2018 ANNUAL REPORT

PROVINCIAL CREDIT UNION

TABLE OF CONTENTS

2018 HIGHLIGHTS

$377M
ASSETS

$340M
DEPOSITS

15K
MEMBERS

$316M
LOANS

$295K
PAID TO MEMBERS

10.41%
GROWTH IN AVG. MEMBER SAVINGS

OUR VISION

Be the financial institution of choice in our market and be recognized for the value we bring to our members and communities

OUR MISSION

We provide professional advice to assist our members in achieving their full financial potential, while positively impacting our communities.

OUR VALUES

- BE SOCIALLY RESPONSIBLE
- BE ACCOUNTABLE
- GO ABOVE AND BEYOND
- BE PARTNERS IN ACTION
- CONTINUOUSLY IMPROVE

BOARD OF DIRECTORS

COREY TREMERE
President

WENDELL DAWSON
Vice President

JACINTA DOIRON
Secretary

BERNARD KEEFE

CAROL BLUM

JASON DOUCETTE

BRYON POEHLMAN

MICHELLE PROCTOR

LINDY MCQUILLAN

CYRILINA CAMPBELL

RICK GIBBS

JOEY GAUTHIER

PRESIDENT'S REPORT

As I said in my first President's report in 2014, and many times since, it's been a true privilege to serve you as President. Our board, along with management and staff are a true reflection of the core values of the Credit Union movement and Provincial Credit Union's mission statement:

"To provide professional advice to assist our members in achieving their full financial potential, while positively impacting our communities."

As you will see outlined in the annual report, with your support, Provincial Credit Union enjoyed a very successful year. Our assets grew by more than $31,367, 000 to reach $377,330,172. Mortgages and commercial loans saw significant increases as well, and Provincial's net income was the best in the history of the credit union, at $1,693,222. Equity now sits at 8.95%, well above the national standard and CUDIC's requirement of 5%. We are also pleased to declare a share dividend rate of 0.70%

On behalf of the board of directors, I'd like to extend a thank you to all staff at the four Provincial Credit Union offices for their continued professional and courteous member service over the past 12 months. Putting the member first in all of their day to day dealings, is integral to the relationship and trust credit unions have earned.

Lastly, I want to thank our members, for your continued loyalty and support of the Credit Union System. I encourage you to continue sharing your thoughts and ideas. Remember, you have a say in how your credit union is governed!

COREY TREMERE
President

$295 THOUSAND REASONS TO DO MORE WITH YOUR MONEY

IN 2018,
PROVINCIAL CREDIT UNION SHARED
$295 THOUSAND
IN PROFITS WITH OUR MEMBERS THROUGH THE SHARE DIVIDEND PROGRAM.

CEO'S REPORT

It is my pleasure to report to you on the operations of Provincial Credit Union , as at December 31st, 2018. Our assets have now surpassed $377,000,000, representing an increase of 9.10%. And with loan growth of 19.3%, Provincial Credit Union had its best year ever.

As we enter the last year of our Strategic Plan, we are continuing to more forward on a number of initiatives. An integral component is Member First. As the name implies, we're working to more proactively meets the needs of our members, and putting them first in all of our interactions. We are seeing results in many facets of our operation. 2018 marked a concerted effort to improve our operational efficiencies, with the centralization of commercial and personal loan administration, as well as our deposit admin. It is working well, although we are still in the early stages and recognize there are some growing pains.

Provincially, PEI Credit Unions are now utilizing a Strategic Plan, to assist all credit unions moving forward. The sharing of services to increase efficiencies is a big focus. In the first tier, IT services and Cyber Security are front and center.

Provincial Credit Union has also partnered with Tignish Credit Union, to retain the services of a Director of Finance, to ensure we have the needed expertise for continued growth. Moving forward it's expected the remaining PEI Credit Unions will participate.

The Charlottetown office of Provincial Credit Union went through a transformation last fall, with the move of our Commercial Lending Services up to the second floor. The relocation freed up much

MEMBERS NEEDS COME FIRST PERIOD

needed space for our retail loans and deposits on the main floor, and at the same time, provided a more professional atmosphere for our commercial clients and staff. New services for business this year include enhancements to Member Direct Small Business on line banking, to include invoicing solutions and payroll. Still on the technology side, our data provider League Data, is in the process of rolling out a new banking origination platform, to enhance both service delivery and the member experience.

