

**Your Neighbourhood Credit  
Union Limited**

**Auditors' Report and  
Financial Statements**

**September 30, 2009**

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*Auditors' Report*

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**To the Members of  
Your Neighbourhood Credit Union Limited**

We have audited the balance sheet of **Your Neighbourhood Credit Union Limited** as at **September 30, 2009** and the statements of retained earnings, accumulated other comprehensive income, income and other comprehensive income and cash flows for the year then ended. These 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 financial statements present fairly, in all material respects, the financial position of the credit union as at **September 30, 2009** and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

***Collins Barrow - Region of Waterloo LLP***

Chartered Accountants  
Licensed Public Accountants

Cambridge, Ontario  
November 10, 2009

**Your Neighbourhood Credit Union Limited**  
**Balance Sheet**  
**September 30, 2009**

	2009	2008
<i>Assets</i>		
Cash and cash equivalents	\$ 11,950,199	\$ 6,925,643
Investments (note 5)	57,729,040	38,967,142
Income taxes receivable	30,000	40,513
Loans to members (notes 6 and 7)	426,019,387	405,037,047
Property and equipment (note 8)	7,150,094	5,511,944
Future income taxes	0	245,600
Other assets (note 9)	<u>3,998,239</u>	<u>3,899,203</u>
	<u>\$ 506,876,959</u>	<u>\$ 460,627,092</u>
<i>Liabilities</i>		
Demand loans (note 10)	\$ 20,000,000	\$ 10,000,000
Accounts payable and accrued charges (note 11)	17,240,698	16,235,391
Members' accounts (note 12)	439,787,430	405,408,253
Share capital (note 14)	<u>4,609,842</u>	<u>4,707,759</u>
	481,637,970	436,351,403
Future income taxes (note 15)	<u>17,000</u>	<u>0</u>
	481,654,970	436,351,403
<i>Members' Equity</i>		
Retained earnings	<u>25,221,989</u>	<u>24,275,689</u>
	<u>\$ 506,876,959</u>	<u>\$ 460,627,092</u>

*On behalf of the board*

  
 \_\_\_\_\_  
 Director

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 Director

**Your Neighbourhood Credit Union Limited**  
**Statement of Retained Earnings**  
**Year Ended September 30, 2009**

	2009	2008
Retained earnings, beginning	\$ 24,275,689	\$ 22,752,866
Net income	<u>946,300</u>	<u>1,522,823</u>
Retained earnings, ending	<u>\$ 25,221,989</u>	<u>\$ 24,275,689</u>

**Your Neighbourhood Credit Union Limited**  
**Accumulated Other Comprehensive Income**  
**Year Ended September 30, 2009**

	2009	2008
Balance, beginning	\$ 0	\$ (113,456)
<b>Other comprehensive income, net of tax</b>		
Increase in unrealized loss on interest rate SWAP agreements, net of taxes of \$0 (2008 - \$35, 828)	<u>0</u>	<u>113,456</u>
Balance, ending (note 4)	<u>\$ 0</u>	<u>\$ 0</u>

**Your Neighbourhood Credit Union Limited**  
**Statement of Income and Other Comprehensive Income**  
**Year Ended September 30, 2009**

	2009	2008
<b>Revenue</b>		
Interest on commercial and agricultural loans and mortgages	\$ 3,309,938	\$ 3,670,323
Interest on residential mortgages	16,594,359	16,046,725
Interest on personal loans	1,864,857	2,644,147
Interest on investments	2,430,315	2,013,314
Other income	<u>2,733,969</u>	<u>2,628,496</u>
	<u>26,933,438</u>	<u>27,003,005</u>
<b>Financial expenses</b>		
Distributions to members - interest on deposits (note 13)	12,393,540	12,857,855
Class B Investment Shares dividend	135,199	223,967
Other interest - net	<u>387,165</u>	<u>450,885</u>
	<u>12,915,904</u>	<u>13,532,707</u>
<b>Financial margin</b>	<u>14,017,534</u>	<u>13,470,298</u>
<b>Expenses</b>		
Administration	1,694,376	2,030,291
Advertising and promotion	370,557	425,850
Board and committee (note 22)	108,405	108,320
Data processing	472,594	543,028
Depreciation and amortization	858,370	873,330
Insurance premium - Deposit Insurance Corporation of Ontario	367,851	302,952
Occupancy cost	1,090,820	1,060,761
Provision for impaired loans (note 7)	941,566	449,118
Salaries and benefits	<u>6,466,259</u>	<u>5,990,132</u>
	<u>12,370,798</u>	<u>11,783,782</u>
<b>Operating income</b>	1,646,736	1,686,516
<b>Fair market value and other adjustments (note 24)</b>	<u>(135,336)</u>	<u>116,366</u>
<b>Income before income taxes and Membership Patronage Dividend</b>	1,511,400	1,802,882
<b>Membership Patronage Dividend</b>	<u>180,000</u>	<u>245,500</u>
<b>Income before income taxes</b>	<u>1,331,400</u>	<u>1,557,382</u>
<b>Provision for (recovery of) income taxes</b>		
Current (note 26)	122,500	225,000
Future (draw down)	<u>262,600</u>	<u>(190,441)</u>
	<u>385,100</u>	<u>34,559</u>
<b>Net income and other comprehensive income</b>	<u>\$ 946,300</u>	<u>\$ 1,522,823</u>

**Your Neighbourhood Credit Union Limited**  
**Statement of Cash Flows**  
**Year Ended September 30, 2009**

	2009	2008
<b>Cash provided by (used for):</b>		
<b>Operating activities:</b>		
Net income	\$ 946,300	\$ 1,522,823
<b>Items not affecting cash:</b>		
Future income taxes	262,600	(154,613)
Amortization	858,370	873,330
Provision for impaired loans	941,566	449,118
Adjustments relating to adoption of CICA 3855	0	113,456
<b>Change in non-cash operating working capital:</b>		
Accounts receivable and prepaid expenses	(468,200)	98,205
Accounts payable and accrued charges	1,085,825	(449,856)
Net change in accrued interest receivable and payable	288,646	1,216,474
Income taxes receivable	<u>10,513</u>	<u>(50,180)</u>
<b>Cash provided by operating activities</b>	<u><b>3,925,620</b></u>	<u><b>3,618,757</b></u>
<b>Financing activities</b>		
Members' accounts	34,379,177	35,801,783
Demand loans	10,000,000	(4,000,000)
Class B Investment shares	(94,636)	(205,675)
Membership shares	(3,281)	(325,797)
Mortgage securitizations (note 25)	<u>33,562,876</u>	<u>0</u>
<b>Cash provided by financing activities</b>	<u><b>77,844,136</b></u>	<u><b>31,270,311</b></u>
<b>Investing activities</b>		
Loans to members	(55,486,782)	(52,037,151)
Purchase of property and equipment	(2,496,520)	(875,521)
Investment in marketable securities (net)	(16,899,983)	20,994,030
Investment in ABCP 2008 Limited Partnership (net)	1,257,484	(2,988,444)
Central liquidity reserve deposit	(3,370,420)	(3,954,080)
Increase in Central shares	(2,781,145)	(1,325,655)
Decrease in CUCO shares	<u>3,032,166</u>	<u>0</u>
<b>Cash used for investing activities</b>	<u><b>(76,745,200)</b></u>	<u><b>(40,186,821)</b></u>
<b>Net increase (decrease) in cash position</b>	<b>5,024,556</b>	<b>(5,297,753)</b>
<b>Cash and cash equivalents, beginning</b>	<u><b>6,925,643</b></u>	<u><b>12,223,396</b></u>
<b>Cash and cash equivalents, ending</b>	<u><u><b>\$ 11,950,199</b></u></u>	<u><u><b>\$ 6,925,643</b></u></u>
<hr/>		
Interest and membership patronage dividends paid	<u><u><b>\$ 12,654,058</b></u></u>	<u><u><b>\$ 11,690,262</b></u></u>
Income taxes paid	<u><u><b>\$ 133,013</b></u></u>	<u><u><b>\$ 174,820</b></u></u>

