2018 ANNUAL REPORT

MORELL CREDIT UNION

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2018 HIGHLIGHTS

$36.8M
ASSETS

$29.3M
DEPOSITS

1,888
MEMBERS

$22.9M
LOANS

$21.9K
PAID TO MEMBERS

1.0%
GROWTH IN MEMBER SAVINGS

OUR MISSION

The mission of Morell Credit Union is to provide competitive financial services tailored to meet the needs of our owners and their communities.

We pride ourselves in directing the organization we control and in the equality of services provided.

Morell Credit Union is a community-minded Co-operative that helps build through its involvement, its leadership, and the retention of financial resources in the community.

HONEST

INCLUSIVE

PASSIONATE

HOLISTIC

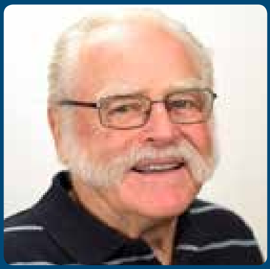
SPIRITUAL

SIMPLISTIC

EVOLUTIONARY

OUR VALUES

BOARD OF DIRECTORS



DENNIS CLOUGH
President

JOHN SUTHERLAND
Vice-President

SHERYLL O'HANLEY
Secretary

RANDY BYRNE

ALLAN COFFIN

SARAH DYMENT

KEILA HEBERT

LISA MACINTYRE

SYDNEY FREIMAN

STAFF

SHERRI CLARK
General Manager

CHARMAINE MURPHY
Manager of Operations

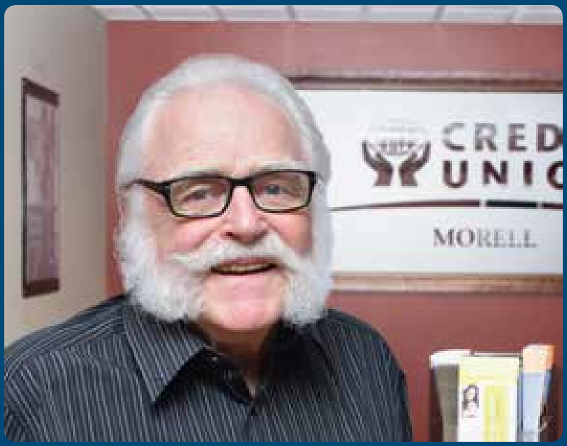
ROSIE QUINN
Financial Services Officer

HEATHER SAMPSON
Investment Officer

FRANCES GALLANT
Member Service

DEBBY MACKINNON
Member Service

PRESIDENT'S REPORT



This could be one of the shortest President's Report on record. Morell Credit Union has been in a favourable financial position for quite a few years. The membership numbers continue to be solid and they continue to use the Credit Union Products and Services that are provided, therefore, helping produce a positive bottom line on the financial statements.

Management has been successful steering the business in the right financial and social direction. This is done in addition to spending numerous hours on provincial, regional and national initiatives. It makes it easier when you know you have a knowledgeable and competent support staff to meet and aid members everyday with a smile. At this time, I would like to congratulate Sherri and her staff on recently winning the Service Excellence Award at the 12th Annual Business and Community Excellence Awards sponsored by the Eastern PEI Chamber of Commerce. We always knew that service levels at our Credit Union are second to none. Winning this award is confirmation of that.

And not to be forgotten are the volunteer Board members who have accumulated much knowledge and experience when dealing with other business and community endeavours. This knowledge and experience, they use to help Morell Credit Union remain an important part of Morell and area (Morell, St. Peter's, Mount Stewart) day to day situations.

I therefore thank these groups for our success.

Respectfully submitted,

G. DENNIS CLOUGH
President

MANAGER'S REPORT

Our Credit union was formed on January 27, 1938 with $2,076 in assets and 185 members. Eighty years in business is quite a milestone to reach and does not come without challenges and some success. It is a testament to you, the membership, that our Credit Union remains an important part of our community.

The financial results for the year ending December 31, 2018 are again positive. Total Assets at year end amounted to $36,876,288, representing an increase of 1.92%. Our loan portfolio grew by 2.6% and our Member Deposits also grew by 1%. Our retained earnings are just over $3.5 million while our equity position remains strong at 9.52%. Well in excess of the 5% requirement.

Over the past year our Credit Union, along with the Board of Directors have been working on developing Strategic Plans, provincially and at the local level. These plans will assist in shaping our Credit Union as we continue to seek active membership growth while delivering a strong member service experience. Working collaboratively with other PEI Credit Unions and Credit Union support organizations will only strengthen an already thriving Credit Union system in PEI.

In 2018, one of our Credit Union Members, Holy Cow, was featured in a national credit union publication, Enterprise Magazine. Quentin and Tanya highlight their Credit Union experience and how working together with Morell Credit Union helped them realize their dreams of moving from a food truck to a successful year-round business. Holy Cow is a great example of how supporting local can build your business.

In January, your Credit Union was nominated for the Service Excellence Award at the 12th Annual Business and Community Excellence Awards, sponsored by the Eastern PEI Chamber of Commerce. We are delighted that Morell Credit Union was the winner of the award. We are very proud of this accomplishment as it is representative of every staff member in the office and how we do business everyday.

Following are some of the comments we received after winning the award:

80 YEARS HELPING MEMBERS DO MORE WITH THEIR MONEY

Way to go, very much deserved!

Keep up the great work, we are blessed to have you in our community are. Be proud of your work, we are!

Always a pleasure to do business with this awesome team! Congratulations!

They are the best, and I hope it never changes. It means a lot to people when you can call a business and a real person answers, so glad to be part of this community and a long-time member of the Morell Credit Union. Great job and congratulations!

I can always count on these great ladies to answer and resolve any questions or concerns I have. Wonderful Service! Congratulations.

Sherri and her staff do an excellent job of promoting the credit union values that distance themselves from the service provided by the big banks!

In closing, I wish to thank our staff for their dedication to our Credit Union's success. Also, I wish to thank the Board of Directors. They give freely of their time to ensure the well being of our Credit Union. At this time, I wish to thank Dennis Clough for his contribution to our Credit Union. Dennis retires from our Board this evening after serving for 18 years.

I look forward to the opportunities that 2019 will offer our Credit Union, and in turn you the membership. With your support, we have prospered for the last 80 years and we look forward to moving our credit union into the future.

Respectfully submitted,

SHERRI CLARK
General Manager

IN OUR COMMUNITY

THIS YEAR, WE SPENT OVER

$32,400

TO MAKE OUR COMMUNITY EVEN BETTER.

