Assiniboine Credit Union

Assiniboine Credit Union Limited

Consolidated Financial Statements

December 31, 2008

MARCH 24, 2009

Auditors' Report

To the Members of Assiniboine Credit Union Limited

We have audited the consolidated balance sheet of Assiniboine Credit Union Limited as at December 31, 2008 and the consolidated statement of operations, comprehensive income and retained surplus and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Credit Union's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Credit Union as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Consolidated Balance Sheet

AS AT DECEMBER 31, 2008

(in thousands of dollars)	2008 $	2007 $
Assets		
Cash on hand and on deposit	12,727	17,142
Investments (note 4)	185,022	150,660
Loans to members (note 5)	2,185,093	1,898,906
Property and equipment (note 6)	18,047	12,006
Other assets (note 7)	12,917	14,507
	2,413,806	2,093,221
Liabilities		
Line of credit (note 8)	79,523	19,208
Members' deposits (note 9)	2,190,897	1,952,546
Accounts payable and accrued liabilities	13,894	10,022
	2,284,314	1,981,776
Commitments, contingencies and guarantees (notes 16 and 17)		
Members' Equity		
Members' shares (note 11)	30,798	29,564
Provision for issue of preference and surplus shares (note 12)	1,343	1,276
Contributed surplus (note 3)	35,633	33,313
Retained surplus	61,718	47,292
	129,492	111,445
	2,413,806	2,093,221

Approved by the Board of Directors

DIRECTOR

DIRECTOR

Consolidated Statement of Operations, Comprehensive Income and Retained Surplus

FOR THE YEAR ENDED DECEMBER 31, 2008

(in thousands of dollars)	2008 $	2007 $
Revenues		
Interest from loans to members	117,199	106,328
Investment income	7,836	6,496
	125,035	112,824
Cost of funds		
Interest paid to members	67,315	62,647
Interest paid on line of credit	1,761	1,378
	69,076	64,025
Financial margin	55,959	48,799
Other income	23,313	22,310
Financial margin and other income	79,272	71,109
Operating expenses		
Personnel	31,053	27,459
Administrative	16,640	15,722
Occupancy	6,665	7,047
Member security	2,348	2,248
Organizational	1,541	1,280
	58,247	53,756
Gross operating margin	21,025	17,353
Provision for doubtful loans (note 5)	2,520	3,396
Income before income taxes	18,505	13,957
Provision for (recovery of) income taxes		
Current	2,203	2,602
Future	708	(322)
	2,911	2,280
Net income and comprehensive income for the year	15,594	11,677
Retained surplus — Beginning of year	47,292	36,685
	62,886	48,362
Dividends on preference shares (note 12)	(820)	(749)
Dividends on surplus shares (note 12)	(348)	(321)
Retained surplus — End of year	61,718	47,292

Consolidated Statement of Cash Flows

FOR THE YEAR ENDED DECEMBER 31, 2008

(in thousands of dollars)	2008 $	2007 $
Cash provided by (used in)		
Operating activities		
Net income and comprehensive income for the year	15,594	11,677
Items not affecting cash		
Amortization	2,352	2,422
Provision for doubtful loans	2,520	3,396
Loss on disposal of property and equipment	8	–
Future income taxes	708	(322)
	21,182	17,173
Net change in non-cash working capital items		
Investments — accrued interest	1,107	(1,755)
Loans to members — accrued interest	(420)	(2,474)
Other assets	1,492	(193)
Members' deposits — accrued interest	4,081	13,585
Accounts payable and accrued liabilities	3,509	(2,992)
	30,951	23,344
Investing activities		
Net loans issued to members	(195,177)	(188,492)
Cash acquired, net of acquisition costs paid	1,895	11,404
Net increase in investments	(30,026)	(44,833)
Purchase of property and equipment	(8,163)	(1,648)
	(231,471)	(223,569)
Financing activities		
Net increase in members' deposits	142,575	184,986
Net increase in line of credit	55,297	10,469
Net decrease in loans payable	–	(8,500)
Income tax savings on dividends	175	206
Net increase (decrease) in common shares	(700)	18
Net decrease in surplus shares	(535)	(780)
Net decrease in preference shares	(707)	(1,137)
	196,105	185,262
Net decrease in cash on hand and on deposit	(4,415)	(14,963)
Cash on hand and on deposit — Beginning of year	17,142	32,105
Cash on hand and on deposit — End of year	12,727	17,142

Supplementary cash flow information

	2008	2007
Income taxes paid	3,203	1,972
Interest paid	64,995	50,440

Notes to Consolidated Financial Statements

DECEMBER 31, 2008

1. CHANGE IN ACCOUNTING POLICIES

On January 1, 2008, Assiniboine Credit Union Limited (the "Credit Union") adopted four new sections of the Canadian Institute of Chartered Accountants ("CICA") Handbook, namely Section 1535, "*Capital Disclosures*"; Section 1400, "*Going Concern*"; Section 3862, "*Financial Instruments — Disclosures*"; and Section 3863, "*Financial Instruments — Presentation*". Section 3862 and 3863 consist of a comprehensive series of disclosures and presentation requirements applicable to financial instruments. These sections revised and enhanced the disclosure requirements set out in Section 3861, "*Financial Instruments — Disclosure and Presentation*", and carry forward unchanged its presentation requirements. Section 1535 consists of comprehensive disclosure requirements related to the Credit Union's objectives, policies and processes for managing capital including required disclosures of externally imposed capital requirements.