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

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*1. Status and nature of activities*

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**Nature of business**

Your Neighbourhood Credit Union Limited (the "credit union") is a financial institution incorporated under the Business Corporation Act of Ontario and operates in accordance with the Credit Unions and Caisses Populaires Act, 1994. The credit union is a member of the Deposit Insurance Corporation of Ontario ("DICO") and is affiliated with Central 1 Credit Union ("Central"). The credit union provides financial products and services to members throughout Southwestern Ontario.

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*2. Significant accounting policies*

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**Basis of presentation**

The financial statements of the credit union have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and legislation for Ontario's Credit Unions and Caisses Populaires. The significant accounting policies used in the preparation of these financial statements conform to Canadian GAAP.

**Effective Interest Method**

Interest income and expense are recognized in the Statement of Income using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability to its fair value at inception. The effective interest rate is established on initial recognition of the financial asset or liability and is not revised subsequently.

The calculation of the effective interest rate includes transaction costs and discounts or premiums that are an integral part of the effective interest rate.

**Fees**

Unless included in the effective interest calculation, fees are recognized on an accrual basis as the service is provided and reported on the Statement of Income.

**The Credit Unions and Caisses Populaires Act, 1994 (the "Act")**

Regulations to the Act specify that certain items are required to be disclosed in the financial statements which are presented at annual meetings of members. This information has been integrated into the basic financial statements and notes and it is management's opinion that the disclosures in these financial statements and notes comply, in all material respects, with the requirements of the legislation. Where necessary, reasonable estimates and interpretations have been made in presenting this information.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

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**2. Significant accounting policies (continued)**

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**Financial instruments**

The credit union recognizes and measures financial assets and financial liabilities on the balance sheet when they become a party to contractual provisions of financial instruments. All financial instruments are measured at fair value on initial recognition. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, loans and receivables, or other financial liabilities. Transaction costs are expensed as incurred for financial instruments classified or designated as available-for-sale. For assets classified as loans and receivables, transaction cost are capitalized on initial recognition.

**Held for trading**

Financial instruments included in this category are cash and short term deposits and government securities. These instruments are recognized initially at fair value. They are subsequently measured at fair value and gains and losses arising from changes in fair value of these instruments are recorded in the statement of income.

**Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable repayment dates, usually with interest, that are not debt securities or instruments are classified as held for trading on initial recognition.

Certain deposits at Central 1 Credit Union ("Central") and members loans have been classified as loans and receivables. These instruments are initially recognized at fair value. They are subsequently valued at amortized cost using the effective interest method less any provision for impairment.

**Available-for-sale financial assets**

Available for sale assets are non-derivative financial assets that are designated as available for sale or are not categorized into any of the other categories. Certain investments in equity instruments have been classified as available for sale. They are initially recognized at fair value. Investments in equity instruments classify as available-for-sale that do not have a quoted market price in an active market are measured at cost less any provision for impairment.

**Other financial liabilities**

Other financial liabilities are non-derivative financial liabilities and include members deposits, membership shares and accounts payable and accrued charges. These instruments are initially recognized at fair value. They are subsequently measured at amortized cost using the effective interest method.

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values are determined by reference to quoted bid or asking prices as appropriate, in the most advantageous active market for the instrument to which the credit union has immediate access.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

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**2. Significant accounting policies (continued)**

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Fair value determined using valuation models require the use of assumptions concerning the amount and timing of estimate future cash flows and discounted rates. In determining those assumptions, the credit union looks primarily to external readily observable market inputs including interest rate yield curves, currency rates and price and rate volatilities, as applicable.

**Member shares**

The credit union has adopted the recommendations of the Canadian Institute of Chartered Accountants relating to the financial statement presentation of Class B Investment Shares Series - 1 and 2, and Membership Shares and the related dividends paid on such financial instruments. In accordance with these recommendations, the credit union's Class B Investments Shares - Series 1 and 2, and Membership Shares are presented in the balance sheet as financial liabilities. These liabilities qualify as capital for regulatory purposes, notwithstanding their financial statement classification. Dividends on all classes of shares are classified as financial expenses in the statement of income.

**Cash and cash equivalents**

The term cash and cash equivalents as used in these financial statements consists of cash on hand.

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

**Property and Equipment**

Property and equipment are stated at cost less accumulated amortization. Amortization is provided on a declining-balance basis for the buildings, computer equipment, office equipment and on the straight-line basis for leasehold improvements. The amortization rates used are as follows:

Buildings	5%
Computer equipment	30%
Office equipment	20%
Leasehold improvements	15 years

**Impairment of long-lived assets**

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value.

**Mortgage securitizations**

The credit union periodically sells mortgage loans to an independent special purpose trust, which in turn issues securities to investors. This program is coordinated through Central 1 Credit Union. These transactions are accounted for as sales and the related loans are removed from the balance sheet when control over the loans has been surrendered and consideration other than beneficial interests in the transferred loans has been received in exchange.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

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**2. Significant accounting policies (continued)**

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The fair value of loans sold and the resulting retained interests are determined using pricing models based on key assumptions such as expected losses, prepayments and discount rates commensurate with the risks involved. The carrying value of retained interests are reviewed annually for impairment and adjusted as required.

Gains or losses on these transactions are reported as non-interest income on the Statement of Income and Other Comprehensive Income.

The amount of these gains or losses are based on the present value of expected future cash flows using management's best estimates of key assumptions such as prepayment rates, excess spread, credit losses and discount rates.

The credit union typically retains interests in the transferred loans, such as excess interest spread, servicing rights and cash reserve accounts. Revenue from servicing the loans is recorded as the services are provided.

**Loans to members**

Loans to members are stated at amortized cost, which includes amounts advanced and applicable charges, less repayments. Interest is recorded using the effective interest rate method over the terms of the loans.

