credit available in the form of loans or other financing for specific amounts and maturities, subject to certain conditions and include recently authorized credit not yet drawn down and credit facilities available on a revolving basis.

	<u>2019</u>	<u>2018</u>
Guarantees and stand-by letters of credit	\$ 209,250	\$ 199,000
Commitments to extend credit:		
Original term to maturity of one year or less	9,934,235	5,903,181
Original term to maturity of more than one year	<u>30,447,245</u>	<u>43,191,748</u>
	<u>\$ 40,590,730</u>	<u>\$ 49,293,929</u>

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

18. RISK MANAGEMENT

The Credit Union's risk management policies are designed to identify and analyze risks, to set appropriate risk limits and controls, and to monitor the risk and adherence to limits by means of reliable and up-to-date information systems. The Credit Union follows an enterprise risk management framework, which involves identifying particular events or circumstances relevant to its objectives, assessing them in terms of profitability and magnitude, determining a response strategy and monitoring progress. The Credit Union regularly reviews its risk management policies and systems to take account of changes in markets and products.

Risk management is carried out by management who reports to the Board. The Board provides written principles for risk tolerance and overall risk management. Management reports to the Board on compliance with the risk management policies of the Credit Union.

Financial instruments comprise the majority of the Credit Union's assets and liabilities. The Credit Union accepts deposits from members at both fixed and floating rates for various periods. The Credit Union seeks to earn an interest rate margin by investing these funds in high quality financial instruments – principally commercial and consumer loans, lines of credit, and commercial and residential mortgages. The primary types of financial risk that arise from this activity are credit risk, liquidity risk and market risk which is comprised of interest rate risk.

The following table describes the significant financial instrument activity undertaken by the Credit Union, the risks associated with such activities and the types of methods used in managing those risks.

<u>Activity</u>	<u>Risks</u>	<u>Method of managing risks</u>
Investments, cash and cash equivalents	Sensitivity to changes in interest rates, liquidity and credit risk, and foreign exchange rate	Asset-liability matching; monitoring of investment restrictions and monitoring of counterparty risk
Member loans	Sensitivity to changes in interest rates, liquidity and credit risk	Asset-liability matching and monitoring of counterparty risk
Member deposits	Sensitivity to changes in interest rates and foreign exchange rates	Asset-liability matching and periodic use of derivatives
Equity-linked derivative contracts	Sensitivity to changes in Canadian equity indices	Options

(a) Interest Rate Risk

Cash flow interest rate risk is the risk that the future cash flows of the Credit Union's financial instruments will fluctuate due to changes in market interest rates. Fair value interest rate risk is the risk that the value of financial instruments will fluctuate because of changes in prevailing market interest rates. Financial margin reported in the statement of net income and comprehensive income may increase or decrease in response to changes in market interest rates. Accordingly, the Credit Union sets limits on the level of mismatch of interest rate re-pricing that may be undertaken, which is monitored by management and reported to the Board.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

18. RISK MANAGEMENT (continued)

(a) Interest Rate Risk (continued)

To manage the re-pricing of asset and liability mismatch opportunities the Credit Union will undertake campaigns to procure deposits or loans that reprice/mature within a specific time period, buy/sell assets that reprice/mature within a specific time period and may purchase derivative instruments. These decisions are based on economic conditions, member behaviour, capital and liquidity levels and compliance with Credit Union policy.

Other types of interest rate risk may involve basis risk, the risk of loss from changes in the relationship of interest rates which may not have identical characteristics (for example the difference between prime rate and variable rate loans and variable rate deposits) and prepayment risk (the risk of loss of interest income arising from early repayment of fixed rate mortgages and loans). These risks are also monitored on a regular basis and reported to the Board.

Interest rate risk is measured by:

- i) Static gap analysis which aggregates cash flows into repricing periods based on the maturity dates of the assets and liabilities.
- ii) Income simulation models that use current interest revenue, current interest expense and market values. These models incorporate assumptions about pricing strategies, growth, volume, new business and interest rates.
- iii) Market value of portfolio equity determines the present value of all assets and liabilities. This provides an estimate of the equity value of the Credit Union.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

18. RISK MANAGEMENT (continued)

a) Interest Rate Risk (continued)

The following schedule shows the Credit Union's sensitivity to interest rate changes as at October 31, 2019. Fixed rate assets and fixed rate liabilities are reported based on scheduled repayments. Variable rate assets and liabilities that are linked to prime rate are reported in the floating rate category. Non-interest bearing assets and non-interest bearing liabilities are reported in the non-rate sensitive category.