The Accounting Standards Board ("AcSB") amended CICA Handbook Section 1400, "*General Standards of Financial Statement Presentation*", to include requirements for management to assess an entity's ability to continue as a going concern and to disclose material uncertainties related to events and conditions that may cast doubt on the entity's ability to continue as a going concern. The Credit Union adopted the new standard effective January 1, 2008. Management noted no issues with the Credit Union's ability to continue as a going concern.

The application of the aforementioned standards only impacted the Credit Union's disclosures included in the financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements, which include Assiniboine Credit Union Limited and its wholly-owned subsidiary, Assiniboine Credit Union Ltd. Holdings, have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

Cash on hand and on deposit

Cash on hand and on deposit consists of cash and deposits with other financial institutions.

Investments

Investments are recorded at amortized cost. If the market value of investments becomes lower than cost and this decline in value is considered to be other than temporary, the investments are written down to market value and the adjustment is recorded in income in the period. The Credit Union assesses whether a financial asset is other than temporarily impaired by assessing whether there is a significant or prolonged decline in fair value and objective evidence of impairment exists such as financial difficulty, breach or default of contracts, probability of bankruptcy or other financial reorganization.

Loans to members

Loans are carried at the principal plus accrued interest, less allowances for doubtful loans. Loans are written off when there is no realistic prospect of recovering the loan in full. Recoveries on loans previously written off are recorded in income in the period.

Allowance for doubtful loans

The Credit Union maintains allowances for doubtful loans that reduce the carrying value of loans identified as impaired to their estimated realizable amounts. A loan is considered impaired as a result of the deterioration in credit quality to the extent that the Credit Union no longer has reasonable assurance that the full amount of the principal and interest will be collected in accordance with the terms of the loan agreement. Estimated realizable amounts are determined by estimating the fair value of security underlying the loans and deducting costs of realization, or by discounting the expected future cash flows at the effective interest rate. Changes in the estimated realizable amounts arising subsequent to initial impairment recognition are adjusted to the allowance.

The allowance for doubtful loans also includes provisions for losses on loans established based on payment arrears, historical loan loss experience, and current economic conditions and trends in particular industries, regions and other groupings of loans in the portfolio.

Financial instruments

The Credit Union initially recognizes all financial assets and liabilities at fair value and subsequently measures these at either amortized cost or fair value depending on the type of instrument. Derivative financial instruments are measured at fair value, even when they are part of a hedging relationship. All financial assets must be designated as either Held for Trading, Available for Sale, Loans and Receivables or Held to Maturity. All financial liabilities must be designated as either Held for Trading or Other Liabilities.

The Credit Union has made the following designations: cash on hand and on deposit and lines of credit are classified as Held for Trading and are carried at fair value; investments, accounts receivable and loans to members are classified as Loans and Receivables and are carried at amortized cost; shares of Credit Union Central of Manitoba ("Central") are classified as Available for Sale and are not actively traded in a quoted market and accordingly recorded at cost; and accounts payable and members' deposits are classified as Other Liabilities and are carried at amortized cost.

Notes to Consolidated Financial Statements

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2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Interest rate swap derivative instruments are used to hedge exposure to interest rate risk. Under interest rate swap contracts, the Credit Union agrees to exchange the difference between fixed and floating rate interest amounts calculated on the agreed notional principal amounts. Such contracts enable the Credit Union to mitigate the risk of changing interest rates. To the extent that the hedging relationship is effective, a gain or loss arising from the hedged item in a fair value hedge adjusts the carrying value of the hedged item and is reflected in earnings, offset by change in fair value of the underlying derivative. Any changes in the fair value of derivatives that do not qualify for hedge accounting are reported in earnings. Changes in fair value relating to the interest rate swaps are included in financial margin.

Revenue recognition

Interest on loans is recorded as income on the effective interest basis except for loans which are considered impaired. Recognition of income ceases on impaired loans when the carrying amount of the loan, including accrued interest, exceeds the estimated realizable amount of the underlying security.

Property and equipment

Property and equipment are recorded at acquisition cost and amortization is provided on a straight-line basis over the estimated useful life of the assets as follows:

Buildings	5%
Furniture and equipment	20%
Data processing equipment and software	10%, 20% and 33%
Signs	20%
Parking lots	5% and 7%
Leasehold improvements	Shorter of the remaining term of the lease or estimated useful life

Income taxes

The Credit Union utilizes the asset and liability method of accounting for future income taxes. This method requires that income taxes reflect the future tax consequences of temporary differences between the carrying amounts of assets and liabilities and their tax bases. Future income tax assets and liabilities are determined for each temporary difference based on substantively enacted tax rates that are expected to be in effect when the temporary differences are expected to be recovered or settled. The effect of a change in tax rates is recognized in the statement of operations in the period that includes the substantive enactment date. Future income tax assets are recognized to the extent that realization is considered more likely than not.