A loan is classified as impaired when a specific provision has been established or a write-off taken or when, in the opinion of management, there is a reasonable doubt as to the ultimate collectability of principal or interest. A loan is also classified as impaired when interest or principal is contractually 90 days past due, unless the loan is fully secured and in the process of collection. Fully secured loans are classified as impaired after a delinquency period of 180 days. Once a loan is classified as impaired, all previously accrued interest in excess of 90 days is reversed and charged against current income.

Loans are generally returned to accrual status when all delinquent principal and interest payments are brought current and the timely collection of both principal and interest is reasonably assured.

The business of the credit union necessitates the management of credit risk. Credit risk is the potential for loss due to the failure of a borrower to meet its financial obligations. The board of directors of the credit union oversees the risk management process. Senior management coordinates policy setting on risk management issues, assesses the risk exposure of the credit union and reviews the effectiveness of internal control processes.

**Allowance for impaired loans**

The allowance for impaired loans is maintained in an amount considered adequate to absorb estimated credit-related losses in the loan portfolio. The allowance for impaired loans reflects management's best estimate of the losses existing in the loan portfolio and their judgments about economic conditions. If the circumstances under which these estimates and judgments were made change, there could be a significant change to the allowance for impaired loans currently recognized. The allowance for impaired loans consists of specific provisions and a general provision, each of which is reviewed on a regular basis. The allowance is increased by provisions for impaired loans which are charged to earnings and reduced by write-offs net of recoveries.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

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**2. Significant accounting policies (continued)**

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Specific provisions are determined on an item-by-item basis and reflect the associated estimated credit loss. The specific provision is the amount that is required to reduce the carrying value of an impaired loan to its estimated realizable amount, which is generally the fair value of any security underlying the loan, net of expected costs of realization.

The non-specific provision is established to absorb any potential credit losses and is determined through analysis of economic developments and current portfolio trends for credit losses and cannot be determined on a loan by loan basis. When losses can be attributed to individual loan facilities, specific provisions are recorded.

Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and there is no realistic prospect of recovery.

**Mortgage broker fees and cashbacks**

Mortgage broker fees and cashbacks are included in prepaid expenses and are amortized over the term of the related mortgage.

**Derivative instruments**

From time to time, the credit union enters into interest rate swaps and equity-linked purchase options to manage exposure to interest rate and other market risks. The credit union does not enter into derivative financial instruments for trading or speculative purposes.

When derivatives are used to manage exposure, the credit union determines for each derivative whether hedge accounting can be applied. Where hedge accounting can be applied, a hedge relationship is designated as a fair value hedge or a cash flow hedge of a specifically identified group of assets or liabilities. The credit union also formally assesses and documents, both at the inception and over the term of the hedge, whether these derivatives are highly effective in offsetting changes in fair values or cash flows of hedged assets or liabilities.

Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge or is terminated. The fair value of the derivative is recognized in assets or liabilities at that time and the gain or loss is deferred and recognized in net interest income in the periods that the hedge items affect net earnings. Hedge accounting is also discontinued on the sale or termination of the hedged item. The fair value of the derivative is recognized in assets or liabilities at that time and the gain or loss is deferred and recognized in net interest income.

Derivatives that no longer qualify for hedge accounting are carried at fair value on a gross basis in assets and liabilities with changes in fair value recorded in other income.

The credit union enters into interest rate swap agreements to manage the exposure to changes in interest rates. The swap agreements are carried at fair value and are reported as assets where they have a positive fair value and as liabilities where they have a negative fair value. Any gains and losses are included in income. Revenues or expenses resulting from these transactions are recognized over the life of the agreements in the year in which they are earned or incurred.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

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**2. Significant accounting policies (continued)**

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Equity-linked purchase options are used to reduce the exposure to stock market fluctuations in the return associated with Equity-Linked Deposit products issued to members. The premiums paid for these options are deferred in other assets and amortized to interest expense on members' deposits over the life of the options.

**Income taxes**

The liability method of income tax allocation is used in accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities, and measured using substantively enacted tax rates and laws that will be in effect when the differences are expected to be reversed. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income in the year that the change occurs.

**Use of estimates**

The preparation of the credit union's financial statements in accordance 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 balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from such estimates. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the year in which they become known.

**Translation of foreign currencies**

The monetary assets and liabilities of the credit union denominated in foreign currencies are translated at the rates of exchange at the balance sheet date. Revenues and expenses are translated at the average exchange rate prevailing during the year. Exchange gains and losses are included in operations.

**Members' deposits**

The members' deposits are recorded at amortized cost. Interest expenses is recorded using the effective interest rate method over the terms of the deposits.

**Future Accounting Changes**

**International Financial Reporting Standards ("IFRS")**

In February 2008, the Canadian Accounting Standards Board announced that GAAP for publicly accountable enterprises will be replaced by IFRS for fiscal years beginning on or after January 1, 2011. Credit unions are specifically scoped into the definition of a publicly accountable enterprise. As such, the credit union will be required to prepare the September 30, 2012 financial statements including comparative information in compliance with IFRS.

IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures. The credit union is currently in the process of assessing the differences between current accounting policies and those provided by IFRS, as well as the alternatives available on adoption. The assessment will include the potential impact of the conversion on accounting policies, information technology and data systems, internal controls over financial reporting, disclosure controls and procedures, financial reporting, and business activities.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

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**3. Change in accounting policies**

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**Current year changes**

Effective October 1, 2008, the credit union adopted the following new accounting pronouncements issued by the Canadian Institute of Chartered Accountants (“CICA”):

- (a) CICA Handbook Sections 3862 and 3863, “Financial Instruments – Disclosures” and “Financial Instruments – Presentation” replace Section 3861, “Financial Instruments – Disclosure and Presentation”, and place an increased emphasis on disclosures regarding the nature and management of risks associated with both recognized and unrecognized financial instruments. Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives and provides guidance on the classification of financial instruments, from the perspective of the issuer, between liabilities and equity. See Note 18 – Financial Risk Management.
- (b) CICA Handbook Section 1535, “Capital Disclosures”, establishes guidelines for the disclosure of information regarding an entity’s capital and how it is managed. Enhanced disclosure with respect to the objectives, policies and processes for managing capital and quantitative disclosures about what an entity regards as capital are required. See Note 16 – Capital Management.
- (c) Emerging Issues Committee 173 “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities” considers whether an entity’s own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and liabilities, including derivative instruments, for presentation and disclosure purposes. The credit union’s adoption of this abstract did not have a material impact on the financial statements.
- (d) Amendments to Section 1400, “General Standards on Financial Statement Presentation” requires the credit union to assess its ability to continue as a going concern and disclose its ability to continue as a going concern. The credit union’s adoption of this amendment did not have a material impact on the financial statements.
- (e) Amendments to Section 3855, “Financial Instruments – Recognition and Measurement” permit certain financial assets classified as Held for Trading to be reclassified to Available-for-sale in rare circumstances. The credit union did not reclassify any financial assets in the current fiscal year as a result of the unprecedented extent of the deterioration in global financial market conditions.