As at October 31, 2019

	Floating Rate	Within 1 Year	1 to 5 Years	Non-Rate Sensitive	Total
Assets					
Cash	\$ 5,453,344	\$ 18,075,000	\$ -	\$ 483,864	\$ 24,012,208
<i>Effective Yield</i>	0.25%	1.80%	0.00%	0.00%	1.03%
Investments	2,000,000	12,545,766	-	102,561	14,648,327
<i>Effective Yield</i>	3.59%	1.80%	0.00%	0.00%	1.68%
Member loans	37,630,907	31,647,639	95,581,769	579,503	165,439,818
<i>Effective Yield</i>	4.83%	3.06%	3.76%	0.00%	3.87%
Other	-	-	-	1,465,773	1,465,773
	<u>45,084,251</u>	<u>62,268,405</u>	<u>95,581,769</u>	<u>2,631,701</u>	<u>205,566,126</u>
Liabilities					
Deposits	65,434,216	55,892,453	12,758,893	29,127,676	163,213,238
<i>Effective Yield</i>	0.92%	2.27%	2.16%	0.00%	1.31%
Equity	-	-	-	20,956,455	20,956,455
Other	-	-	-	21,396,430	21,396,430
	<u>65,434,216</u>	<u>55,892,453</u>	<u>12,758,893</u>	<u>71,480,561</u>	<u>205,566,123</u>
Net gap	<u><u>\$(20,349,965)</u></u>	<u><u>\$ 6,375,952</u></u>	<u><u>\$ 82,822,876</u></u>	<u><u>\$(68,848,860)</u></u>	<u><u>\$ 3</u></u>

As at October 31, 2018

Net gap	<u><u>\$(25,421,557)</u></u>	<u><u>\$ 17,218,000</u></u>	<u><u>\$ 56,463,000</u></u>	<u><u>\$(48,259,443)</u></u>	<u><u>\$ -</u></u>
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The following table provides the potential before-tax impact of a 1% increase or decrease in the Credit Union's financial margin before provision for loan impairment. These measures are based on assumptions made by management and validated by experience. All interest rate risk measures are based upon interest rate exposures at specific time continuously changing as a result of business activities and management's risk initiatives.

Impact on financial margin before taxes and provision for loan impairment of:

	2019	2018
1% increase in rates	\$ 600,000	\$ 570,000
1% decrease in rates	\$ (580,000)	\$ (560,000)

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

18. RISK MANAGEMENT (continued)

(b) Credit Risk

Credit risk is the risk that financial loss will be incurred due to the failure of a counterparty to discharge its contractual commitment or obligation to the Credit Union arising from member loans, investments, securities and derivative instruments with positive market values. The primary credit risk arising from loans is the possibility that members will be unable or unwilling to repay some or all of the principal and interest on their loans. Allowances for credit losses are made for potential losses that have been identified at the statement of financial position date.

Management of credit risk is an integral part of the Credit Union's activities. Management carefully monitors and manages the Credit Union's exposure to credit risk by a combination of methods. Credit risk arises principally from lending activities that result in member loans and advances and treasury activities that result in investments in cash resources. The overall management of credit risk is centralized in the Audit and Risk, and Finance Committees, which reports to the Board.

Concentration of loans is managed by the implementation of sector and member specific limits.

The Credit committee is responsible for approving and monitoring the Credit Union's tolerance for credit exposures. It accomplishes this through review and approval of the Credit Union's lending policies and through setting of limits on credit exposures to individual members and across sectors. The Credit Union maintains levels of borrowing approval limits, and prior to advancing funds to a member, an assessment of the credit quality of the member is made. The Credit Union emphasizes responsible lending in its relationships with members and establishes that loans are within the member's ability to repay, rather than relying exclusively on collateral.

The Credit Union often takes security as collateral in common with other lending institutions. The Credit Union maintains guidelines on the acceptability of specific types of collateral. Collateral may include mortgages over residential properties and charges over business assets such as premises, inventory and accounts receivable. Where significant impairment indicators are identified, the Credit Union will take additional measures to manage the risk of default, which may include seeking additional collateral.