Translation of foreign currencies

Cash on hand and on deposit and members' deposits denominated in foreign currencies are translated into Canadian dollars at the rates prevailing on the balance sheet date. Revenues and expenses are translated using monthly average exchange rates. Realized and unrealized gains and losses arising from translation are included in other income.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. BUSINESS COMBINATION

On January 1, 2008 the Credit Union completed an amalgamation with Buffalo Credit Union Limited ("Buffalo") and continued under the name "Assiniboine Credit Union Limited". There was no cash consideration exchanged in this transaction. The transaction has been accounted for as prescribed under CICA 1580, "Business Combinations". Under these requirements, the Credit Union was identified as the purchaser for accounting purposes and as such, the purchase method of accounting was used. The consolidated statement of operations, comprehensive income and retained surplus includes the operations of Buffalo since the date of amalgamation.

Notes to Consolidated Financial Statements

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3. BUSINESS COMBINATION (CONTINUED)

Under the purchase method of accounting, the net assets of the acquired enterprises are recorded at fair value. The fair values of the assets and liabilities acquired were determined with reference to current market interest rates for similar financial instruments, and valuation techniques that follow generally accepted accounting principles. The excess of fair value of net assets acquired over the shares issued in connection with the business combination is recorded as contributed surplus in the consolidated balance sheet. Common shares issued by Buffalo under the member share subscription program ($672,000) were redeemed subsequent to the amalgamation date. As a result, the former Buffalo members common share balances were reduced to $5 per member in accordance with the Credit Union's common share policy as defined in note 11.

The following table summarizes the estimated fair values of the assets acquired and the liabilities assumed as at January 1, 2008:

(in thousands of dollars)	Buffalo $
Assets acquired	
Cash on hand and on deposit	1,945
Investments	5,443
Loans to members	93,110
Property and equipment	238
Other assets	610
Total assets	101,346
Liabilities assumed	
Loans payable to Credit Union Central of Manitoba	5,018
Members' deposits	91,695
Accounts payable and accrued liabilities	363
Total liabilities	97,076
Fair value of net assets acquired	4,270
Shares issued	
Common shares	699
Surplus shares	697
Class Assiniboine preference shares	504
Total shares issued	1,900
Acquisition costs	50
	1,950
Contributed surplus	
	2,320
Cost of purchase	4,270

Notes to Consolidated Financial Statements

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4. INVESTMENTS

(in thousands of dollars)	2008 $	2007 $
Credit Union Central of Manitoba		
Shares	13,431	7,993
Contract deposits	170,239	140,208
	183,670	148,201
Manitoba Builder Bonds, bearing interest at 3.7%, maturing in 2010	200	200
Credential Securities Inc. debenture, non-interest bearing, maturing in 2020	250	250
	184,120	148,651
Accrued interest receivable	902	2,009
	185,022	150,660

The above contract deposits bear interest at rates ranging from 2.50% to 4.63% with maturity dates ranging from January 2009 to September 2010.

5. LOANS TO MEMBERS

Loans to members are presented net of allowances for doubtful loans totalling $7,401,000 (2007 – $7,542,000), consisting of specific allowances of $3,269,000 (2007 – $3,964,000) for loans considered impaired and $4,132,000 (2007 – $3,578,000) as non-specific allowances, as follows:

(in thousands of dollars)	2008 $	2007 $
Consumer		
Loans	283,189	257,437
Mortgages	1,376,805	1,156,488
Lines of credit	142,803	104,836
Commercial		
Loans	57,717	64,046
Mortgages	293,929	279,593
Lines of credit	32,953	39,370
Accrued interest	5,098	4,678
	2,192,494	1,906,448
Allowance for doubtful loans	(7,401)	(7,542)
	2,185,093	1,898,906

Notes to Consolidated Financial Statements

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5. LOANS TO MEMBERS (CONTINUED)

The following schedule provides the amount of non-performing and performing loans in each of the major loan categories together with the specific and non-specific loan allowances relating to these loans:

			2008	2007
(in thousands of dollars)	Gross loan balances $	Total specific and non-specifc allowance $	Net loan balances $	Net loan balances $
Non Performing				
Consumer				
Loans	2,991	2,095	896	1,669
Mortgages	7,831	13	7,818	6,317
Lines of credit	378	322	56	1,113
Commercial				
Loans	2,281	412	1,869	1,483
Mortgages	1,386	209	1,177	3,931
Lines of credit	220	218	2	3,571
Accrued interest	449	–	449	415
	15,536	3,269	12,267	18,499
Performing				
Consumer	1,791,597	3,412	1,788,185	1,504,383
Commercial	380,712	720	379,992	371,761
Accrued Interest	4,649	–	4,649	4,263
	2,192,494	7,401	2,185,093	1,898,906