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**4. Comprehensive Income**

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On October 1, 2006, the credit union adopted the new financial instruments section of the CICA Handbook. There were no transition adjustments attributable to the remeasurement of financial assets and financial liabilities at fair value which would have been recognized in opening retained earnings or opening accumulated other comprehensive income as at October 1, 2006 as the adjustments were not considered significant to these financial statements.

Management has reviewed the financial instruments sections and determined there is no significant impact on the current year's results of operations.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

<i>5. Investments</i>	2009	2008
<b>Investments in marketable securities</b>		
(Market value \$18,047,818; 2008 - \$1,110,013)	\$ 18,005,499	\$ 1,105,516
<b>Central 1 Credit Union</b>		
Liquidity reserve deposits	34,532,248	31,161,828
Shares	2,781,145	0
CUCO shares	679,188	3,711,354
<b>Investment in ABCP 2008 Limited Partnership</b>	<u>1,730,960</u>	<u>2,988,444</u>
	<u>\$ 57,729,040</u>	<u>\$ 38,967,142</u>

A Liquidity Reserve Deposit equal to 7% of the credit union's total assets at each calendar quarter end is a condition of membership in Central 1 Credit Union. These Liquidity Reserve Deposits consist of seven (2008 - seven) fixed rate investments due within one to two years, bearing interest at an average rate of 0.67% (2008 - 3.28%). At maturity, these deposits are reinvested at market rates for various terms. The carrying value of the liquidity reserve at Central approximates market value.

At a special general meeting held on May 31, 2008, members of Credit Union Central of Ontario (CUCO) approved a resolution to facilitate a sale of CUCO to Credit Union Central of British Columbia (CUCBC) to form a new national financial services entity named Central 1 Credit Union ("Central"). Prior to the sale, members of Credit Union Central of Ontario were required to hold an investment equal to 0.80% of a credit union's total assets in CUCO shares to remain a member in good standing. Subject to closing adjustments, these shares were converted into new Class A and Class E shares with Central on December 31, 2008. Also, during the current fiscal year, the credit union had a write-down of the Investment in ABCP 2008 Limited Partnership in the amount of \$697,679.

**Asset-Backed Commercial Paper Limited Partnership and Central 1 Credit Union Merger**

At a special general meeting held May 31, 2008, members of Credit Union Central of Ontario Limited (CUCO) approved a resolution to facilitate the merger of CUCO and Credit Union Central of British Columbia (CUCBC) to form a new national financial services entity named Central 1 Credit Union (Central).

As a pre-condition of this merger, CUCO was required to divest itself of investments in certain third-party asset-backed commercial paper (ABCP). The resolution approved the creation of a limited partnership (ABCP LP) to acquire these investments funded by member credit unions in proportion to their share investment in CUCO. As a result, on July 1, 2008, immediately prior to the merger of CUCO and CUCBC, the excluded ABCP with a total par value of \$186,916,000 was acquired by the ABCP LP at its estimated fair value of \$133,564,000 including accrued interest, net of expenses, and other assets. As there is still no liquid market in these ABCP investments, the fair values used to determine the acquisition price were provided by Edenbrook Hill Capital Ltd., a firm engaged by CUCO to provide an independent valuation of the assets underlying the ABCP investments.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
**September 30, 2009**

**5. Investments (continued)**

**Investments in marketable securities**

Included in investments in marketable securities are investments held in Central, in provincial bonds and in instruments of Canadian chartered banks. The carrying amounts of the investments approximate their respective market values. The investments are summarized as follows:

	<b>2009</b>	<b>2008</b>
Total principal amount	\$18,005,499	\$1,105,516
Range of individual principal amounts	\$1,000,000 to \$5,000,000	\$500,000 to \$600,000
Range of maturity dates	October 28, 2009 to August 12, 2010	October 6, 2008 to October 14, 2008
Range of interest rates	0.40% to 1.40%	2.21% to 2.48%

**Liquidity reserve deposit**

As a condition of maintaining membership in Central in good standing, the credit union is required to maintain on deposit in Central an amount equal to 7% (2008 - 7%) of the aggregate of its own share capital and deposits as of the preceding calendar year end, updated in February of each year.

The liquidity reserve deposits are investments in Central Liquidity Deposits. The terms are summarized as follows:

	<b>2009</b>	<b>2008</b>
Total principal amount	\$34,532,248	\$31,161,828
Range of individual principal amounts	\$999,902 to \$8,434,063	\$1,206,638 to \$6,604,031
Range of maturity dates	October 22, 2009 to February 22, 2011	October 27, 2008 to June 24, 2009
Range of interest rates	0.31% to 1.41%	3.08% to 4.07%

**Central 1 Credit Union – shares**

As a condition of maintaining membership in Central, the credit union is required to keep an investment in shares of Central equal to 0.60% of the total assets of the credit union as at the preceding calendar year end, updated in December of each year.

No market exists for shares of Central except that they may be surrendered on withdrawal from membership for proceeds equal to the paid-in value, to be redeemed in accordance with a Central by-law providing for the redemption of its share capital.

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<i>6. Loans to members</i>	2009	2008
Residential mortgages	\$ 326,078,751	\$ 317,451,107
Personal loans	29,071,056	31,725,085
Commercial and agricultural loans and mortgages	<u>71,781,242</u>	<u>56,789,051</u>
	426,931,049	405,965,243
<b>Allowance from impaired loans:</b>		
Residential mortgages (note 7)	(9,086)	(920)
Personal loans (note 7)	(679,692)	(536,554)
Commercial and agricultural loans and mortgages (note 7)	<u>(222,884)</u>	<u>(390,722)</u>
	<u>\$ 426,019,387</u>	<u>\$ 405,037,047</u>

Personal loans bear interest at fixed and variable annual rates and are repayable in monthly blended principal and interest instalments over a maximum period of five years. Residential and commercial mortgage loans bear interest at fixed and variable annual rates and are repayable in monthly blended principal and interest instalments over a maximum period of ten years based on a maximum amortization period of thirty-five years. Line of credit loans bear interest at variable rates and are repayable in minimum interest only, not in advance, subject to annual review.

Commercial, agricultural and personal loans, including line of credit loans, are repayable to the credit union in monthly blended principal and interest instalments over a maximum term of seven years, except for line of credit loans which are repayable on revolving credit basis and required minimum monthly payments.

All loans are open and, at the option of the borrower, may be repaid at any time without notice or penalty, with the exception of commercial and residential mortgage loans with a term exceeding one year which are closed.

At September 30, 2009, the aggregate amount of commercial and residential mortgage loan commitments was \$11,515,596 (2008 - \$19,440,573). The approved unused lines of credit amounted to \$49,268,026 (2008 - \$49,348,577).