Positively impacting our communities is a cornerstone of the credit union movement, and an aspect of the business we take great pride in. Last year Provincial Credit Union gave back $150,000 to the communities we serve. We provide sponsorships and donations to countless organizations, many of which you will see listed in this annual report.

In closing thank you to our members for your patronage during the last year, and I would like to acknowledge our board of directors and Provincial Credit Union's staff as well. A strong board and dedicated employees, have been instrumental to our success in 2018.

Sincerely,

BERNARD GILLIS
Chief Executive Officer

IN OUR COMMUNITY

THIS YEAR, WE SPENT OVER

$150,000

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!

MONTAGUE OFFICE DONATES TO SOUTHERN KINGS & QUEENS FOOD BANK

Kyle Osmond (left), Mutual Funds Investment Specialist at the Montague office of Provincial Credit Union, and Tanya Ramsay, Manager, present a cheque for $1000 to Frank Dorte, Southern Kings and Queens Food Bank Coordinator.

PROUD SUPPORTER OF LENNON HOUSE IN SOUTH RUSTICO

The Stella Maris Branch of Provincial Credit Union supports Lennon House in South Rustico, a client centered recovery home.

On hand for the cheque presentation were branch manager Shanna Doiron (right), and representing Lennon House are Dianne Young, Linda MacDonald,

INVESTING IN HEALTHIER COMMUNITIES

QEH FOUNDATION

Our annual donation to the QEH Foundation. Presenting the cheque to QEH Foundation Board Chair Bob Sear, is Heather Doucette from our Stella Maris office.

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.

$7.5K

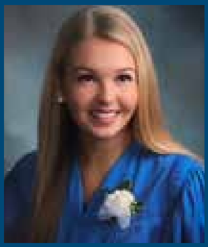
SCHOLARSHIPS

We are pleased to announce 5 Provincial Credit Union Scholarship Recipients for 2018. Each scholarship recipient received $1,500 towards furthering their education. In total, Provincial Credit Union distributed $7,500.

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

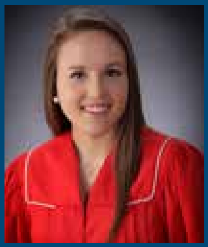
NOT PICTURED: JASMINE KATZ

JESSICA GALLANT



ABBY CLOW

BRENNA HOWATT



KATHERINE MCEWEN

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.

CREDIT UNION SUPPORTS BREAST CANCER AWARENESS DAY

Patricia Dunn (right), from the Stratford office of Provincial Credit Union, presents a cheque to Kelly Power, from Canadian Cancer Society

Funds were raised through a 50/50 draw, bake sale and basket raffle at the Stratford, Charlottetown & Stella Maris branches.

HELPING THE VOLUNTARY RESOURCE CENTRE

Doug Bridges (left) and Doug Geldert from the Charlottetown office, present our annual donation to Sylvie Arsenault from the Voluntary Resource Centre. Funds help support the organization's newsletter.

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.

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.

MAKING OUR COMMUNITIES EVEN BETTER ONE ORGANIZATION AT A TIME

IN 2018 PROVINCIAL CREDIT UNION ALSO SUPPORTED THE FOLLOWING ORGANIZATIONS

A & S SCRAP METAL METROS
ANDREWS HOCKEY
CAMP ABEGWEIT GOLF TOURNAMENT
CANADIAN FOUNDATION FOR PHARMACY
CANADIAN LEBANESE NEW YEAR
CANADIAN MENTAL HEALTH ASSOCIATION
CHARLOTTETOWN POLICE ASSOCIATION BENEFIT
CLOSE TO THE GROUND SERIES
COLDEST NIGHT OF THE YEAR (HARVEST HOUSE)
DUNDAS PLOWING MATCH
EASTERN PEI CHAMBER OF COMMERCE
FUSION CHARLOTTETOWN
GLEN STEWART HOME & SCHOOL ASSOCIATION
GOLD CUP PARADE
GREATER CHARLOTTETOWN CHAMBER OF COMMERCE
HOSPICE PEI
ISLAND NATURE TRUST
JUNIOR ACHIEVEMENT OF PEI
KIDNEY FOUNDATION OF CANADA
KIDSPORT PEI
MOOD DISORDERS SOCIETY OF CANADA
NORTH RIVER HOCKEY SWEETHEART TOURNAMENT
MUSIC PEI
NORTON'S RAZZLE DAZZLE RED
OSTOMY CANADA
OYSTER BED SPEEDWAY
PARASPORT AND RECREATION PEI
PARKINSON CANADA
PEI BUSINESS WOMEN'S ASSOCIATION
PEI COUNCIL OF PEOPLE WITH DISABILITIES
PEI FAMILY VIOLENCE PREVENTION SERVICES
PEI NEWCOMERS ASSOCIATION
PEI SYMPHONY
ROTARY CLUB OF CHARLOTTETOWN ROYALTY
ROTARY CLUB OF HILLSBOROUGH
RUSTICO NORTH STAR MIDGET A
SHERWOOD METROS JUNIOR C
SPECIAL OLYMPICS OF PEI
SPRING PARK UNITED CHURCH
SPUD TOURNAMENT
ST. COLUMBA PRESBYTERIAN CHURCH
ST. JAMES PRESBYTERIAN CHURCH
STARS FOR LIFE
THE FOUR TELLERS
THE GIDEONS
THYRAMUS CORPORATION
UNDER 14 GIRLS PROVINCIAL SOFTPITCH
UNDER 14 PEI WAVE RINGETTE
UPEI BAJA SOCIETY
VICTORIA ROW MERCHANTS