The change in the allowance for doubtful loans is as follows:

			2008	2007
(in thousands of dollars)	Consumer $	Commercial $	Total $	Total $
Balance — Beginning of year	5,279	2,263	7,542	5,383
Acquisition of Buffalo	116	17	133	–
Loans written off in the year	(1,930)	(864)	(2,794)	(1,237)
Provisions made in the year	2,377	143	2,520	3,396
Balance — End of year	5,842	1,559	7,401	7,542

Loans past due but not impaired

A loan is considered past due when a counterparty has not made a payment by the contractual due date. The following table presents the carrying value of loans that are past due 31 days and greater but not classified as impaired because they are either fully secured or collection efforts are reasonably expected to result in repayment.

(in thousands of dollars)	31–60 days $	61–89 days $	90 days and greater $	Total $
Consumer	12,752	4,905	3,876	21,533
Commercial	841	252	125	1,218
	13,593	5,157	4,001	22,751

Notes to Consolidated Financial Statements

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5. LOANS TO MEMBERS (CONTINUED)

The principal collateral and other credit enhancements the Credit Union holds as security for loans include (i) insurance, mortgages over residential lots and properties, (ii) recourse to business assets such as real estate, equipment, inventory and accounts receivable, (iii) recourse to the commercial real estate properties being financed, and (iv) recourse to liquid assets, guarantees and securities. Valuations of collateral are updated periodically depending on the nature of the collateral. The Credit Union has policies in place to monitor the existence of undesirable concentration in the collateral supporting its credit exposure.

During the year ended December 31, 2008, the Credit Union did not acquire any assets in respect of delinquent loans.

6. PROPERTY AND EQUIPMENT

			2008	2007
(in thousands of dollars)	Cost $	Accumulated amortization $	Net $	Net $
Land	2,268	–	2,268	2,268
Buildings	7,042	2,175	4,867	2,814
Furniture and equipment	6,133	4,175	1,958	1,869
Data processing equipment and software	11,368	5,486	5,882	1,402
Signs	1,334	701	633	703
Parking lots	469	148	321	351
Leasehold improvements	5,811	3,693	2,118	2,599
	34,425	16,378	18,047	12,006

Amortization expense recorded during the year totalled $2,352,000 (2007 – $2,422,000).

7. OTHER ASSETS

(in thousands of dollars)	2008 $	2007 $
Accounts receivable	4,079	3,774
Prepaid expenses	956	2,806
Unamortized loan acquisition costs	6,734	6,793
Income taxes recoverable	551	–
Future income tax asset	597	1,134
	12,917	14,507

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8. LINE OF CREDIT

The Credit Union has in place a line of credit with Central in the amount up to 10% of member deposits. The line of credit is secured by an assignment, hypothecation, charge and pledge of its loans outstanding to Central and bears an annual interest rate based on the chartered banks overnight funds rate (3.05% at December 31, 2008), and is payable on demand. At year end, the balance was $79,523,000 (2007 – $19,208,000).

9. MEMBERS' DEPOSITS

	2008	2007
(in thousands of dollars)	$	$
Savings	483,217	464,841
Chequing	381,330	390,968
Term deposits	707,857	549,228
Registered deposits	588,262	521,361
Inactive accounts	203	201
Accrued interest payable	30,028	25,947
	2,190,897	1,952,546

10. CAPITAL MANAGEMENT

Capital is managed in accordance with policies established by the Board of Directors. Management regards a strong capital base as an integral part of the Credit Union's strategy. The Credit Union has a capital plan to provide a long-term forecast of capital requirements. Capital is defined as members' equity which includes members' shares, the provision for the issuance of preference shares and surplus shares, contributed surplus and retained surplus. All of the elements of capital are monitored throughout the year, and modifications of capital management strategies are made as appropriate. The Board of Directors determines annually the extent of any dividend payments on eligible member shares, within the context of its overall capital management plan.

The Credit Union operates pursuant to the Credit Unions and Caisses Populaires Act (Manitoba) (the "Act"). Regulations to the Act establish the following requirements with respect to capital and liquidity reserves:

Capital

The Regulations to the Act requires that the Credit Union establish and maintain a level of capital as follows:
a) members' equity not less than 5% of assets;
b) surplus not less than 3% of assets; and
c) capital as defined in the Regulations not less than 8% of the risk-weighted value of assets as defined in the Regulations.

The Credit Union has met these requirements as at December 31, 2008.

Liquidity reserve

The Credit Union shall maintain in cash on hand and deposits and investments offered by Central not less than 8% of its total member savings and deposits.

The Credit Union has met this requirement as at December 31, 2008.

Notes to Consolidated Financial Statements

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11. MEMBERS' SHARES

As a result of the amalgamation with Buffalo, each issued and outstanding common, surplus, Class Assiniboine preference and Class Astra preference share, as applicable, of the Credit Union and Buffalo were converted into an equivalent share in the amalgamated Credit Union.