<i>7. Allowance for impaired loans</i>	2009	2008
<b>Residential mortgages</b>		
Balance, beginning of year	\$ 920	\$ 17,924
Loans written-off as uncollectible (net of recoveries)	<u>(244)</u>	<u>(17,004)</u>
	676	920
Provision for impaired loans	<u>8,410</u>	<u>0</u>
Balance, end of year	<u>9,086</u>	<u>920</u>

**Your Neighbourhood Credit Union Limited**  
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<i>7. Allowance for impaired loans (continued)</i>	2009	2008
<b>Personal loans</b>		
Balance, beginning of year	536,554	640,995
Loans written-off as uncollectible (net of recoveries)	<u>(401,632)</u>	<u>(312,422)</u>
	134,922	328,573
Provision for impaired loans	<u>544,770</u>	<u>207,981</u>
Balance, end of year	<u>679,692</u>	<u>536,554</u>
<b>Commercial and agricultural loans and mortgages</b>		
Balance, beginning of year and end of year	390,722	158,978
Loans written-off as uncollectible (net of recoveries)	<u>(556,224)</u>	<u>(9,393)</u>
	(165,502)	149,585
Provision for impaired loans	<u>388,386</u>	<u>241,137</u>
Balance, end of year	<u>222,884</u>	<u>390,722</u>
	<u>\$ 911,662</u>	<u>\$ 928,196</u>
The gross impaired loans break down is as follows:		
Residential mortgages	\$ 10,810,501	\$ 3,840,680
Personal loans	948,575	682,303
Commercial and agricultural loans and mortgages	<u>1,204,204</u>	<u>1,325,781</u>
	<u>\$ 12,963,280</u>	<u>\$ 5,848,764</u>

Included in other income are recoveries on loans previously written off for the year ended September 30, 2009 amount to \$44,565 (2008 - \$40,798).

The allowance for impaired loans provided in the accounts of the credit union is, in all material respects, in accordance with the relevant by-law of the Deposit Insurance Corporation of Ontario.

**Your Neighbourhood Credit Union Limited**  
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<i>8. Property and equipment</i>		2009	2008	
	Cost	Accumulated Amortization	Net	Net
Land	\$ 1,084,152	\$ 0	\$ 1,084,152	\$ 1,084,152
Buildings	4,221,960	1,469,073	2,752,887	487,849
Computer equipment	3,661,450	2,719,381	942,069	1,239,818
Office equipment	2,420,929	1,816,574	604,355	679,917
Leasehold improvements	<u>3,427,989</u>	<u>1,661,358</u>	<u>1,766,631</u>	<u>2,020,208</u>
	<u>\$ 14,816,480</u>	<u>\$ 7,666,386</u>	<u>\$ 7,150,094</u>	<u>\$ 5,511,944</u>

Included in property and equipment in Fiscal 2009 is \$2,401,738 work in progress, representing capital improvements made to property and equipment. Amortization of this amount will commence upon completion of the projects in Fiscal 2010.

<i>9. Other assets</i>		2009	2008
Accounts receivable		\$ 303,273	\$ 173,198
Accrued interest receivable		1,045,259	1,414,423
Prepaid expenses		<u>2,649,707</u>	<u>2,311,582</u>
		<u>\$ 3,998,239</u>	<u>\$ 3,899,203</u>

<i>10. Demand loans</i>		2009	2008
Central 1 Credit Union			
• Interest and principal due on maturity, rate at 0.75%, due May 5, 2010		\$ 10,000,000	\$ 0
• Interest and principal due on maturity, rate at 0.80%, due June 30, 2010		10,000,000	0
• Interest and principal due on maturity		<u>0</u>	<u>10,000,000</u>
		<u>\$ 20,000,000</u>	<u>\$ 10,000,000</u>

The credit union has established a borrowing capacity for \$36,590,000 (2008 - \$26,510,000) (Canadian) and \$300,000 (2008 - \$350,000) (US). This borrowing capacity is secured by a general security agreement. At the year end, the amount of borrowing capacity utilized was \$20,000,000 (2008 - \$10,000,000).

**Your Neighbourhood Credit Union Limited**  
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<i>11. Accounts payable and accrued charges</i>	2009	2008
Accrued interest on members' accounts	\$ 14,414,098	\$ 14,494,616
Other (including certified cheques)	<u>2,826,600</u>	<u>1,740,775</u>
	<u>\$ 17,240,698</u>	<u>\$ 16,235,391</u>

<i>12. Members' accounts</i>	2009	2008
Chequing accounts	\$ 70,034,246	\$ 56,544,703
Deposits		
Savings	58,190,861	66,370,315
Fixed rate, fixed term	211,057,711	188,225,650
Registered saving plans	80,104,141	75,540,933
Registered retirement income funds	20,024,322	18,324,101
Life insured deposits	<u>376,149</u>	<u>402,551</u>
	<u>\$ 439,787,430</u>	<u>\$ 405,408,253</u>

**Term deposits**

Outstanding term deposits for periods of one to five years generally may not be withdrawn, prior to maturity, without penalty.

Withdrawal privileges on all deposit accounts are subject to the overriding right of the Board of Directors to impose a waiting period.

<i>13. Interest on deposits</i>	2009	2008
Chequing accounts	\$ 209,874	\$ 529,287
Deposits		
Savings	503,191	769,781
Fixed Rate, fixed term	7,773,611	7,879,489
Registered saving plans	3,022,660	2,890,953
Registered retirement income funds	883,430	786,877
Life insured deposits	<u>774</u>	<u>1,468</u>
	<u>\$ 12,393,540</u>	<u>\$ 12,857,855</u>

**Your Neighbourhood Credit Union Limited**  
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<i>14. Share capital</i>	2009	2008
Membership Shares	\$ 287,019	\$ 290,300
Class B Investment Shares - Series 1 and 2	<u>4,322,823</u>	<u>4,417,459</u>
	<u>\$ 4,609,842</u>	<u>\$ 4,707,759</u>

The authorized share capital consists of an unlimited number of membership shares and an unlimited number of patronage shares.

Membership shares have an issue price of \$5.00. Members are required to have two shares. Membership shares may be redeemed subject to the credit union being in compliance with the capital adequacy requirements (note 16). As at September 30, 2009, there were 28,770 (2008 - 29,329) members.

Pursuant to an Offering Statement dated August 29, 2007, the credit union issued 1,500,000 Series 1 Class B Investment Shares. Series 1 Class B Investment Shares are non-cumulative, non-voting, non-participating special shares, which bear dividends at a rate established by the Board of Directors each year. The shares are redeemable at the option of the holder, subject to a maximum of 10% of the previous September 30 balance being redeemed during the year and subject to approval by the Board of Directors.

Pursuant to an Offering Statement dated September 28, 2001, the credit union issued 1,799,924 Series 2 Class B Investment Shares. Series 2 Class B Investment Shares are non-cumulative, non-voting, non-participating special shares, which bear dividends at a rate established by the Board of Directors each year. The shares are redeemable at the option of the holder, subject to a maximum of 10% of the previous September 30 balance being redeemed during the year and subject to approval by the Board of Directors.

Pursuant to an Offering Statement dated March 19, 1998, the credit union issued 1,493,500 Class B Investment Shares. Class B Investment Shares are non-cumulative, non-voting, non-participating special shares, which bear dividends at a rate established by the Board of Directors each year. The shares are redeemable at the option of the holder, subject to a maximum of 10% of the previous September 30 balance being redeemed during the year and subject to approval by the Board of Directors.