THIS CONTRIBUTED TO THE

$600,000

TOTAL THAT CREDIT UNIONS IN PEI SPEND EACH YEAR.

CREDIT UNION PLACE

350K
VISITORS

150K
TICKETS SOLD

$75K
MEMBERS SAVED IN FEES

15
FREE EVENTS

A STRONG PART OF OUR ISLAND COMMUNITY

In 2018, Credit Union Place in Summerside continued to be a strong partnership for the credit union system on PEI. Working on enhancing our presence within the building, 2018 marked the announcement that a new branch concept would be opening in Credit Union Place giving our members a new and convenient location to bank at.

A new credit union ding-free ATM will be incorporated into the new branch as well as a contemporary meeting space and re-vamped seating area, complete with electronic charging stations. We are excited to expand into this premiere venue as Credit Union Place continues to be one of the top entertainment destinations in the Maritimes.

In 2019 not only will our members experience a more convenient location to visit with us at Credit Union Place but they will also continue to enjoy the many discounts offered to them through our partnership. To date we have seen a yearly savings of $75,000 for our members through discounts on gym memberships, pool use, bowling and other services offered at the multipurpose facility. We look forward to serving you in a more convenient location in 2019!

GET ACTIVE

2018 marked the second year of our social cause across Island credit unions – where we are committed to more physically active communities on PEI. This initiative was conceptualized around the 2016 Public Health Officer's Report which reported that over half of Islanders consider themselves physically inactive. Physical inactivity leads to a staggering decrease in overall health resulting in a higher risk factor for the development of health conditions including stroke, heart disease, obesity and type 2 diabetes. This decrease in health can negatively impacts a household's finances, especially in the retirement stages where income is fixed.

1.4K

ISLAND STORM

A returning sponsorship for the credit union system in 2018 was our continued involvement with the Island Storm – our local professional NBL team. Through the Storm we have been able to give added value to our local communities through the offering of free events such as the popular Under 25 Free games, where anyone aged twenty-five or younger could see the game for free. Over 1,400 free tickets were used last year.

Also in partnership with the Storm we were able to bring you the Cancer Awareness game with proceeds going to the Canadian Cancer Society PEI Division. This game was unique as we were able to auction off custom purple jerseys worn by the players during the game, resulting in over $3,000 raised for CCS. We continue to enjoy our partnership with the Storm and the added value it brings to our communities!

$6K

GYM REBATE PROGRAM

The Get Active Gym Program offered $50 cash back to any of our members who paid some sort of gym membership fees in 2018 returned for its second year. This resulted in close to $6,250 being rebated to our members across PEI. We're so proud to be able to assist these members and in turn, encouraging more Islanders to get physically active.

$6K

SCHOLARSHIPS

We are pleased to announce 3 Morell Credit Union Scholarship Recipients for 2018. Each scholarship recipient received $2,000 towards furthering their education. In total, Morell Credit Union distributed $6,000.

We wish all students the best in their studies and future endeavors.

KEEGHAN GILLIS

LILY MACKINNON

SIERRAH LAYBOLT

3.6K

JUNIOR ACHIEVEMENT

Since 2016, credit unions on the Island have built a valuable partnership with JA PEI.

Working off JA's already well-received programming, we teamed up to enhance their Economics for Success program with the additional knowledge of a financial expert. Economics for Success focuses on the importance of financial literacy and teaches students budgeting skills which they'll need for the future.

Through the growing popularity of the program we have currently been able to instruct over 3,600 students at 14 different Island high-schools.

50/50 PROGRAM

In January of 2018 Morell Credit Union began a 50/50 program as another way to give back to our communities. Approximately 125 members play our lottery weekly. The program raised over $6,000 last year with $3,000 being paid out weekly to the winners.

The Board of Directors are pleased to present the remaining $3,000, $1,000 each to Morell Consolidated School, Mount Stewart Consolidated School and Morell Regional High School for their breakfast programs.

FILL THE YUMOB

In December our sixth Annual #FilltheYuMob took place outside of Toys'R'Us.

As a direct result of the general public's generosity, we filled our new, much larger YuMob to the top in under 4 hours. The generosity was so great that we had to use an additional pick-up truck to transport all the toys.

A huge thank you to the Pownal Peewee AA team 2 who volunteered to be our elves and help us out this year, as well as Santa and Geoffrey the Giraffe who both made an appearance.

Of course, this wouldn't have been possible without the support from the Toys'R'Us Charlottetown store and staff, thank you for being amazing every year.

All the toys were delivered to Santa's Angels, a volunteer group that delivers the toys on Christmas Day to over 300 local families in need. Thank you to everyone who participated in this incredible cause.

RONALD MCDONALD HOUSE CHARITIES ATLANTIC

13
FAMILIES

246
NIGHTS

FAMILY COMES FIRST

We are proud of our ongoing partnership with Ronald McDonald House Charities Atlantic in many different capacities for 2018. With our Members Stay Free program, credit union members are able to stay at the Ronald McDonald House in Halifax for free while their child is being treated at the IWK. During 2018, this program was able to help 13 families on PEI totaling 246 nights spent at the Ronald McDonald House.

Alongside our member program, 2018 marked the first year we were involved with the annual PJ Walk – a major fundraiser for the RMHC Atlantic held in three cities across the Maritimes. The PJ Walk raised $230,000 in total, with the event on PEI raising more than $63,000 of that amount.

We look forward to continuing our support for our members who have to visit Halifax for their child's treatment into 2019. We're proud to help ease a small portion of the inevitable stress.

SMALL BUSINESS WEEK

OUR STAFF OUT AND ABOUT IN THE COMMUNITY PERFORMING RANDOM ACTS OF KINDNESS

FOR THE LOVE OF BURGERS

With the backing of Morell Credit Union, Quentin Gillis and Tanya O'Brien have become Prince Edward Island's most acclaimed purveyors of burger and fries.

Published July 18, 2018 in Enterprise Magazine
By Alexandra Gill

Prince Edward Islanders might be partial to potatoes but they are even bigger fans of burgers. So much so, the province is home to a wildly popular, month-long festival called PEI Burger Love.

"I don't think anyone counts calories on PEI in April," says Quentin Gillis, the co-owner of Holy Cow Burgers & Wings and a member of Morell Credit Union (1,900 members, $36 million in assets).