NOW POWERED BY 100% RENEWABLE ELECTRICITY WITH BULLFROG POWER

In 2018, Provincial Credit Union entered into a partnership with Bullfrog Power, in a concerted effort to reduce our carbon footprint. Simply put, it's an offset program. By choosing renewable electricity with Bullfrog Power, we began offsetting our electricity use with green energy. For every kWh of electricity used by Provincial Credit Union, a kWh from a renewable source is put on the grid on our behalf. Provincial Credit Union pays a premium on the electricity we use, and no special equipment is required. Any home or business can be bullfrog powered.

Here on Prince Edward Island, The West Cape Wind Farm has partnered with Bullfrog Power. Located near O'Leary, the Island's largest wind farm has a total of 55 turbines, capable of powering nearly 25,000 homes annually. Thinking about renewable energy for your home or business? Here's an added incentive. For every new sign up, Bullfrog helps to fund new green energy products all across the country

bullfrogpowered® business | WE PROUDLY CHOOSE RENEWABLE ENERGY.

FINANCIAL STATEMENTS

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902-368-2643

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INDEPENDENT AUDITOR'S REPORT

To the Members of Provincial Credit Union Limited

Opinion

We have audited the financial statements of Provincial 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 and schedules 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.

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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 judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Credit Union’s internal control.
- Evaluate the appropriateness of accounting policies 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 19, 2019

PROVINCIAL CREDIT UNION

STATEMENT OF FINANCIAL POSITION

December 31, 2018

	2018	2017
ASSETS		
Cash and cash equivalents (Note 5)	**$ 12,687,414**	$ 6,939,689
Investments (Note 6)	**40,263,891**	59,870,734
Accounts receivable (Note 7)	**2,383,200**	8,372,749
Member loans and mortgages (Note 8)	**316,448,585**	265,328,299
Provision for impaired loans (Note 9)	**(323,352)**	(384,201)
Prepaid expense	**176,988**	185,850
Deferred tax asset (Note 11)	**274,504**	319,844
Property and equipment (Schedule 1)	**2,692,943**	2,728,763
Due from CU PEI Investment Corp. (Note 12)	**2,675,999**	2,600,999
Property held for resale	**50,000**	-
	$377,330,172	$345,962,726
LIABILITIES		
Accounts payable and accrued liabilities	**$ 424,258**	$ 267,296
Employee benefits payable	**1,094,823**	1,147,316
Accrued interest payable	**1,651,223**	1,381,818
Income taxes payable	**143,330**	15,176
Member deposits (Note 13)	**299,709,763**	267,979,016
Share deposits	**40,547,897**	43,105,008
	343,571,294	313,895,630
Contingent liabilities (Note 14)		
MEMBERS' EQUITY		
Share capital (Statement 4)	**74,380**	75,820
Undistributed earnings (Statement 4)	**33,684,498**	31,991,276
	33,758,878	32,067,096
	$377,330,172	$345,962,726