The Board of Directors declared a 3.08% (2008 - 4.20%) dividend to the holders of Class B Investment Shares - Series 1 and 2.

Shares may be withdrawn on demand on withdrawal from membership, subject to the credit union meeting capital adequacy requirements and the discretion of the directors who may require notice.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
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**15. Future income taxes** **2009** **2008**

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The credit union's basic income tax rate is approximately 23% (2008 - 24%). Future income taxes relate primarily to capital cost allowance claimed for income tax purposes in excess of amortization on capital assets for financial reporting purposes, a portion of the allowance for impaired loans being non-deductible for income tax purposes, and differences between investment reporting for accounting and income tax purposes.

The components of future income taxes at September 30, 2009 and 2008 are as follows:

Property and equipment	\$ 4,300	\$ 45,400
Benefit of loss carried forward	0	223,000
Allowance for impaired loans	<u>(21,300)</u>	<u>(22,800)</u>
	<u>\$ (17,000)</u>	<u>\$ 245,600</u>

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**16. Capital management**

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The credit union maintains policies and procedures relative to capital management so as to ensure that capital levels are sufficient to cover risks inherent in the business. The credit union's objectives when managing capital are:

- (i) To ensure that the quantity, quality and composition of capital required reflects the inherent risks of the credit union and to support the current and planned operations and portfolio growth.
- (ii) To provide a basis for confidence among Members, depositors, creditors and regulatory agencies.
- (iii) To ensure that the credit union maintains a level of capital that sufficiently protects against unanticipated losses and to comply with the minimum regulatory capital requirements set out in the Act.

Regulatory capital is calculated as a percentage of total assets and of risk-weighted assets. Risk-weighted assets are calculated by applying risk weight percentages, as prescribed by the Act, to various asset categories, operational and interest rate risk criteria. The prescribed risk weights are dependent upon the degree of risk associated with the asset.

As at September 30, 2009, the credit union had regulatory capital of \$30,257,662 (2008 - \$28,862,212). In accordance with the requirements of the Act and accompanying Regulations, credit unions are required to maintain sufficient capital to meet two tests:

**1. Leverage test**

Regulatory capital, comprising membership shares, any other class of qualifying share capital that may be issued and retained earnings, must amount to at least 4.00% of total assets as at September 30, 2009. The leverage tests result at September 30, 2009 was 5.92% (2008 - 6.29%)

**Your Neighbourhood Credit Union Limited**  
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**16. Capital management (continued)**

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**2. Risk-weighted assets test**

Regulatory capital, comprising membership shares, any other class of qualifying share capital that may be issued and retained earnings, must amount to at least 8.00% of risk-weighted assets as at September 30, 2009. The risk weighting of assets is specified in Section 15 of the Regulations to the Act. The risk-weighted asset test result at September 30, 2009 was 16.61% (2008 - 18.58%).

At September 30, 2009, the credit union exceeded the minimum requirements of the Act and its Regulations with respect to the leverage and risk weighted-assets test.

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**17. Commitments**

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**Leases**

The credit union has entered into lease agreements related to various branch locations. Under the terms of the leases, the minimum lease payments for the next five years and subsequent are as follows:

2010	\$ 389,990
2011	424,229
2012	367,164
2013	368,835
2014	307,540
Thereafter	<u>1,858,915</u>
	<u>\$ 3,716,673</u>

The credit union entered into agreements for the purchase of capital expenditures totaling approximately \$1,051,000.

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**18. Financial risk management**

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The Board of Directors (the "Board") has overall responsibility for the establishment and oversight of the credit union's risk management framework. The Board has delegated to the Audit Committee the responsibility for the development and monitoring of risk management policies. The Audit Committee reports regularly to the Board on its activities.

All risk management policies and established limits ensure that the credit union is in full adherence to the regulatory requirements prescribed in the Act as well as DICO's standards of Sound Business and Financial Practices. The Board receives reports from management on the credit union's exposure to credit, interest rate, liquidity, foreign currency and other price risk regularly in order to monitor financial risks.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
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**18. Financial risk management (continued)**

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**Credit Risk**

Credit risk is the potential for financial loss to the credit union if a borrower or guarantor fails to meet payment obligations in accordance with agreed terms. The credit union's financial assets that are affected by credit risk include loans receivable from Members, investments, and derivative financial instruments. Credit risk is one of the most significant financial risks to the credit union.

The credit union's primary objective when managing credit risk is to ensure a portfolio of high quality financial assets properly diversified so as to balance the risk associated with the portfolio and return on assets.

Credit risk is managed in accordance with the Retail Credit Risk Management Policy and Commercial Credit Risk Management Policy for loans receivable from Members and the Market Risk Management Policy for investments and derivatives financial instruments.

For loans receivable from Members, credit risk is managed through an infrastructure based upon:

- (i) Approval by the Board of all credit risk management policies;
- (ii) Approval by the Chief Executive Officer of the discretionary limits of lending officers throughout the credit union;
- (iii) Credit adjudication subject to compliance with established policies, exposure guidelines and discretionary limits, as well as adherence to established standards of credit assessment. Credit approvals are escalated to the Management Credit Committee and ultimately to the Board dependent upon credit exposure level and restricted party transactions;
- (iv) Credit division is charged with oversight of the following:
  - a. The establishment of guidelines to monitor and limit concentrations in the portfolios in accordance with Board approved policies governing regulatory requirements, industry risk and group exposures;
  - b. The development and implementation of credit risk models and policies for establishing borrower risk ratings to quantify and monitor the level of risk and facilitate management of retail and commercial credit;
  - c. Implementation of an ongoing monitoring process of the key risk factors used in the credit union credit risk models.

Management has designed and implemented an effective system to measure, monitor and report credit risk exposure. Management reports credit risk exposure to the Board regularly. The credit union has operated within compliance with its credit risk management policies throughout the year.

In conducting lending activities, the credit union diversifies its portfolio of loans receivable from Members in order to reduce overall credit risk. Residential mortgage and personal loans are diversified between authorized loan types, forms of security and certain sectoral groupings.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
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**18. Financial risk management (continued)**

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Commercial loans are diversified through the establishment of credit exposure limits for specific industry sectors and groups of related borrowers.

Credit exposure is assessed through the following:

- (i) Probability of default, which is an estimate of probability that an obligor with a certain borrower risk rating will default within a one year time horizon.
- (ii) Loss given default, which represents the unsecured portion expected to be lost when a borrower defaults.

Credit risk rating systems are designed to assess and quantify the risk inherent in credit activities in an accurate and consistent manner as follows:

- (i) Commercial loans are principally assessed based on the Member's ability to service debt (debt service coverage ratio) and the secured amount (loan to value ratio). Management regularly reviews the commercial loan portfolio and assesses the credit risk associated with each loan.
- (ii) Matrix credit scoring systems are used in assessing credit risk associated with residential mortgage and personal loans. These loans are managed as pools of homogeneous risk exposures using internal benchmarks based upon Equifax Beacon Score's. These global standard credit scores track each individual's past credit history and, using a mathematical model, predicts how likely a person is to repay a loan.