The credit quality of the commercial loan portfolio and agricultural loan portfolio for those loans that are neither past due nor impaired can be assessed by reference to the Credit Union's internal rating system. The Credit Union assesses the quality of loans using an internal rating tool. This rating tool takes into consideration a number of factors, such as the security, the borrower's management performance, current and projected financial results and industry statistics related to the borrower's industry and utilizes the experience and judgment of the Credit department. The current risk rating format consists of seven categories reflecting various degrees of risk and the availability of collateral.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

18. RISK MANAGEMENT (continued)

(b) Credit Risk (continued)

The following information represents the maximum exposure to credit risk before taking into consideration any collateral. For financial assets recognized on the statement of financial position, the exposure to credit risk is their stated carrying amount. For off balance sheet items, the maximum exposure is the full amount of the undrawn facilities or loan commitment.

	<u>2019</u>	<u>2018</u>
On balance sheet exposure		
Cash and cash equivalents	\$ 24,012,208	\$ 22,373,194
Investments	14,648,327	6,304,361
Member loans	<u>165,424,646</u>	<u>153,534,179</u>
	<u>\$ 204,085,181</u>	<u>\$ 182,211,734</u>
Off balance sheet exposure		
Guarantees and stand-by letters of credit	\$ 209,250	\$ 199,000
Commitments to extend credit		
Original term to maturity of one year or less	9,934,235	5,903,181
Original term to maturity of more than one year	<u>30,447,245</u>	<u>43,191,748</u>
	<u>\$ 40,590,730</u>	<u>\$ 49,293,929</u>

Concentration of credit risk exists if a number of borrowers are engaged in similar economic activities or are located in the same geographic region, and indicates the sensitivity of the Credit Union to developments affecting a particular segment of borrowers or geographic region.

Geographic credit risk exists for the Credit Union due to its primary service area being in Vermillion, Mannville and surrounding areas.

(c) Market Risk

Market risk is the risk of loss in value of financial instruments that may arise from changes in market factors such as interest rates, equity prices and credit spreads. The Credit Union's exposure changes depending on market conditions. Market risks that have a significant impact on the Credit Union include fair value risk and interest rate risk.

(d) Fair Value Risk

Fair value risk is the potential for loss from an adverse movement in the value of a financial instrument. The Credit Union incurs fair value risk on its member loans, investments and member deposits. The Credit Union does hedge its fair value risk regarding its equity linked derivatives. For further information on fair value of financial instruments see Note 21.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

18. RISK MANAGEMENT (continued)

(e) Liquidity Risk

Liquidity risk is the risk that the Credit Union will encounter difficulty in raising funds to meet its obligations to members and other liabilities. To mitigate this risk, the Credit Union is required to maintain, in the form of cash and term deposits, a minimum liquidity at all times as described in Note 19. The Credit Union has established policies which include minimum liquidity requirements, eligibility requirements for liquid assets, investments with counterparties, deposit concentration and diversification limits. The Credit Union monitors expected cash inflows and outflows on a daily, cyclical and long-term basis. The Credit Union's preferred source of funding is member deposits; however, borrowing from Central is permitted during periods where loan demand exceeds deposit growth. Other sources of funding such as sale of assets, deposits from other credit unions and wholesale deposits are acceptable.

On a periodic basis management ensures that it has adhered to the regulatory requirement of the *Credit Union Act* of Alberta's minimum liquidity ratio of 6% of total assets. The Credit Union's liquidity ratio was 7.05% at October 31, 2019 (2018 – 7.35%).

Management reviews its compliance with these policies and reports its statutory liquidity position to the Board on an exception basis. It reports the operating liquidity to the Board on a monthly basis. The Audit, Risk and Finance Committee ensures that a periodic review/audit is performed to verify compliance with policy and procedures (no less than annually).

(f) Foreign Exchange Risk

Foreign exchange risk is not considered significant at this time as the Credit Union does not engage in any active trading of foreign currency positions or hold significant foreign currency denominated financed investments for an extended period.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

19. CAPITAL MANAGEMENT

The Credit Union's objectives when managing capital are:

- (a) To ensure the long term viability of the Credit Union and the security of member deposits by holding a level of capital deemed sufficient to protect against unanticipated losses.
- (b) To comply at all times with the capital requirements set out in the *Credit Union Act*.