Each member must purchase one common share. No member may hold more than 10% of the issued shares of any class. Each member of the Credit Union has one vote, regardless of the number of shares that a member holds.

Authorized shares

Common shares

Authorized common share capital consists of an unlimited number of common shares, issued and redeemable at $5 each. The total amount of common shares purchased or redeemed by the Credit Union in a fiscal year shall not exceed the total amount of common shares issued in that year if the Credit Union's equity is, or would by such purchase or redemption be, less than the level of capital as prescribed by the Act as defined in note 10.

Surplus shares

Authorized surplus share capital consists of an unlimited number of surplus shares, issued and redeemable at $1 each. Dividends are payable at the discretion of the Board of Directors. The total amount of surplus shares purchased or redeemed by the Credit Union in a fiscal year shall not exceed 5% of the amount of surplus shares outstanding at the last fiscal year end of the Credit Union if the Credit Union's equity is, or would by such purchase or redemption be, less than the level of capital as prescribed by the Act as defined in note 10.

Preference shares

Authorized Class Assiniboine preference share capital consists of 3,000,000 non-voting Class Assiniboine preference shares, having a cumulative dividend rate, when declared, of not less than the first year rate of the latest issue of Canada Savings Bonds, issued and redeemable at $10 each.

Authorized Class Astra preference share capital consists of 1,000,000 non-voting Class Astra preference shares, having a cumulative dividend rate, when declared, of not less than the annual dividend rate of a one-year guaranteed investment certificate as offered by the five largest Canadian banks, issued and redeemable at $5 each.

Dividends are payable at the discretion of the Board of Directors. The total amount of preference shares purchased or redeemed by the Credit Union in a fiscal year shall not exceed 20% of the amount of preference shares outstanding at the last fiscal year end of the Credit Union if the Credit Union's equity is, or by such purchase or redemption would be, less than the level of capital as prescribed by the Act as defined in note 10.

Issued shares

(in thousands of dollars)	Balance beginning of year $	Shares issued $	Shares redeemed $	Balance end of year $
Common shares	542	747	748	541
Surplus shares	12,773	1,080	535	13,318
Class Assiniboine preference shares	13,457	1,245	584	14,118
Class Astra preference shares	2,792	153	124	2,821
Total members' shares	29,564	3,225	1,991	30,798

12. DIVIDENDS ON PREFERENCE AND SURPLUS SHARES

The Board of Directors has declared, and the Credit Union has accrued, a 5.5% dividend totalling $943,000 (2007 – $893,000) on Class Assiniboine and Class Astra preference shares. The Board also declared, and the Credit Union has accrued a 3% dividend totalling $400,000 (2007 – $383,000) on surplus shares.

The total amount of dividends accrued on preference shares, net of the related tax savings of $123,000 (2007 – $144,000), has been reflected as a charge to retained surplus.

The total amount of dividends accrued on surplus shares, net of the related tax savings of $52,000 (2007 – $62,000), has been reflected as a charge to retained surplus.

13. 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 risks and adherence to limits by means of reliable and up-to-date information systems. The Credit Union follows an enterprise risk management framework with an overall objective of managing risk within acceptable thresholds. The Credit Union regularly reviews its risk management policies and systems to take account of changes in markets, products and emerging best practice.

Responsibility for monitoring the Credit Union's overall enterprise risk management framework is delegated by the Board of Directors to the Audit and Risk Committee. Oversight and monitoring of risk management is carried out by a number of delegated committees reporting to the Board of Directors. The Board of Directors provides written principles for risk tolerance and overall risk management, and management reports to the committees and Board of Directors on compliance with the risk management policies of the Credit Union. In addition, the Credit Union maintains an Internal Audit function which is responsible for independent review of risk management and the Credit Union's control environment.

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

Activity	Risks	Method in managing risks
Investments and cash on hand and on deposit	Sensitivity to changes in interest rates, foreign exchange rates, and credit risk	Asset-liability matching, monitoring of investment restrictions and monitoring of counterparty risk
Loans to members	Sensitivity to changes in interest rates, and credit risk	Asset-liability matching, periodic use of derivatives and monitoring of counterparty risk
Members' deposits	Sensitivity to changes in interest rates and foreign exchange rates	Asset-liability matching, periodic use of derivatives

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13. RISK MANAGEMENT (CONTINUED)

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 a financial instrument will fluctuate because of changes in prevailing market interest rates. Financial margin reported in the consolidated statement of operations 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 the Credit Union's management and reported to the Board of Directors on a monthly basis.

In managing interest rate risk, the Credit Union relies primarily upon the use of asset-liability matching and interest rate sensitivity models. Periodically, the Credit Union may enter into interest rate swaps to hedge exposure to interest rate risk. The Credit Union enters into interest rate swap agreements for the sole purpose of managing interest rate exposures in the balance sheet and not for speculative purposes. Interest rate swap contracts exchanging fixed rate interest for floating rate interest are designated and assessed as effective fair value hedges.