This year, 85 restaurants participated in Burger Love. Holy Cow's Mr. Irresisti-Bull — a juicy eight-ounce PEI beef patty stacked between a hand-rolled potato-onion bun spread with three house-made sauces and oozing local Gouda cheese — was one of the bestsellers. Between Holy Cow's 100-seat restaurant and its roaming Wicked Fries food truck, Gillis and his 35 employees sold a whopping 9,338 burgers that month, or more than 300 a day.

And to think that just four years ago, Gillis and his wife Tanya O'Brien were ready to give up on their struggling food truck—until the support of a small community and its credit union turned their business around. "We nearly lost our minds," says Gillis, recalling that first brutally slow summer in Charlottetown. He and O'Brien, on maternity leave from her full-time job with the provincial government, had plenty of experience, both having worked in the food-and-beverage service industry since high school. And their hand-cut fries were pedigreed (their potatoes come from the same farm that supplies the Five Guys franchisees in the Maritimes and Montreal). But their food truck was stationed in a downtown parking lot that was hard to access, lacked curb appeal and couldn't lure enough customers to make ends meet.

The next summer, they decided to give Wicked Fries on last shot, moving to the village of Morell, with a population of 300, where O'Brien grew up and had family.

Location, as they say, is everything. Wicked Fries was now parked next to a picturesque, meadow-fringed section of the province-wide Confederation Trail. It also helped that they were on the main highway and there weren't many other places to eat on the drive from Charlottetown to Souris. "Our sales just took off, by about 600 percent," says Gillis. "People were coming from two hours away."

After a rock-star summer, Morell Credit Union manager Sherri Clark asked if they would be interested in staying. She offered them a six-month lease on a bricks-and-mortar restaurant that had been sitting empty for more than a year. "It would have been easy to say no and take the winter off," Gillis recalls. "But after all the support we got from the community, it didn't feel right to pack up and say, 'See you next year.' And the plan they proposed left us with very little risk."

"The credit union helped us put the deal together and we obviously had to show them our numbers. None of them could believe what they were seeing."
– Quentin Gillis

Winter is typically a tough season for any restaurant. To Gillis's surprise, their revenues kept growing. Holy Cow obviously had the advantage of being the only restaurant in town. Gillis didn't take the situation for granted, giving back to community as much goodwill as he received by using small local suppliers whenever possible for seafood, beef, potatoes, bread, milk, cheese and even beer.

In April of 2016, Holy Cow crushed its first Burger Love. The couple extended the lease for another six months to test whether Morell could sustain both a restaurant and a food truck. The summer went so well they ended up purchasing the building. "The credit union helped us put the deal together and we obviously had to show them our numbers. None of them could believe what they were seeing," Gillis says.

After Ashley Cudmore was hired as head chef in the spring of 2017, a flood of catering opportunities began flowing their way. Cudmore's managerial assistance—"she plays a huge part," says Gillis — also gave him time to stand back and focus on big-picture operations.

As Burger Love approached, Gillis knew something had to change. Holy Cow had become a victim of its own success. "Last year, people were coming from all over but they had to wait 30 minutes for a seat and another 30 minutes for food. You could hear the grumbling."

His secret sauce? Instead of bringing the Island to Holy Cow, he took Mr. Irresisti-Bull to them. Gillis gathered his crew and put Wicked Fries back on the road for the Tip-2-Tip Burger Trip. "Our Facebook page blew up!" says Gillis. "We had trouble booking spots initially but after a few days, we had communities approaching us."

Holy Cow didn't win Most Loved Burger and Gillis says his employees were pretty disappointed, although some folks suggested they should have earned a congeniality award for sampling and posting about fellow burger contestants on every stop. Gillis also earned enough to buy a second food truck, which he'll be taking on tour this summer. "At the end of the day, we did exactly what we set out to do: took the stress off the restaurant, increased sales, put all these employees to work and got our name out there. You can't buy that kind of publicity." ◊

SERVICE EXCELLENCE AWARD

EASTERN PEI CHAMBER OF COMMERCE

The Eastern PEI Chamber of Commerce celebrates Eastern PEI Business's successes, innovations and contributions to the Eastern community at the 12th Annual Business and Community Excellence Awards.

Morell Credit Union is pleased to be awarded the Service Excellence Award.

FINANCIAL STATEMENTS

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INDEPENDENT AUDITOR'S REPORT

To the Members of Morell Credit Union Limited

Opinion

We have audited the financial statements of Morell Credit Union Limited (the Credit Union), which comprise the statement of financial position as at December 31, 2018, and the statements of changes in members' equity, profit and loss and cash flow for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Credit Union as at December 31, 2018, and its financial performance and its cash flow for the year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

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

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

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

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

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

(continues)

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

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

MRSB Chartered Professional Accountants

MRSB CHARTERED PROFESSIONAL ACCOUNTANTS

Charlottetown, PE

February 11, 2019

MORELL CREDIT UNION
STATEMENT OF FINANCIAL POSITION
December 31, 2018

	2018	2017
ASSETS		
Cash and cash equivalents (Note 5)	**$ 1,894,962**	$ 1,896,138
Investments (Note 6)	**11,275,329**	11,163,939
Accounts receivable (Note 7)	**201,463**	187,621
Income taxes recoverable	**4,924**	-
Member loans and mortgages (Note 8)	**22,904,089**	22,324,771
Provision for impaired loans (Note 9)	**(126,954)**	(140,375)
Prepaid expense	**25,983**	24,879
Deferred income taxes (Note 11)	**1,921**	2,416
Property and equipment (Schedule 1)	**694,571**	719,493
	$ 36,876,288	$ 36,178,882
LIABILITIES		
Accounts payable and accrued liabilities	**$ 86,152**	$ 49,284
Employee benefits payable	**25,636**	21,494
Accrued interest payable	**220,153**	219,179
Income taxes payable	**-**	864
Member deposits (Note 12)	**29,301,580**	29,631,820
Share deposits	**3,731,690**	2,888,304
	33,365,211	32,810,945
Lease commitments (Note 13)		
MEMBERS' EQUITY		
Share capital (Statement 4)	**9,440**	9,310
Undistributed earnings (Statement 4)	**3,501,637**	3,358,627
	3,511,077	3,367,937
	$ 36,876,288	$ 36,178,882

ON BEHALF OF THE BOARD

G Dennis Clough ______ Director

John Sutherland ______ Director

Notes 1 - 19 are an integral part of these financial statements

STATEMENT OF CHANGES IN MEMBERS' EQUITY

Year Ended December 31, 2018

	2018	2017
Members' shares (Note 14)		
Balance - beginning of year	**$ 9,310**	$ 8,930
Issuance of members' shares, net of redemption	**130**	380
Balance - end of year	**9,440**	9,310
Undistributed earnings		
Balance - beginning of year	**3,358,627**	3,206,304
Net income (Statement 5)	**143,010**	152,323
Balance - end of year	**3,501,637**	3,358,627
Members' equity	**$ 3,511,077**	$ 3,367,937