For investments and derivative financial instruments, risk is measured by reviewing exposure to individual counterparties to ensure the assets are within the policy limit by issuer weightings and by dollar amount. The quality of the counterparties is assessed through published credit rating agencies.

Except as noted, the carrying amount of financial assets recorded in the financial statements represents the credit union's maximum exposure to credit risk without taking into account the value of any collateral obtained. The risk of losses from loans undertaken is reduced by the nature and quality of collateral obtained.

**Interest rate risk**

Interest rate risk refers to the potential impact of changes in interest rates on the credit union's earnings when maturities of its financial liabilities are not matched with the maturities of its financial assets. It is the policy of the credit union to keep exposure to interest rate fluctuations within limits set by the Board of Directors and by the Act.

The credit union's exposure to interest rate risk depends on the size and direction of interest rate changes, and on the size and maturity of mismatched positions. An interest-sensitive asset or liability is repriced when market interest rates change, when there is cash flow from final maturity, normal amortization, or when Members exercise prepayment, conversion or redemption options are offered for the specific product.

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**18. Financial risk management (continued)**

Interest rate risk is managed in accordance with the Structural Risk Management Policy. The Board delegates the responsibility to manage interest rate risk on a day-to-day basis to management.

The credit union's Structural Risk Management Policy includes:

- (i) Guidelines and limits on the structuring of the maturities, price and mix of deposits, loans, mortgages and investments and the management of cash flows derived from financial assets in relation to liabilities.
- (ii) Guidelines and limits on the use of derivative products to hedge against changes in cash flows as a result of changes in interest rates.

The table below summarizes amounts by maturity dates and effective rates of return for the following on-balance sheet financial instruments.

September 30, 2009	Variable Rate	Less Than One Year	One to 7 Years	Non-rate Sensitive	Total	Effective Rate
<b>Contractual rates of return</b>						
Cash resources	\$ 0	\$ 0	\$ 0	11,950,199	\$ 11,950,199	0.00 %
Loans to members	132,114,360	46,874,673	247,030,354	0	426,019,387	5.38 %
Investments	5,498	38,336,688	15,926,500	3,460,354	57,729,040	0.63 %
Members' deposits	133,981,857	124,507,595	181,297,978	0	439,787,430	3.14 %
<b>Discretionary dividend rates (note 14)</b>						
Class B Bonus Shares	0	0	4,322,823	0	4,322,823	3.08 %
Membership shares	0	0	0	287,019	287,019	0.00 %
September 30, 2008	Variable Rate	Less Than One Year	One to 7 Years	Non-rate Sensitive	Total	Effective Rate
<b>Contractual rates of return</b>						
Cash resources	\$ 0	\$ 0	\$ 0	6,925,643	\$ 6,925,643	0.00 %
Loans to members	124,065,297	25,940,980	255,030,770	0	405,037,047	5.90 %
Investments	5,498	32,261,828	0	6,699,816	38,967,142	2.79 %
Members' deposits	131,122,708	148,848,493	125,437,052	0	405,408,253	3.14 %
<b>Discretionary dividend rates (note 14)</b>						
Class B Bonus Shares	0	0	4,417,459	0	4,417,459	4.20 %
Membership shares	0	0	0	290,300	290,300	0.00 %

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
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**18. Financial risk management (continued)**

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**Liquidity Risk**

Liquidity risk is the risk that the credit union will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or other financial assets.

The credit union engages in proper liquidity risk management practices to comply with regulatory requirements and to guarantee the funding of Member needs and obligations. The credit union's overall objective when managing liquidity is to ensure limited exposure to material liquidity risk.

Liquidity risk is managed in accordance with the Liquidity Risk Management Policy. Key elements of this policy include limits on the sources, quality and amount of liquid assets to meet operational requirements, regulatory requirements and contingency funding. Liquidity is monitored by management on a regular basis.

**Foreign currency exchange risk**

Foreign currency exchange risk refers to the potential impact of changes in foreign exchange rates on the credit union's earnings when balances of its foreign currency liabilities are not matched with the balances of its foreign currency assets. It is the policy of the credit union to mitigate exposure to foreign exchange rate fluctuations by matching its foreign currency liabilities to its foreign currency assets. At September 30, 2009, the credit union had U.S. dollar denominated liabilities of \$1,634,379 (2008 - \$1,930,376) and U.S. dollar denominated assets of \$2,132,616 (2008 - \$1,387,528).

**Other Price Risk**

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices other than those arising from interest rate risk or currency risk. The credit union is primarily exposed to other price risk through investments. However, these investments are limited to ensure diversification and quality of financial assets.

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**19. Fair Values of Financial Instruments**

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**Fair Value**

The amounts set out below represent the fair values of the credit union's financial instruments using the valuation methods and assumptions described below. The fair values disclosed do not reflect the value of assets that are not considered financial instruments, such as capital assets, prepaid expenses and future income taxes.

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

**Your Neighbourhood Credit Union Limited**  
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**19. Fair Values of Financial Instruments (continued)**

September 30, 2009	Fair Value	Book Value	Fair Value Over (Under) Book Value
<b>Assets</b>			
Cash resources	\$ 11,950,199	\$ 11,950,199	\$ 0
Loans to members	502,464,427	426,019,387	76,445,040
Investments	58,169,199	57,729,040	440,159
Other assets	1,348,532	1,348,532	0
<b>Liabilities</b>			
Members' deposits	430,643,430	439,787,430	(9,144,000)
Other liabilities	17,240,698	17,240,698	0
<b>Liabilities qualifying as regulatory capital</b>	<b>4,609,842</b>	<b>4,609,842</b>	<b>0</b>
September 30, 2008	Fair Value	Book Value	Fair Value Over (Under) Book Value
<b>Assets</b>			
Cash resources	\$ 6,925,643	\$ 6,925,643	\$ 0
Loans to members	406,673,212	405,037,047	1,636,165
Investments	39,561,243	38,967,142	594,101
Other assets	1,587,621	1,587,621	0
<b>Liabilities</b>			
Members' deposits	407,658,208	405,408,253	2,249,955
Other liabilities	16,235,391	16,235,391	0
<b>Liabilities qualifying as regulatory capital</b>	<b>4,707,759</b>	<b>4,707,759</b>	<b>0</b>

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

- (i) The fair values of cash resources, certain other assets and other liabilities are assumed to approximate their carrying values, due to their short-term nature;
- (ii) The fair value of investments is assumed to be equal to the estimated market value of investments provided in note 5;
- (iii) The estimated fair values of floating rate loans and floating rate deposits are assumed to be equal to the respective book values as the interest rates on these loans and deposits reprise to market on a periodic basis; and
- (iv) The estimated fair values of fixed rate loans and fixed rate deposits are determined by discounting the expected future cash flows of these loans and deposits at current market rates for products with similar terms and credit risks.