Sensitivity analysis is used to assess the change in value of the Credit Union's financial instruments against a range of incremental basis point changes in market interest rates over a twelve month period. Interest rate shock analysis is calculated in a similar manner to sensitivity analysis but involves a more significant change of 100 basis points or greater in market interest rates. Based on current differences between financial assets and financial liabilities as at December 31, 2008, the Credit Union estimates that an immediate and sustained 100 basis point increase in market interest rates would increase financial margin by $1,254,000 over the next 12 months while an immediate and sustained 100 basis points decrease in market interest rates would decrease financial margin by $1,324,000 over the next 12 months.

Other types of interest rate risk may involve basis risk, which is the risk of loss arising from changes in the relationship of interest rates which have similar but not identical characteristics (for example the difference between prime rates and the Canadian Deposit Offering Rate), and prepayment risk, which is the risk of loss of interest income arising from the early repayment of fixed rate mortgages and loans. These risks are also monitored on a regular basis by management.

The following schedule shows the Credit Union's sensitivity to interest rate changes as at December 31, 2008. Amounts with floating rates or due or payable on demand are classified as maturing within less than one year, regardless of maturity. Loans and deposits subject to fixed rates are based on contractual terms. Amounts that are not interest sensitive have been grouped together.

	Financial statement amounts		Interest rate swap agreements		
(in thousands of dollars)	Assets $	Liabilities and members' equity $	Assets $	Liabilities $	Net asset/ liability gap $
Expected repricing or maturing date					
Less than one year	866,109	1,024,012	18,251	–	(139,652)
1 to 2 years	346,212	262,186	–	–	84,026
2 to 3 years	323,449	210,181	–	–	113,268
3 to 4 years	370,458	186,980	–	–	183,478
4 to 5 years	418,176	182,418	–	–	235,758
Over 5 years	43,018	3,601	–	18,251	21,166
Not interest sensitive	46,384	544,428	–	–	(498,044)
	2,413,806	2,413,806	18,251	18,251	–

The average rate for interest bearing assets is 4.96% and for interest bearing liabilities is 3.02%.

13. RISK MANAGEMENT (CONTINUED)

Interest sensitive assets and liabilities cannot normally be perfectly matched by amount and term to maturity. One of the roles of a credit union is to intermediate between the expectations of borrowers and depositors.

Credit risk

Credit risk is the risk that a Credit Union member or counterparty will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the balance sheet date. Significant changes in the economy of Manitoba or deteriorations in lending sectors which represent a concentration within the Credit Union's loan portfolio may result in losses that are different from those provided for at the balance sheet 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 loans to members and investing activities that result in investments in cash resources. There is also credit risk in unfunded loan commitments. The overall management of credit risk is centralised in the Credit Risk Management department, with regular reports to the Audit and Risk Committee and the Board of Directors.

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

The Board of Directors establishes the Credit Union's tolerance for credit exposures and the principles the Credit Union follows in managing credit risk. 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 to establish that loans are within the member's ability to repay, rather than relying exclusively on collateral.

The classes of financial instrument to which the Credit Union is most exposed are loans to members, cash on hand and on deposit, and investments.

(in thousands of dollars)	Outstanding $	Undrawn commitments $	Total exposure $
Credit risk exposure			
Cash on hand and on deposit	12,727	–	12,727
Investments	185,022	–	185,022
Consumer loans	1,802,797	174,656	1,977,453
Commercial loans	384,599	103,449	488,048
Total exposure	2,385,145	278,105	2,663,250

Cash on hand and on deposit and investments

Credit risk arises from the investments in cash resources held by the Credit Union to meet regulatory and internal liquidity requirements. This aspect of credit risk is principally managed by management who reports to the Board of Directors. The managed assets consist of cash resources held with Central. All of the Credit Union's liquidity investments are held with Central. Central invests on behalf of the Credit Union as per the investment policies approved by the Investment Committee of the Board of Directors of Central. The investment policy requires that all investments are highly-rated and that all of the assets are readily convertible to cash.

13. RISK MANAGEMENT (CONTINUED)

Consumer loans

Consumer loans to members consist of $1,376,805,000 residential mortgages which are fully secured by residential property. Approximately 53% of these mortgages are insured by Canada Mortgage and Housing Corporation and other mortgage insurance providers. The Credit Union's credit policies allow for conventional, uninsured residential mortgages with a loan to value ratio of up to 80%. The balance of the consumer loan portfolio consists of loans and lines of credit which are either secured by residential mortgages or chattels, or are unsecured.

Commercial loans

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 Union's commercial lending diversification by industry type is as follows:

	2008 %
Real estate, rental and leasing	43
Accommodation and food services	13
Business services	10
Retail and wholesale trade	9
Manufacturing and construction	7
Arts, entertainment and recreation	6
Health care and social assistance	5
Transportation and warehousing	4
Other industries	3

The credit quality of the commercial loan portfolio for those loans which are neither past due or impaired can be assessed by reference to the Credit Union's internal rating system. The Credit Union assesses the probability of a default using internal rating tools as well as the experience and judgement of the Credit Risk Management department. Member loans are regularly reviewed and ratings are updated as appropriate.