Notes 1 - 19 are an integral part of these financial statements

STATEMENT OF COMPREHENSIVE INCOME

Year Ended December 31, 2018

	2018	2017
Income		
Interest and investment	**$ 1,240,422**	$ 1,156,521
Cost of capital and borrowing		
Interest and service charges	**367,265**	373,423
Share dividends	**21,946**	16,474
	389,211	389,897
Financial margin	**851,211**	766,624
Other		
Commissions	**278,002**	264,283
Miscellaneous	**36,023**	27,649
	314,025	291,932
	1,165,236	1,058,556
Expenses		
Advertising and promotions	**73,572**	51,500
Amortization of property and equipment	**34,826**	31,736
Automated teller machines	**14,351**	14,672
Data processing	**117,939**	106,959
Director expenses	**15,115**	15,540
Dues and memberships	**2,198**	1,680
Insurance	**62,199**	58,072
Loss on disposal of property and equipment	**-**	7,172
Office	**36,593**	35,990
Premises	**47,371**	44,849
Professional fees	**20,659**	21,789
Provision (recovery) impaired loans	**(695)**	(65,545)
Service fees	**139,715**	130,220
Telephone	**8,428**	12,080
Travel	**6,595**	5,675
Wages and wage levies	**420,609**	407,441
	999,475	879,830
Income before income taxes	**165,761**	178,726
Income taxes (recovery)		
Current (Note 15)	**22,256**	27,178
Deferred (benefit)	**495**	(775)
	22,751	26,403
Net income	**$ 143,010**	$ 152,323

Notes 1 - 19 are an integral part of these financial statements

STATEMENT OF CASH FLOW

Year Ended December 31, 2018

	2018	2017
Cash flows from operating activities		
Net income	**$ 143,010**	$ 152,323
Items not affecting cash:		
Amortization of property and equipment	**34,826**	31,736
Deferred income taxes	**495**	(775)
Loss on disposal of property and equipment	**-**	7,172
	178,331	190,456
Changes in non-cash working capital:		
Investments	**(111,391)**	(2,708,308)
Accounts receivable	**(13,842)**	(2,782)
Income taxes recoverable	**(5,788)**	563
Prepaid expense	**(1,104)**	(758)
Accounts payable and accrued liabilities	**36,870**	(18,324)
Employee benefits payable	**4,142**	(2,026)
Accrued interest payable	**974**	15,333
	(90,139)	(2,716,302)
	88,192	(2,525,846)
Cash flows from investing activities		
Increase in member loans and mortgages, net of provision	**(592,740)**	(1,629,053)
Purchase of property and equipment	**(9,904)**	(53,791)
	(602,644)	(1,682,844)
Cash flows from financing activities		
Share deposits	**843,516**	661,861
Member deposits	**(330,240)**	2,727,272
	513,276	3,389,133
Decrease in cash and cash equivalents	**(1,176)**	(819,557)
Cash and cash equivalents - beginning of year	**1,896,138**	2,715,695
Cash and cash equivalents - end of year	**$ 1,894,962**	$ 1,896,138
Cash flow supplementary information		
Interest received	**$ 1,258,088**	$ 1,158,774
Interest paid	**$ 371,764**	$ 360,019
Income taxes paid	**$ 27,180**	$ 26,314

Notes 1 - 19 are an integral part of these financial statements

1. REPORTING ENTITY

Morell Credit Union Limited was incorporated provincially under the Companies Act of Prince Edward Island on January 27, 1938 and is governed by the Prince Edward Island Credit Unions Act. The Credit Union's registered office is located in Morell, PE. Morell Credit Union Limited is a member-owned financial institution whose principal business activities include financial and banking services for its members at its branch in Morell, Prince Edward Island.

2. BASIS OF ACCOUNTING

These financial statements have been prepared in accordance with and are in compliance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The principal accounting policies applied in the preparation of the financial statements are set out in Note 4.

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

These financial statements were authorized for issue by the Board of Directors on February 11, 2019.

As explained in changes in accounting policies in Note 4, the Credit Union has adopted IFRS 9 Financial Instruments issued in July 2014 with a date of initial application of January 1, 2018.

3. BASIS OF MEASUREMENT

The financial statements have been prepared on a historical cost basis except for available for sale investments which are at fair value through profit and loss.

4. SIGNIFICANT ACCOUNTING POLICIES

Cash and cash equivalents

Cash and cash equivalents is comprised of cash on hand and cash in financial institutions. Cash and cash equivalents are carried at amortized cost in the statement of financial position.

Investments

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Credit Union has the positive intent and ability to hold to maturity, and which are not designated as at FVTPL or as available-for-sale.

Held-to-maturity investments are carried at amortized cost using the effective interest method, less any impairment losses.

Available-for-sale investments are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. Unquoted investments whose fair value cannot be measured reliably are carried at cost. All other available-for-sale investments are measured at fair value after initial recognition.

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Accounts receivable

Accounts receivable arise from miscellaneous rebates and accrued interest on loans and mortgages and investments. An allowance for bad debts has been calculated through discussions with management, assessment of the other circumstances influencing the collectibility of amounts and using historical loss experience. Amounts deemed uncollectible are written off and deducted from the carrying value of the receivable. Amounts subsequently recovered from accounts previously written off are credited to the allowance account in the year of recovery.

Loans and mortgages

Loans and advances were initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method.

Impairment

The Credit Union measures loss allowances at an amount equal to lifetime expected credit losses.

Expected credit losses are a probability-weighted estimate of credit losses. They are measured as follows:

• financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the Credit Union in accordance with the contract and the cash flows that the Credit Union expects to receive);

• financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cashflows

If the terms of a financial asset are renegotiated or modified or an existing financial assets replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognized.

At each reporting date, the Credit Union assesses whether financial assets carried at amortized cost are credit-impaired. A financial asset is ‘credit-impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Evidence that a financial asset is credit-impaired includes significant financial difficulty of the borrower or issuer; a breach of contract such as a default or past due event; the restructuring of a loan or advance by the Credit Union on terms that the Credit Union would not consider otherwise; it is becoming probable that the borrower will enter bankruptcy or other financial reorganization.

Loss allowances for expected credit losses are presented in the statement of financial position as financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets.