ON BEHALF OF THE BOARD

Jacinta Doiron ____________ Director

Bernard Keefe ____________ Director

Notes 1 to 20 are an integral part of these financial statements

STATEMENT OF CHANGES IN MEMBERS' EQUITY

Year Ended December 31, 2018

	2018	2017
Members' shares (Note 15)		
Balance - beginning of year	**$ 75,820**	$ 77,510
Redemption of members' shares, net	**(1,440)**	(1,690)
Balance - end of year	**74,380**	75,820
Undistributed earnings		
Balance - beginning of year	**31,991,276**	30,799,164
Net income (Statement 5)	**1,693,222**	1,192,112
Balance - end of year	**33,684,498**	31,991,276
Members' equity	**$ 33,758,878**	$ 32,067,096

Notes 1 to 20 are an integral part of these financial statements

PROVINCIAL CREDIT UNION

STATEMENT OF COMPREHENSIVE INCOME

Year Ended December 31, 2018

	2018	2017
Income		
Interest and investment	**$ 11,796,948**	$ 10,480,132
Cost of capital and borrowing		
Interest and service charges	**2,894,250**	2,424,747
Share dividends	**295,360**	195,948
	3,189,610	2,620,695
Financial margin	**8,607,338**	7,859,437
Other		
Commissions	**2,493,203**	2,676,994
Miscellaneous	**183,310**	170,183
	2,676,513	2,847,177
	11,283,851	10,706,614
Expenses		
Advertising and promotions	**437,070**	436,883
Amortization of property and equipment	**144,911**	185,919
Credit Union development	**15,438**	18,722
Data processing	**954,127**	900,439
Democracy	**56,286**	56,263
Dues and memberships	**5,009**	5,852
Insurance	**499,026**	475,527
Loss on disposal of property and equipment	**-**	2,334
Miscellaneous	**14,397**	14,987
Office	**320,795**	283,718
Premises	**331,909**	345,210
Professional fees	**65,397**	78,000
Provision for impaired loans	**10,012**	56,079
Service fees	**1,780,229**	2,084,132
Telephone	**54,121**	51,142
Travel	**19,501**	19,592
Wages and wage levies	**4,150,398**	3,943,815
	8,858,626	8,958,614
Income before income taxes	**2,425,225**	1,748,000
Income taxes		
Current (Note 16)	**686,663**	543,333
Deferred	**45,340**	12,555
	732,003	555,888
Net income	**$ 1,693,222**	$ 1,192,112

Notes 1 to 20 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	**$ 1,693,222**	$ 1,192,112
Items not affecting cash:		
Amortization of property and equipment	**144,911**	185,919
Deferred income taxes	**45,340**	12,555
Loss on disposal of property and equipment	**-**	2,334
	1,883,473	1,392,920
Changes in non-cash working capital:		
Investments	**19,606,842**	(13,909,060)
Accounts receivable	**5,989,549**	(1,410,118)
Prepaid expense	**8,862**	3,948
Accounts payable and accrued liabilities	**156,962**	(71,811)
Employee benefits payable	**(52,493)**	(75,448)
Accrued interest payable	**269,404**	102,618
Income taxes payable	**128,154**	(48,851)
	26,107,280	(15,408,722)
	27,990,753	(14,015,802)
Cash flows from investing activities		
Increase in member loans and mortgages, net of provision	**(51,181,134)**	(13,824,140)
Purchase of property and equipment	**(109,090)**	(42,627)
Property held for resale	**(50,000)**	37,068
	(51,340,224)	(13,829,699)
Cash flows from financing activities		
Increase in member deposits	**31,730,747**	18,880,493
Increase (decrease) in share deposits	**(2,558,551)**	3,553,664
Advances to CU PEI Investment Corp.	**(75,000)**	(601,512)
	29,097,196	21,832,645
Increase (decrease) in cash and cash equivalents	**5,747,725**	(6,012,856)
Cash and cash equivalents - beginning of year	**6,939,689**	12,952,545
Cash and cash equivalents - end of year	**$ 12,687,414**	$ 6,939,689
Cash flow supplementary information		
Interest received	**$ 11,790,820**	$ 10,412,896
Interest paid	**$ 2,724,446**	$ 2,337,951
Income taxes paid	**$ 558,509**	$ 622,412

Notes 1 to 20 are an integral part of these financial statements

1. REPORTING ENTITY

On October 1, 2013 Metro Credit Union Limited amalgamated with Stella Maris Credit Union Limited to form Provincial Credit Union Limited. On January 1, 2015 the Provincial Credit Union Limited. amalgamated with Montague Credit Union Ltd and is operating under Provincial Credit Union Limited. It is incorporated under the Companies Act of Prince Edward Island and is governed by the Prince Edward Island Credit Unions Act. Provincial Credit Union Ltd. is a member-owned financial institution whose principal business activities include financial and banking services for its members at its branches in Charlottetown, Stratford, Montague and North Rustico, Prince Edward Island.