The Credit Union measures the adequacy of capital using two methods:

- i) Total capital as a percentage of total assets; and
- ii) Total capital as a percentage of risk weighted assets. Under this method the Credit Union reviews its loan portfolio and other assets and assigns a risk weighting using definitions and formulas set out in the *Credit Union Act*. The more risk associated with an asset, a higher weighting is assigned. This method allows the Credit Union to measure capital relative to the possibility of loss with more capital required to support assets that are seen as being higher risk.

Credit Union management ensures compliance with capital adequacy through the following:

- (a) Setting policies for capital management, monitoring and reporting;
- (b) Setting policies for related areas such as asset liability management;
- (c) Reporting to the Board of Directors or its committees regarding financial results and capital adequacy;
- (d) Reporting to the Corporation on its capital adequacy; and
- (e) Setting budgets and reporting variances to those budgets.

The Credit Union is required under the *Credit Union Act* to have a capital balance that is equal to or exceeds the greater of:

- i) 4% of total assets; and
- ii) 8% of risk weighted assets.

As of October 31, 2019 the Credit Union's available capital as a percentage of total assets was 10.32% (2018 - 10.94%) and the available capital as a percent of risk weighted assets was 15.30% (2018 - 14.79%). Therefore, the Credit Union has exceeded its minimum capital requirement at October 31, 2019.

Furthermore, the Corporation requires an additional regulatory capital buffer of 2.5% of total risk weighted assets.

The Corporation also expects the Credit Union to hold an additional internal capital buffer equal to a minimum of 2% of total risk weighted assets.

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

20. DERIVATIVES

Equity-linked options are used to fix costs on term deposit products which pay a return to the deposit holder based on the change in equity market indexes. The embedded derivative in the term deposit product as well as the option derivatives is marked to market through interest income investments. The fair value of the equity linked derivative contract is separately presented as part of derivative instrument assets.

The fair value of the equity-linked option contract is \$55,200 (2018 - \$133,214). The fair value of the embedded derivative is \$55,200 (2018 - \$133,214). Both items are marked to market through income. This had no effect on income for the year ended October 31, 2019.

The notional amounts of equity-linked derivative contracts maturing at various times are as follows:

	<u>2019</u>	<u>2018</u>
Within 1 year	\$ 180,546	\$ 1,048,406
Within 2 years	118,042	180,547
Within 3 years	265,943	118,041
Within 4 years	48,874	123,166
Within 5 years	<u>179,332</u>	<u>48,874</u>
	<u>\$ 792,737</u>	<u>\$ 1,519,034</u>

Notional amounts are the contract amounts used to calculate the cash flows to be exchanged.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

21. FINANCIAL INSTRUMENT CLASSIFICATION AND FAIR VALUE

Fair value amounts disclosed represent point in time estimates that may change in subsequent reporting periods due to market conditions or other factors. The Credit Union has estimated fair values taking into account changes in interest rates and credit risk that have occurred since the assets and liabilities were acquired. These calculations represent the Credit Union's best estimates based on a range of methods and assumptions. Since they involve uncertainties, the fair values may not be realized in an actual sale or immediate settlement of the instrument. Interest rate changes are the main cause of changes in the fair value of the Credit Union's financial instruments.

The following methods and assumptions are used to estimate the fair market value:

- i) The fair values of cash, demand deposits, certain other assets and certain other liabilities approximate their carrying values, due to their short-term nature.
- ii) The estimated fair values of floating-rate investments, member loans and member deposits are assumed to equal carrying value as the interest rates automatically reprice to market.
- iii) The estimated fair values of fixed-rate investments, member loans and member deposits are determined by discounting the expected future cash flows of these items at current market rates for products with similar terms and credit risks.

The most significant assumption relates to the discount rates utilized. If the forward yield curve of such instruments would increase by 10 basis points then the fair value of financial assets would decrease by \$278,500 (2018 - \$22,700) and the fair value of financial liabilities would decrease by \$112,820 (2018 - \$8,200). A corresponding decrease of 10 basis points in the forward yield curve would result in a \$278,500 (2018 - \$22,700) increase in the fair value of financial assets and a \$112,820 (2018 - \$8,200) increase in the fair value of financial liabilities.

The total value of loans determined using the above assumptions is reduced by the allowance for impaired loans.