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Credit Union determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off.

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

An individual measurement of impairment is based on management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management made judgements about a debtor's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable were independently approved by the Credit Risk function.

The collective allowance for groups of homogeneous loans was established using statistical methods such as roll rate methodology or loss rates. The roll rate methodology used statistical analysis of historical data on delinquency to estimate the amount of loss. Management applied judgement to ensure that the estimate of loss arrived at on the basis of historical information was appropriately adjusted to reflect the economic conditions and product mix at the reporting date. Roll rates and loss rates were benchmarked against actual loss experience.

The IBNR allowance covered credit losses inherent in portfolios of loans and advances, when there was objective evidence to suggest that they contained impaired items but the individual impaired items could not yet be identified. Loans that were subject to a collective IBNR provision were not considered impaired.

In assessing the need for collective loss allowance, management considered factors such as credit quality, portfolio size, concentrations and economic factors. To estimate the required allowance, assumptions were made to define how inherent losses were modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowance depended on the model assumptions and parameters used in determining the collective allowance.

Impairment losses on assets measured at amortized cost were calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses on available for-sale assets were calculated as the difference between the carrying amount and the fair value.

If an event occurring after the impairment was recognized caused the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit or loss.

Impairment losses were recognized in profit or loss and reflected in an allowance account against loans and receivable. Interest on the impaired assets continued to be recognized through the unwinding of the discount. At December 31, 2018, interest accrued on impaired loans and mortgages totals $Nil (2017 - $Nil).

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Deferred income taxes

Income tax expense comprises current and deferred tax.

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

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset or liability in a transaction and at the time of the transaction affects neither accounting or taxable profit or loss.

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

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

Property and equipment

Property and equipment is stated at cost less accumulated amortization and is amortized over its estimated useful life on a declining balance basis at the following rates:

Building	4%
Equipment	20%
Computer hardware	30%, 45% and 55%

One-half of the annual rate is recorded in the year of acquisition; no amortization is recorded in the year of disposal.

Finance charges

Fees related to the purchase of Index-Linked RRSP units are amortized using the straight-line method over the term of the investment and are netted against the cost of the liability.

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Employee future benefits

The Credit Union records annually the estimated liabilities for pension and other benefit obligations, which are payable to its employees in subsequent years under the Credit Union's policy.

The Credit Union provides post employment benefits through a defined contribution plan. Pension expenses for the defined contribution pension plan include the required employer contributions. Contributions to the plan are recognized as an expense in the period that the relevant employee services are rendered. During the year, the contributions by the Credit Union to the defined contribution pension plan were $16,791 (2017 - $17,604).

Liabilities are recorded for employee benefits including salaries and wages, deductions at source and bonuses that are expected to be settled within twelve months of the financial statement date. These represent present obligations resulting from employees' services provided to the financial statement date and are calculated at the undiscounted amounts based on remuneration rate that the Credit Union expects to pay at the financial statement date.

Benefits such as medial care are non-vesting and are expensed by the Credit Union as the benefits are taken by the employees.

Member deposits

Borrowings and deposits and membership shares that are classified as liabilities are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method. Term, RRSP, RRIF and demand deposits can be fixed or variable rate. Interest can be paid annually, semi-annually, monthly or upon maturity.

Share deposits pay a dividend return at the discretion of the Board of Directors. Privileges of the shares are under the authority of the Board of Directors. The dividend rate declared and paid for 2018 was 0.75% (2017 - 0.75%) and was based on the average of the lowest monthly share balances.

Share deposits

The Credit Union has authorized an unlimited number of voting equity shares, with a value of $5 per share. The shares are non-transferable, redeemable by the Credit Union, retractable by members subject to the Credit Union's right to suspend redemption, if the redemption would impair the financial stability of the Credit Union, for a period of up to twelve months by Board resolution and indefinitely by Board resolution with the approval of the Credit Union Deposit Corporation.

As at the financial statement date, the Credit Union has 1,888 member shares issued and outstanding with a value of $9,440 (2017 - 1,862 shares with a value of $9,310).

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4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Interest

Effective interest rate:

Interest income and expense are recognized in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

• the gross carrying amount of the financial asset; or

• the amortized cost of the financial liability.

When calculating the effective interest rate for financial instruments other than credit impaired assets, the Credit Union estimates future cash flows considering all contractual terms of the financial instrument, but not expected credit losses. For credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including expected credit losses.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Revenue and expense recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Credit Union and the revenue can readily be measured. The principal sources of revenue are interest and fee income. Interest on loans and mortgages is recognized and reported on an accrual basis using the effective interest method.

Other fee and commission income – including account servicing fees, loan discharge and administration fees, and syndication fees – is recognized as the related services are performed.

Operating expenses are recognized upon the utilization of the services or at the date of their origin. Expenses incurred directly in the origination of loans and mortgages are deferred and recognized in profit or loss, as a reduction to income over the expected life of the relevant loans and mortgages. Other fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

Foreign currency translation

Accounts in foreign currencies have been translated into Canadian dollars using the temporal method. Under this method, monetary assets and liabilities have been translated at the year end exchange rate. Non-monetary assets have been translated at the rate of exchange prevailing at the date of transaction. Revenues and expenses have been translated at the average rates of exchange during the year, except for amortization, which has been translated at the same rate as the related assets.

Foreign exchange gains and losses on monetary assets and liabilities are included in the determination of profit or loss.

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Use of judgements and estimates

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgement in applying the Credit Union's accounting policies. The estimates and underlying assumptions are continually reviewed on an ongoing basis based on historical experience, best knowledge of current events and conditions and other factors that are believed to be reasonable under the circumstances, including expectations of future events. The resulting accounting estimates will, by definition, seldom equal the related actual results, and actual results may ultimately differ from these estimates.

Revisions to accounting estimates are recorded in the period in which the estimate is reversed if the revision affects only that period or in the period of revision and in future periods if the revision affects both the current and future periods.

The areas involving a high degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements include the impairment of financial instruments: assessment of whether credit risk on the financial asset has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of ECL, measurement of employee benefits, and the estimates of useful lives for depreciation of property and equipment, classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are solely payments of principal and interest on the principal amount outstanding.

Financial assets and financial liabilities

The Credit Union initially recognizes loans and advances, deposits and liabilities on the date on which they are originated. A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

On initial recognition, a financial asset is classified as measured at: amortized cost, FVOCI or FVTPL. A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL: the asset is held within a business model whose objective is to hold assets to collect contractual cash flow; and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. All other financial assets are classified as measured at FVTPL. Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Credit Union changes its business model for managing financial assets. There we no changes to any of the Credit Union business models during the current year (prior year: Nil).