The Credit Union has assessed 84% of the dollar value of commercial loans as having a satisfactory or higher rating. A further 15% of the commercial loans are assessed as having adequate security coverage, however, are being monitored more closely due to factors such as debt service coverage, working capital and debt to equity levels. The remaining 1% of the commercial loans are assessed as unsatisfactory.

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 10. The Credit Union's own risk management policies require it to maintain sufficient liquid resources to cover cash flow imbalances, to retain member confidence in the Credit Union and to enable the Credit Union to meet all financial obligations. This is achieved through maintaining a prudent level of liquid assets, through management control of the growth of the loan portfolio, securitizations and asset-liability maturity management techniques. Management monitors forecasts of the Credit Union's liquidity requirements on the basis of expected cash flows as part of its liquidity management. The Credit Union also maintains a borrowing facility with Central as an integral part of its liquidity management strategy as disclosed in note 8.

13. RISK MANAGEMENT (CONTINUED)

The remaining contractual maturity of recognized financial liabilities is as follows:

(in thousands of dollars)	Payable on demand $	Payable on a fixed date: Less than 1 year $	1 to 2 years $	2 to 5 years $	More than 5 years $	Total $
Line of credit	79,523					79,523
Members' deposits	932,036	416,218	262,186	579,579	878	2,190,897
Accounts payable and accrued liabilities	–	11,171	–	–	2,723	13,894
	1,011,559	427,389	262,186	579,579	3,601	2,284,314

Foreign exchange risk

Foreign exchange risk is the risk that arises when future commercial transactions or recognized assets or liabilities are denominated in a foreign currency. 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.

Price risk

Price risk arises from changes in market risks, other than interest rate, credit, liquidity or foreign exchange risk, such as changes in equity and commodity prices, where these changes cause fluctuations in the fair value or future cash flows of a financial instrument. The Credit Union is not exposed to significant price risk at this time.

14. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Differences between carrying value and fair value of investments, loans, deposits and other financial assets and liabilities are caused by differences between the interest rate obtained at the time of the original investment, loan or deposit and the current rate for the same product. Loans and deposits that are priced with variable rates have a fair value equal to carrying value, as they are priced at current interest rates.

While fair value amounts are designed to represent estimates of the amounts at which assets and liabilities could be exchanged in a current transaction between arm's length willing parties, the Credit Union normally holds all of its fixed term investments, loans and deposits to their maturity date. Consequently, the fair values presented are estimates derived by taking into account changes in the market interest rates and may not be indicative of the net realizable value. Furthermore, as many of the Credit Union's financial instruments lack an available trading market, the fair value of investments, loans and deposits with fixed rates are estimated using discounted cash flow models with discount rates based on current market interest rates for similar types of financial instruments. The inputs to the valuation model for fixed rate loans include scheduled loan amortization rates and estimated rates of repayment with the future cash flows discounted using current market rates for equivalent groups of mortgages or loans. The future cash flows on fixed rate deposits are discounted to their estimated present value using current market rates for equivalent groups of fixed rate deposits. Other inputs may include the addition of an interest rate spread to incorporate an appropriate risk premium. The significant assumptions included in the determination of fair value include estimates of credit losses, interest rates and discount rates.

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 $4,562,000 and the fair value of financial liabilities would decrease by $2,469,000. A corresponding decrease of 10 basis points in the forward yield curve would result in a $4,579,000 increase in the fair value of financial assets and a $2,477,000 increase in the fair value of financial liabilities.

The fair values disclosed exclude the value of assets and liabilities not considered financial instruments such as other assets and property and equipment.

Notes to Consolidated Financial Statements

14. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

Financial assets and liabilities are recognized on the consolidated balance sheet at fair value, cost or amortized cost according to the categories determined by the accounting framework for financial instruments. The carrying values and fair values for each category of financial instruments are presented in the table below:

As at December 31, 2008:

(in thousands of dollars)	Financial assets/ liabilities at fair value $	Financial assets/ liabilities at cost or amortized cost $	Estimated fair value $	Fair value greater (less) than carrying value $
Financial assets				
Cash on hand and on deposit	12,727	–	12,727	–
Investments	–	185,022	188,074	3,052
Loans to members	–	2,185,093	2,191,675	6,582
Accounts receivable	–	4,079	4,079	–
Total financial assets	12,727	2,374,194	2,396,555	9,634
Financial liabilities				
Line of credit	79,523	–	79,523	–
Members' deposits	–	2,190,897	2,208,873	17,976
Accounts payable and accrued liabilities	–	13,894	13,894	–
Total financial liabilities	79,523	2,204,791	2,302,290	17,976

As at December 31, 2007:

(in thousands of dollars)	Financial assets/ liabilities fair value $	Financial assets/ liabilities at cost or amortized cost $	Estimated fair value $	Fair value greater (less) than carrying value $
Financial assets				
Cash on hand and on deposit	17,142	–	17,142	–
Investments	–	150,660	150,223	(437)
Loans to members	–	1,898,906	1,884,640	(14,266)
Accounts receivable	–	3,774	3,774	–
Total financial assets	17,142	2,053,340	2,055,779	(14,703)
Financial liabilities				
Line of credit	19,208	–	19,208	–
Members' deposits	–	1,952,546	1,960,514	7,968
Accounts payable and accrued liabilities	–	10,022	10,022	–
Total financial liabilities	19,208	1,962,568	1,989,744	7,968

Notes to Consolidated Financial Statements

15. RELATED PARTY TRANSACTIONS

Credit Union Central of Manitoba (“Central”)

The Credit Union is a member of Central which acts as a depository for surplus funds from, and makes loans to, credit unions. Central also provides other services for a fee to the Credit Union and acts in an advisory capacity.

Celero Solutions

The Credit Union has entered into an agreement with Celero Solutions to provide information technology services including banking system services and network infrastructure. Celero Solutions is a company formed as a joint venture by the Credit Union Centrals of Alberta, Saskatchewan and Manitoba along with Concentra Financial Services Association and Credit Union Electronic Transaction Services.

Credit Union Deposit Guarantee Corporation

All credit unions in the Province of Manitoba are monitored by the Credit Union Deposit Guarantee Corporation (the “Corporation”) which was formed for the protection of individual members against financial loss on their deposits in credit unions. All credit unions pay annual assessments to support activities of the Corporation.

Everlink Payment Services Inc.

The Credit Union receives electronic transaction switching services from Everlink Payment Services Inc. (“Everlink”). In accordance with the Credit Union’s accounting policy for these services, the Credit Union records revenue or expense and a receivable from or a liability to Central representing the Credit Union’s proportionate share of Everlink’s operating income or loss for the year.

Directors

Transactions with directors are at terms and conditions as set out by the statutes, by-laws and policies of the Credit Union.

Remuneration of $196,000 (2007 – $225,000) was paid to directors during the year. Expenses paid by the Credit Union on behalf of the directors were $45,000 (2007 – $31,000).

Loans to directors at government prescribed rates of interest total $116,000 at December 31, 2008.

Loans to directors and staff

As at December 31, 2008, outstanding loans to directors, management and staff totalled 1.30% (2007 – 1.39%), in aggregate, of the assets of the Credit Union.

16. COMMITMENTS AND GUARANTEES

Director and officer indemnification

The Credit Union indemnifies its directors and officers against any and all claims or losses reasonably incurred in the performance of their service to the Credit Union to the extent permitted by law. The Credit Union has acquired and maintains liability insurance for its directors and officers.

Notes to Consolidated Financial Statements

16. COMMITMENTS AND GUARANTEES (CONTINUED)

Leases

Under the terms of various premise leases, the Credit Union is committed to future aggregate lease payments as follows:

(in thousands of dollars)

	$
2009	1,665
2010	1,273
2011	942
2012	808
2013	464
Thereafter	2,437

17. CONTINGENCIES

The Credit Union, in the course of its operations, is subject to lawsuits. As a policy, the Credit Union will accrue for losses in instances where it is probable that liabilities will be incurred and where such liabilities can be reasonably estimated. A significant claim has been made against the Credit Union, however, the Credit Union has no reason to believe that this claim will have a material impact on the Credit Union's financial position and accordingly, no provision has been recorded in these statements.

18. PENSION PLAN

The Credit Union has a defined contribution pension plan for qualifying employees. The contributions are held in trust by the Cooperative Superannuation Society Limited and are not recorded in these financial statements. The Credit Union matches employee contributions which range between 5% and 7% of the employee's salary. The expense and payments for the year ended December 31, 2008 were $1,237,000 (2007 – $1,055,000). As a defined contribution pension plan, the Credit Union has no further liability or obligation for future contributions to fund future benefits to plan members.

19. FUTURE IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In 2006, the AcSB published a new strategic plan that will significantly affect financial reporting requirements for Canadian entities. The AcSB strategic plan outlines the convergence of Canadian GAAP with International Financial Reporting Standards ("IFRS") over an expected five year transitional period. In February 2008, AcSB announced that IFRS will be used for financial statements relating to fiscal years beginning on or after January 1, 2011. The Credit Union's transition date of January 1, 2011 will require the restatement for comparative purposes of certain amounts reported in its financial statements for the year ending December 31, 2010. While the Credit Union has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

In January 2008, CICA Handbook Section 3064, *Goodwill and Intangible Assets*, was published. This new accounting standard reinforces the approach under which assets are recorded only if they meet the definition of an asset and the recognition criteria for an asset. It also clarifies the application of the concept of matching costs with revenues, so as to eliminate the current practice of recognizing as assets, items that do not meet the definition of an asset and the recognition criteria for an asset. On January 1, 2009, the Credit Union will apply this standard retrospectively with restatement of prior periods. The Credit Union is currently assessing the impact of the initial application of this standard on its consolidated financial statements.

20. COMPARATIVE FIGURES

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