	<u>2019</u>			<u>2018</u>		
	<u>Fair Value (FV)</u>	<u>Carrying Value (CV)</u>	<u>Change</u>	<u>Fair Value (FV)</u>	<u>Carrying Value (CV)</u>	<u>Change</u>
Assets						
Cash and cash equivalents	\$ 24,012,208	\$ 24,012,208	\$ -	\$ 22,373,194	\$ 22,373,194	\$ -
Investments	14,648,327	14,648,327	-	6,302,361	6,304,361	(2,000)
Member loans	163,371,646	165,424,646	(2,053,000)	151,039,179	153,534,179	(2,495,000)
Other	137,539	137,539	-	133,214	133,214	-
	<u>\$ 202,169,720</u>	<u>\$ 204,222,720</u>	<u>\$ (2,053,000)</u>	<u>\$ 179,847,948</u>	<u>\$ 182,344,948</u>	<u>\$ (2,497,000)</u>
Liabilities						
Member deposits	\$ 185,424,737	\$ 184,212,737	\$ 1,212,000	\$ 163,603,815	\$ 163,074,815	\$ 529,000
Other liabilities	396,931	396,931	-	612,743	612,743	-
	<u>\$ 185,821,668</u>	<u>\$ 184,609,668</u>	<u>\$ 1,212,000</u>	<u>\$ 164,216,558</u>	<u>\$ 163,687,558</u>	<u>\$ 529,000</u>
Equity	<u>\$ 16,348,052</u>	<u>\$ 19,613,052</u>	<u>\$ (3,265,000)</u>	<u>\$ 15,631,390</u>	<u>\$ 18,657,390</u>	<u>\$ (3,026,000)</u>

(continued)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

21. FINANCIAL INSTRUMENT CLASSIFICATION AND FAIR VALUE (continued)

Assets and liabilities recorded at fair value in the statement of financial position are measured and classified in a hierarchy consisting of three levels for disclosure purposes; the three levels are based on the priority of the inputs to the respective valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lower priority to unobservable inputs (Level 3). An asset or liability's classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. The input levels are defined as follows:

- Level 1: Unadjusted quoted prices in an active market for identical assets or liabilities.

Assets measured at fair value and classified as Level 1 include cash and cash equivalents and derivatives.

- Level 2: Quoted prices in markets that are not active or inputs that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 2 inputs include quoted prices for assets in markets that are considered less active. There are no assets measured at fair value and classified as Level 2.

- Level 3: Unobservable inputs that are supported by little or no market activity and are significant to the estimated fair value of the assets or liabilities.

Level 3 assets and liabilities would include financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of estimated fair value requires significant management judgment or estimation.

Assets measured at fair value and classified as Level 3 include Central shares and Concentra shares.

There were no transfers between fair value hierarchy levels for the years ended October 31, 2019 and 2018.

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

22. EXPLANATION OF TRANSITION TO IFRS 9

On November 1, 2018, the Credit Union adopted IFRS 9 *Financial Instruments*, which replaced the guidance in IAS 39 *Financial Instruments: Recognition and Measurement*. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities. The Credit Union elected not to restate comparative figures as permitted by the transitional provisions of IFRS 9. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognized in opening retained earnings or accumulated other comprehensive income (AOCI) of the current period.

Classification and measurement of financial assets and financial liabilities

IFRS 9 classification is generally based on the business model in which a financial asset is managed and whether its contractual cash flows represent solely payments for principal and interest (SPPI). The standard eliminates existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. For the purposes of determining the classification of financial assets, the business model test has been applied on the basis of facts and circumstances existing at the date of initial application with the resulting classification applied retrospectively.

Derivatives embedded within host contracts that are financial assets in the scope of IFRS 9 are no longer separated from the host contract. Instead, the whole hybrid contract is assessed for classification in accordance with the above requirements.

The classification and measurement of financial liabilities is largely retained from IAS 39. However, under IAS 39, all fair value changes of liabilities designated under the fair value option were recognized in profit or loss. Under IFRS 9, the amount of change in fair value attributable to the Credit Union's own credit risk is generally required to be presented in other comprehensive income.

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' (ECL) model. The new impairment model also applies to certain undrawn lines of credit, loan commitments, and letters of credit. The Credit Union recognizes ECL for financial assets classified as FVOCI and amortized cost.