The Credit Union classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortized cost or FVTPL. The Credit Union derecognizes a financial liability when its contractual obligations are discharged or cancelled, or expire.

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

The Credit Union derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Credit Union neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognized) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in OCI is recognized in profit or loss. In transactions in which the Credit Union neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Credit Union continues to recognize the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Credit Union currently has legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

The Credit Union has classified its financial assets and liabilities as follows:

Cash and cash equivalents - amortized cost

Available-for-sale investments - fair value through profit and loss

Held-to-maturity investments - amortized cost

Accounts receivable, member loans and mortgages, member and share deposits, accrued liabilities and accounts receivable - amortized cost

<u>Changes in accounting policies</u>

Except for the changes below, the Credit Union has consistently applied the accounting policies as set out in Note 4 to all periods presented in these financial statements. Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively with no changes to opening undistributed earnings.

The Credit Union has adopted IFRS 9 Financial Instruments issued in July 2014 with a date of initial application of January 1, 2018. The requirements of IFRS 9 represent a significant change from IAS 39 Financial Instruments: Recognition and Measurement. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

The key changes to the Credit Union’s accounting policies resulting from its adoption of IFRS 9 are summarized below.

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with an ‘expected credit loss’ model. Under IFRS 9, credit losses are recognized earlier than under IAS 39.

5. CASH AND CASH EQUIVALENTS

	2018	2017
Cash in financial institutions	**$ 1,389,246**	$ 1,579,612
Cash on hand	**505,716**	316,526
	$ 1,894,962	$ 1,896,138

6. INVESTMENTS

Shares

	2018	2017
Concentra Financial Services Association - 20,000 Class D Series 1 preferred shares	**$ 500,000**	$ 500,000
Atlantic Central Credit Union Limited - common shares	**335,340**	297,170
Atlantic Central Credit Union Limited - Class B preferred shares	**91,500**	91,500
Atlantic Central Credit Union Limited - Class LSM preferred shares	**64,201**	64,201
League Data Limited - 1,511 Class B preferred shares	**15,510**	15,510
Morell Consumers Co-operative Association, Ltd.	**1,902**	1,902
Atlantic Central Credit Union Limited - Class PEI shares	**800**	800
	1,009,253	971,083

Debentures

Atlantic Central Credit Union Limited liquidity deposit - 1.75%	**2,215,076**	2,192,857
Atlantic Central Credit Union Limited term deposit - 1.83%; matures May 7, 2019	**2,000,000**	2,000,000
League Savings and Mortgage term deposit - 1.75%; matures October 30, 2019	**2,035,000**	2,000,000
Atlantic Central Credit Union Limited term deposits - 1.78%; matures April 9, 2019	**2,000,000**	2,000,000
Atlantic Central Credit Union Limited term deposit - 2.25%; matures December 4, 2019	**1,000,000**	1,000,000
League Savings and Mortgage term deposit - 1.60%; matures May 31, 2020	**1,016,000**	1,000,000
	10,266,076	10,192,857
Grand total	**$ 11,275,329**	$ 11,163,940

Liquidity deposits are investments placed with Atlantic Central Credit Union Limited to provide protection against cash flow demand. National standards have been established requiring 6% of Morell Credit Union Limited assets to be held on deposit.

7. ACCOUNTS RECEIVABLE

	2018	2017
Accrued interest - loans and mortgages	**$ 122,162**	$ 140,126
Accrued interest - investments	**67,054**	43,954
Other receivables	**12,247**	3,541
	$ 201,463	$ 187,621

8. MEMBER LOANS AND MORTGAGES

2018	Total loans	Allowance	Net loans
Personal and business	$ 9,125,456	$ (77,693)	$ 9,047,763
Lines of credit and overdrafts	1,539,403	(49,261)	1,490,142
Mortgages	10,922,615	-	10,922,615
LS&M reverse mortgages	1,316,615	-	1,316,615
	$ 22,904,089	$ (126,954)	$ 22,777,135

2017	Total loans	Specific allowance	Net loans
Personal and business	$ 9,444,154	$ (90,375)	$ 9,353,779
Lines of credit and overdrafts	839,910	(50,000)	789,910
Mortgages	10,547,448	-	10,547,448
LS&M reverse mortgages	1,493,260	-	1,493,260
	$ 22,324,772	$ (140,375)	$ 22,184,397

9. PROVISION FOR IMPAIRED LOANS

	2018	2017
Provision for impaired loans - beginning of year	**$ 140,375**	$ 221,219
Provision (recovery) impaired loans - current year	**(695)**	(65,545)
Recovery of loans written off	**8,293**	6,877
Loans written off - current year	**(21,019)**	(22,176)
Provision for impaired loans - end of year	**$ 126,954**	$ 140,375

Members' loans can have either variable or fixed rate of interest. The rates offered to members are determined by the type of security offered, the member's credit worthiness, competition from other lenders and the current prime rate.

10. LOANS IN ARREARS

The following is an analysis of loans in arrears based on the age of repayments outstanding:

	2018	2017
31 to 60 days	$ 15,283	$ -
61 to 90 days	-	24,208
Over 180 days	16,206	-
	$ 31,489	$ 24,208

11. DEFERRED INCOME TAXES

Deferred income taxes reflect the tax consequences of 'temporary differences' between the statement of financial position carrying amounts and the tax bases of assets and liabilities. These deferred income taxes are calculated using the income tax rates and tax laws that are expected to apply when these temporary differences are reflected in taxable income.