**Your Neighbourhood Credit Union Limited**  
**Notes to the Financial Statements**  
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**20. Derivative instruments**

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**Equity-linked deposits**

The credit union has \$1,573,137 (2008 - \$1,269,267) of Index-Linked Term Deposit products outstanding to its members. These term deposits have maturities of three and five years and pay interest to the depositors, at the end of the term, based on the performance of various market indices. The credit union has entered into agreements with Credit Union Central of Ontario to offset the exposure to the indices associated with these products. The credit union pays a fixed amount on the face value of these term deposit products. At the end of the term, the credit union receives from the counterpart payments equal to the amount that will be paid to the depositors based on the performance of the respective indices.

The purpose of these agreements is to provide a hedge against market fluctuations. These agreements have fair values that vary based on the particular contract and changes in interest rates. The current replacement cost of these contracts amount to \$181,303 (2008 - \$204,637) at year end. At year end, these agreements did not qualify as effective hedge transactions.

At September 30, 2009, the credit union has unmerited premiums of \$132,511 (2008- \$63,283) relating to payments made under its agreements. These amounts are being amortized on a straight-line basis over the term of the contracts to which they relate, which are from three to five years.

**Interest Rate SWAP Agreements**

The credit union has entered into interest rate swap agreements in order to manage exposure to fluctuating interest rates. The notional amounts of the swaps do not represent amounts exchanged between parties and are not a measure of the credit union's exposure resulting from the use of swaps. The amounts exchanged are based on interest rates applied to the notional amounts. The notional value of the interest rate swap agreements as at September 30, 2009 was \$31,944,190 (2008 - \$26,000,000) in favour of an unrelated creditworthy third party, taking into account interest rates at that time. The credit union has recognized fair value adjustment in the amount of \$23,715 (2008 - \$116,366) in income for the year ended September 30, 2009.

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**21. Director and officer loans**

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As at September 30, 2009, the aggregate value of interest-bearing personal and mortgage loans outstanding to directors and officers totaled \$1,181,124 (2008 - \$1,107,554). These loans were granted under the same underwriting terms and conditions as loans to other members, and are included in loans to members on the balance sheet. There was no allowance for impaired loans required in respect of these loans.

The regulations require the financial statements to disclose a general description of the nature, number and aggregate value of Restricted Party transactions, as defined, and the allowance for loan losses related to such transactions. Restricted Party has been defined to include a person, and the person's relative, spouse, or relative of the spouse, who has been a director, officer or committee member in the preceding twelve months, and corporations in which the person owns more than 10% of the voting shares.

**Your Neighbourhood Credit Union Limited**  
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**22. Board and committee remuneration**

The Board Chair is remunerated at the rate of \$300 (2008 - \$300) per meeting, Committee Chairs receive \$270 (2008 - \$270) per meeting and Board and Committee members and Recording Secretary are paid \$240 (2008 - \$240) per meeting.

**23. Pension plan**

The credit union has a defined contribution pension plan covering all employees. The plan is a contributory plan with funding of benefits based on the related employee's earnings. Contributions vest after two years of service with the credit union. Once the contributions vest, employees may receive benefits upon retirement or termination of their employment. The credit union recognized an expense during the year relating to its portion of the contribution totaling \$242,089 (2008 - \$190,446).

**24. Fair market value and other adjustments**

	2009	2008
The fair market value and other adjustments are as follows:		
Write-down of investment in ABCP 2008 Limited Partnership (note 5)	\$ (697,679)	\$ 0
Interest rate SWAP (note 20)	23,715	116,366
Mortgage securitizations (note 25)	<u>538,628</u>	<u>0</u>
	<u>\$ (135,336)</u>	<u>\$ 116,366</u>

**25. Mortgage Securitizations**

As part of its program of liquidity, capital and interest rate risk management, the credit union enters into an arrangement to fund loan growth by selling residential mortgages to an unrelated third party.

The credit union securitizes mortgages through the transfer of mortgage loans to a special purpose entity.

As of September 30, 2009, the aggregate value of securitized loans outstanding amounted to \$38,673,016 (2008 - \$10,603,557). The net gain on the sale of mortgages resulting from these securitizations is immediately recognized in the Statement of Income and Other Comprehensive Income as "Other income". None of the mortgage loans were delinquent at September 30, 2009. In addition, there were no credit losses incurred on the mortgages transferred in 2009.

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**25. Mortgage Securitizations (continued)** **2009** **2008**

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As part of this mortgage receivable transfer, the credit union retains mortgage servicing responsibilities but does not receive an explicit servicing fee for its servicing responsibilities. The credit union's retained interest in the mortgages sold consists of two elements. The first is the credit union's right to future cash flows arising from any excess of the mortgage cash flows over and above the contractual return due to the mortgage pool investors. The second component of the retained interest is the credit enhancement provided to the third party in the form of cash collateral accounts. The credit union's retained interests are subject to credit, prepayment and interest rate risks on the securitized mortgages.

The third party, as holder of the securitized mortgages, has recourse only to a cash collateral account and cash flow from the securitized mortgages. The investors and the third party have no recourse to the credit union's other assets.

The retained interests related to mortgage pools sold in the current year were measured using the key assumptions outlined in the table below. These assumptions are set as at the date of the securitization.

	<b>2009</b>	<b>2008</b>
Weighted average life (in months)	<b>55.56</b>	43.00
Prepayment rate assumption ( %)	<b>18.00</b>	9.60
Expected credit losses (% of portfolio)	<b>0.00</b>	1.00
Excess spread (%)	<b>2.25</b>	1.13
Residual cash flows discounted at (%)	<b>3.00</b>	5.00

The following table summarizes the credit union's securitization activity for the year ended September 30, 2009:

Principal value of mortgages sold	\$ <b>33,562,876</b>	\$ 0
Net cash proceeds received	<b>33,779,239</b>	0
Retained rights to future excess spread	<b>538,628</b>	0
Pre-tax gain on sale	<b>290,783</b>	0

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**26. Income taxes** **2009** **2008**

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The company's provision for income taxes is comprised of the following:

Federal and provincial income taxes at a combined tax rate of 23.00% (2008 - 24.00%)	\$ 306,222	\$ 373,772
Difference in income taxes resulting from:		
Items not deductible for income taxes purposes	2,633	11,285
Amortization expense in excess of capital cost allowance	38,265	14,481
Difference in allowance for doubtful accounts for accounting and income tax purposes	(380)	(90,068)
Utilization of loss carry forwards from prior years	(209,095)	0
Other	<u>(15,145)</u>	<u>(84,470)</u>
	<u>\$ 122,500</u>	<u>\$ 225,000</u>

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**27. Comparative figures**

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The presentation of certain accounts of the previous year has been changed to conform with the presentation adopted for the current year.

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**28. Subsequent event**

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Subsequent to the year end, the credit union entered into an agreement to purchase certain net assets of Standard Tube Employees' (Woodstock) Credit Union Limited.