IFRS 9 requires the Credit Union to measure the loss allowance for a financial instrument at an amount equal to the lifetime ECL if the credit risk on the financial instrument has increased significantly since initial recognition, or if the financial instrument is a purchased or originated credit-impaired financial asset.

Alternatively, if the credit risk on a financial instrument has not increased significantly since initial recognition, the Credit Union is required to measure the loss allowance for that financial instrument at an amount equal to 12 month ECL.

(Continues)

VERMILION CREDIT UNION LIMITED

NOTES TO FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED OCTOBER 31, 2019

22. EXPLANATION OF TRANSITION TO IFRS 9 (continued)

Summary of impact upon adoption of IFRS 9 - Classification and measurement

The table below reconciles the carrying amount of financial instruments under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on November 1, 2018. The table below also illustrates the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Credit Union's financial assets and financial liabilities as at November 1, 2018.

	IAS 39 Measurement category	IFRS 9 Measurement category	IAS 39 Carrying amounts	IFRS 9 Carrying amounts
Financial assets				
Cash and cash equivalents	FVTPL	FVTPL	\$22,373,194	\$22,373,194
Investments				
Shares	Available for sale	FVTPL	\$2,053,118	\$2,053,118
Term deposits	Held-to-Maturity	Amortized cost	\$4,251,243	\$4,249,053
Derivative assets	FVTPL	FVTPL	\$133,214	\$133,214
Member loans	Loans and receivables	Amortized cost	\$153,534,179	\$153,275,896
Total financial assets			\$182,344,948	\$182,084,475
Financial liabilities				
Member deposits	Other financial liabilities	Amortized cost	\$163,074,815	\$163,074,815
Derivative liabilities	FVTPL	FVTPL	\$133,214	\$133,214
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost	\$251,847	\$251,847
Total financial liabilities			\$163,459,876	\$163,459,876

The Credit Union's significant accounting policies on the classification of financial instruments under IFRS 9 are set out in Note 3. The application of these policies resulted in the reclassifications as set out in the table above and explained below:

a) Investments in equity investments that do not have a quoted market price in an active market, including Credit Union Central of Alberta shares, classified as available-for-sale under IAS 39, were reclassified as FVTPL.

b) On October 31, 2018 the Credit Union reclassified additional amounts to impaired loans from principal performing member loans. This reclassification is the result of the transition to IFRS 9, and the related new ECL model.

VERMILION CREDIT UNION LIMITED

SCHEDULE I

SCHEDULE OF OPERATING EXPENSES

FOR THE YEAR ENDED OCTOBER 31, 2019

	<u>2019</u>	<u>2018</u>
Personnel		
Salaries	\$ 1,936,985	\$ 1,828,393
Benefits	249,804	240,991
Training and other	<u>100,262</u>	<u>92,361</u>
	<u>2,287,051</u>	<u>2,161,745</u>
Occupancy		
Repairs and maintenance	54,445	49,002
Utilities	36,561	36,236
Depreciation	36,542	36,542
Property taxes	<u>27,455</u>	<u>26,799</u>
	<u>155,003</u>	<u>148,579</u>
Security		
Deposit guarantee assessment	157,439	150,324
Bonding	30,426	27,836
Insurance	<u>2,334</u>	<u>2,821</u>
	<u>190,199</u>	<u>180,981</u>
Organization		
Central dues	42,663	42,323
Directors' fees	29,075	19,550
Directors' expenses	19,790	20,964
Other	<u>12,689</u>	<u>20,346</u>
	<u>104,217</u>	<u>103,183</u>
General		
Computer, cash and service charges	542,441	542,993
Office	123,756	116,156
Advertising and community support	111,807	81,995
Office equipment, rental and maintenance	74,427	57,053
Professional fees	56,328	55,839
Depreciation	53,322	50,806
Courier and postage	34,403	33,866
Travel	32,530	23,268
Loan associated expenses	32,289	19,522
Telephone	31,250	30,762
Depreciation of intangible assets	30,853	50,371
Insurance	19,018	17,769
Loss on disposal of property and equipment	<u>-</u>	<u>11,299</u>
	<u>1,142,424</u>	<u>1,091,699</u>
	<u>\$ 3,878,894</u>	<u>\$ 3,686,187</u>

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