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

	2018	2017
Property and equipment	$ 1,921	$ 2,416

12. MEMBER DEPOSITS

	2018	2017
Term deposits	$ 8,131,436	$ 8,721,861
Personal chequing accounts	7,729,653	7,586,294
Registered Retirement Savings Plan (RRSP) deposits	6,968,655	7,052,633
Registered Retirement Income Fund (RRIF) deposits	2,539,360	2,594,752
Tax Free Savings Account (TFSA) deposits	2,404,509	2,272,999
Call deposits	1,527,967	1,403,281
	$ 29,301,580	$ 29,631,820

13. LEASE COMMITMENTS

The Credit Union has entered into a lease agreement for the lease of a photocopier. Future minimum lease payments as at December 31, 2018 are as follows:

2019	$ 3,657
2020	3,657
2021	914
	$ 8,228

14. MEMBERS' SHARES

	Number of shares	**December 31 2018**	Number of shares	December 31 2017
Balance - beginning of year	**1,862**	**$ 9,310**	1,786	$ 8,930
Shares issued, net of redemption	**26**	**130**	76	380
Balance - end of year	**1,888**	**$ 9,440**	1,862	$ 9,310

15. INCOME TAXES

The income tax provision recorded differs from the income tax obtained by applying the statutory income tax rate of 31.98% (2017 - 32.47%) to the income for the year and is reconciled as follows:

	2018	2017
Income before income taxes	**$ 165,761**	$ 178,726
Income tax expense at the combined basic federal and provincial tax rate:	**$ 53,013**	$ 58,032
Increase (decrease) resulting from:		
Small business deduction	**(27,660)**	(30,477)
Taxable capital gain in excess of financial statement gain	**-**	2,329
Capital cost allowance claimed in excess of amortization	**(598)**	(704)
Non-deductible expenses	**(2,070)**	623
Tax reserves	**3,863**	23,625
Provision for loan loss reserve	**(222)**	(21,282)
Recovery of loans previously written off	**2,652**	2,233
Loans written off in the current period	**(6,722)**	(7,201)
Effective tax expense	**$ 22,256**	$ 27,178

The effective income tax rate is 13.43% (2017 -15.21%).

16. LINE OF CREDIT AVAILABILITY

The Credit Union has an approved line of credit with Atlantic Central Credit Union Limited of $900,000, which is due for renewal on December 31, 2020, and was not utilized at the year end. The line of credit bears an interest rate of prime and is secured by a general security agreement.

17. RELATED PARTY TRANSACTIONS

Morell Credit Union Limited provides financial services to members. These members hold the loans, deposits and share deposits and therefore the interest income and interest expense are transacted in the ordinary course of business with these members.

As at period end, some members of the Board of Directors, Credit Committee, management and employees had loans and mortgages from Morell Credit Union Limited. These loans were in the normal course of operations with interest rates at the regular rates offered to all members of the Credit Union. Interest rates of deposits and dividends on shares were at identical rates offered to all Credit Union members.

Key management personnel include the General Manager and other senior officers of the Credit Union. The components of total compensation received by key management personnel, and balances due to/from key management personnel are as follows:

	2018	2017
Short-term employee benefits	**$ 173,080**	$ 164,100
Contributions to a retirement pension plan	**9,284**	8,842
Deposit balances due to key management at December 31	**277,913**	318,195

Short-term employee benefits include salaries, variable compensation and other benefits. The mortgage and deposit transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

18. RISK MANAGEMENT

The Credit Union manages significant risks through a comprehensive infrastructure of policies, procedures, methods, oversight, and independent review designed to reduce the significant risks and to manage those risks within an appropriate threshold. The Board of Directors is provided with timely, relevant, accurate, and complete reports on the management of significant risks. Significant risks managed by the Credit Union include credit, liquidity, currency and interest rate risks.

(a) Credit risk

Credit risk is the risk that a member will fail to meet their obligation to the Credit Union. Providing credit facilities to qualified members is one of the Credit Union's primary sources of earnings and is the area where the Credit Union is exposed to the most significant risk. Approval of these facilities is based on the member's ability to repay principal and interest over the term of the facility, which is determined by following Board approved policies and procedures, which includes assessing the member's credit history, character, collateral, and debt servicing capacity. In addition, the Credit Union provides to its employees comprehensive training to ensure compliance with Credit Union lending policies and procedures. Also, formal policies governing approval of credit facilities including acceptable risk assessment and security requirements are in place.

Overdue loan accounts, or lending delinquency, is closely monitored and frequently reported to senior management to ensure all allowances for potential loan losses are adequately provided for and written-off when collection efforts have been exhausted. Credit risk is mitigated primarily by the nature and quality of the underlying security as described by approved lending agreements.

(continues)

18. RISK MANAGEMENT *(continued)*

The Credit Union's loan portfolio is focused in two main areas: consumer and commercial loans and mortgages, the latter of which are to mainly small and mid-sized companies. A syndication process is available with other Credit Unions for larger commercial loans, when considered necessary, to appropriately mitigate the Credit Union's credit risk. Consumer mortgages are made available on a conventional basis up to 80% of the lesser of cost or appraised value of single family housing, up to 75% on other residential properties, up to 65% of the lesser of cost or appraised value on commercial properties having general purpose usage and up to 50% of the lesser of cost or appraised value on commercial properties designed for specific use. Other credit facilities provided include personal overdrafts that have no recourse to the Credit Union.

The Credit Union's policy is to pursue timely realization of the collateral in an orderly manner. The Credit Union does not generally use the non-cash collateral for its own operations. During the year, the Credit Union did not take possession of collateral held as security against loans and advances.

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Credit Union considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Credit Union's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing the remaining lifetime probability of default (PD) as at the reporting date; with the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Credit Union allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgements. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower. Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates so, for example, the difference in risk of default between credit risk grades 1 and 2 is smaller than the difference between credit risk grades 2 and 3. Each exposure is allocated to a credit risk grade at initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade.

The Credit Union considers a financial asset to be in default when the borrower is unlikely to pay its credit obligations to the Credit Union in full, without recourse by the Credit Union to actions such as realizing security (if any is held); the borrower is past due more than 90 days on any material credit obligation to the Credit Union. Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding.

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18. RISK MANAGEMENT *(continued)*

The Credit Union incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. Based on advice from economic experts and consideration of a variety of external actual and forecast information, the Credit Union formulates a ‘base case’ view of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. The base case represents a most-likely outcome and is aligned with information used by the Credit Union for other purposes such as strategic planning and budgeting. The other scenarios represent more optimistic and more pessimistic outcomes.

The key inputs into the measurement of expected credit losses are the term structure of the following variables: probability of default (PD); loss given default (LGD); and exposure at default (EAD). These parameters are generally derived from internally developed statistical models and other historical data. They are adjusted to reflect forward-looking information as described above. PD estimates are estimates at a certain date, LGD is the magnitude of the likely loss if there is a default. The Credit Union estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. EAD represents the expected exposure in the event of a default

Cash and equivalents and investments have low credit risk exposure as these assets are high quality investments with low risk counterparties. For the loan portfolio, the Credit Union reviews the member's capacity to repay the loan rather than relying exclusively on collateral.

(b) Liquidity risk

Liquidity risk is the risk of being unable to meet financial commitments without having to raise funds at unreasonable prices or sell assets on a forced basis. The Credit Union has established policies to ensure the Credit Union is able to generate sufficient funds to meet all of its financial commitments in a timely and cost effective manner. The Credit Union's liquidity management practices include ensuring the quality of investment acquired for liquidity purposes meet very high standards, matching maturities of assets and liabilities and monitoring cash flow on a regular basis. Management monitors the Credit Union's liquidity position and reports to the Board on a regular basis.

The Credit Union is required to maintain 6% of prior quarter's assets in liquid investments in which 100% must be held by Atlantic Central Credit Union Limited and the Credit Union was in compliance with this requirement at year end. Cash flows payable under financial liabilities by remaining contractual maturities are disclosed in Schedule 2. The Credit Union expects that many members will not request repayment on the earliest date the Credit Union could be required to pay.

(c) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Credit Union is exposed to currency risk through its cash accounts and member deposits. The Credit Union maintains deposits in foreign currencies to service its member accounts.

(continues)

18. RISK MANAGEMENT *(continued)*

(d) Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate materially due to changes in market interest rates. The Credit Union is exposed to interest rate risk through its loans and mortgages, providing lending services to its members for a rate based on the Bank of Canada base rate plus a risk premium determined at the loan inception. The Credit Union manages and controls interest rate risk primarily by managing asset and liability maturities. Interest rate risk is measured on a quarterly basis and the results are reported to the Board of Directors.

19. CAPITAL MANAGEMENT

Morell Credit Union Limited provides lending services to its members in the form of loans, lines of credit and mortgages. The Credit Union's objective in the lending process is to remain within the lending guidelines set for the institution and to provide an adequate return to its members through adjusting risk premiums with the level of assessed risk on an individual basis. These services are provided to members at the discretion of the general manager and lending personnel within the established parameters. Total lending activities managed by the Credit Union as of December 31, 2018 amounted to $22,904,089 (2017 - $22,324,771).

Consistent with other Prince Edward Island Credit Unions, Morell Credit Union Limited is required by the Credit Union Deposit Insurance Corporation to maintain an equity level of 5% of the Credit Union's total assets. This ratio is calculated by adding the undistributed earnings at the end of the previous period plus the operating surplus in the current period and members' shares, divided by the total assets of the Credit Union.

	2018	2017
Undistributed earnings	**$ 3,501,637**	$ 3,358,627
Members' shares	**9,440**	9,310
Total regulatory equity	**3,511,077**	3,367,937
Total assets	**36,876,288**	36,178,882
	9.52 %	9.31 %

Credit Union bylaws require Morell Credit Union Limited to maintain sufficient liquid assets and a line of credit to meet its normal cash flow requirements. Overall, a minimum liquid asset level of 10% of total assets must be maintained to ensure ongoing cash flow requirements are met.

	2018	2017
Total assets	**$ 36,876,288**	$ 36,178,882
Liquid assets	**13,371,754**	13,247,698
	36.26 %	36.62 %

Schedules to Financial Statements **(Schedule 1)**

Statement of Property and Equipment

Year Ended December 31, 2018

	Cost beginning of year	Additions	Disposals and write downs	Cost end of year	Amort beginning of year	Amort in year	Disposals	Amort end of year	NBV 2018	NBV 2017
Land	$ 130,535	$ -	$ -	$ 130,535	$ -	$ -	$ -	$ -	$ 130,535	$ 130,535
Building	856,691	-	-	856,691	325,475	21,249	-	346,724	509,967	531,216
Equipment	245,904	9,904	-	255,808	192,201	11,730	-	203,931	51,877	53,703
Computer hardware	191,966	-	-	191,966	187,927	1,847	-	189,774	2,192	4,039
	$1,425,096	$ 9,904	$ -	$1,435,000	$ 705,603	$ 34,826	$ -	$ 740,429	$ 694,571	$ 719,493

Notes 1 - 19 are an integral part of these financial statements

Schedules to Financial Statements **(Schedule 2)**

Interest Rate Sensitivity

Year Ended December 31, 2018

	Under 1 year	Over 1 to 5 years	Over 5 years	Not interest rate sensitive	Total
ASSETS					
Cash and cash equivalents	$ 1,243,304	$ -	$ -	$ 651,658	$ 1,894,962
Effective interest rate	1.57 %	- %	- %	- %	
Investments	10,266,076	-	-	1,009,253	11,275,329
Effective interest rate	1.81 %	- %	- %	- %	
Accounts receivable	-	-	-	201,463	201,463
Member loans and mortgages	1,553,924	17,385,057	2,348,012	-	21,286,993
Effective interest rate	4.45 %	4.36 %	5.18 %	- %	
Lines of credit and overdrafts	1,490,142	-	-	-	1,490,142
Effective interest rate	5.88 %	- %	- %	- %	
Income taxes recoverable	-	-	-	4,924	4,924
Prepaid expense	-	-	-	25,983	25,983
Deferred income taxes	-	-	-	1,921	1,921
Property and equipment	-	-	-	694,571	694,571
	$ 14,553,446	$ 17,385,057	$ 2,348,012	$ 2,589,773	$ 36,876,288
LIABILITIES AND MEMBERS' EQUITY					
Accounts payable and accrued liabilities	$ -	$ -	$ -	$ 86,152	$ 86,152
Employee benefits payable	-	-	-	25,636	25,636
Accrued interest payable	-	-	-	220,153	220,153
Member deposits	16,443,168	5,151,538	-	7,706,874	29,301,580
Effective interest rate	1.70 %	1.75 %	- %	- %	
Share deposits	3,731,690	-	-	-	3,731,690
Effective interest rate	0.75 %	- %	- %	- %	
Members' shares	9,440	-	-	-	9,440
Effective interest rate	0.75 %	- %	- %	- %	
Undistributed earnings	-	-	-	3,501,637	3,501,637
	$ 20,184,298	$ 5,151,538	$ -	$ 11,540,452	$ 36,876,288

The above table sets out assets and liabilities on the earlier of contractual maturity or repricing date. Use of the table to derive information about the Credit Union's interest rate risk position is limited by the fact that certain borrowers may choose to terminate their financial instruments at a date earlier than contractual maturity or repricing dates. For example, loans and mortgages are shown at contractual maturity but certain could prepay earlier.

As at December 31, 2018, Morell Credit Union Limited's net interest spread was 2.26%. The net interest spread is calculated by expressing the difference between (a) the percentage of income earned on the average year end interest bearing assets and (b) the percentage of costs of capital and borrowings on the average year end interest bearing liabilities.

Notes 1 - 19 are an integral part of these financial statements

NOTES

NOTES

CREDIT UNION

MORELL

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