2. BASIS OF PRESENTATION

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 19, 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 recorded at fair value through profit and loss.

4. SIGNIFICANT ACCOUNTING POLICIES

<u>Cash and cash equivalents</u>

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

<u>Investments</u>

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 fair value through profit or loss (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 period of recovery.

Loans and mortgages

Member loans and mortgages are initially measured at fair value, net of origination fees and inclusive of transaction costs incurred. Member loans and mortgages are subsequently measured at amortized cost, using the effective interest rate method, less any impairment losses.

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 (ie. 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 cash flows

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 judgments 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 allowance covers 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 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).

<u>Deferred income taxes</u>

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.

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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 allows 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:

Buildings	5%
Equipment	20%
ATMs	10%
Computer hardware	30%, 45% and 55%
Pavement	8%
Computer software	100%

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

Finance charges

The Credit Union periodically purchases mortgages from Concentra Financial, Omista Credit Union and League Savings and Mortgage. Generally a premium is paid for the mortgages purchased, calculated by reference to the interest rate inherent in the mortgages and the rate of interest in effect at the time of purchase. The premium paid is amortized using the straight-line method over the life of the mortgage purchase plan and is netted to the applicable mortgage asset.

Property held for resale

Property held for resale is carried at the market value of the loan or mortgage foreclosed, adjusted for estimates of revenues to be received and costs to be incurred subsequent to foreclosure, and the estimated net proceeds from the sale of the assets.

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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 period, the contributions by the Credit Union to the defined contribution pension plan were $244,214 (2017 - $233,511).

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 0.7% (2017 - 0.5%) 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.

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.

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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 the statement of profit and 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 period 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 net income.

Use of judgments 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 judgment 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.

(continues)

4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

The areas involving a high degree of judgment 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 expected credit losses, 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 is charged or cancelled, or expire.

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.

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4. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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

Member loans and mortgage, member and share deposits, accounts receivable, accounts payable and accrued liabilities - amortized cost

Changes in accounting standards

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	**$ 9,872,618**	$ 4,490,889
Cash on hand	**2,814,796**	2,448,800
	$ 12,687,414	$ 6,939,689

6. INVESTMENTS

	2018	2017
Shares		
Atlantic Central Credit Union Limited - common shares	**$ 3,206,740**	$ 2,935,370
Atlantic Central Credit Union Limited - Class B preferred shares	**821,400**	821,400
Atlantic Central Credit Union Limited - Class LSM Shares	**416,603**	416,603
Concentra Financial - Class D preferred shares	**250,000**	250,000
League Data - 10.034 Class B Preferred Shares	**100,340**	100,340
Atlantic Central Credit Union Limited - Class PEI shares	**2,400**	2,400
Concentra shares	**1,020**	10
CU PEI Investment Corp. - 2,000 Class A common shares, 25 Class B common shares, and 1,510 class A preferred shares	**60**	60
	4,798,563	4,526,183
Debentures		
Atlantic Central Credit Union Limited liquidity - 1.75%	**22,965,328**	21,259,551
Concentra Financial - 2.15%; matures June 14, 2019	**5,000,000**	-
Concentra Financial - 2%; matures April 30, 2019	**3,500,000**	-
Concentra Financial - 1.87%; matures January 16, 2019	**3,000,000**	5,085,000
Concentra Financial - 1.89%; matures January 7, 2019	**1,000,000**	1,000,000
Concentra Financial - 1.78%; matured October 17, 2018	**-**	4,000,000
Concentra Financial - 1.75%; matured August 7, 2018	**-**	5,000,000
Concentra Financial - 1.65%; matured May 4, 2018	**-**	5,000,000
Concentra Financial - 1.72%; matured November 19, 2018	**-**	4,000,000
Concentra Financial - 1.50%; matured February 5, 2018	**-**	3,000,000
Atlantic Central Credit Union Limited - 1.28%; matured February 5, 2018	**-**	2,000,000
Concentra Financial - 1.3%; matured March 19, 2018	**-**	5,000,000
	35,465,328	55,344,551
	$ 40,263,891	$ 59,870,734

The credit union shall maintain sufficient liquid assets to meet its obligations as they come due. As prescribed in the Credit Union Regulations, Section 2, the credit union shall maintain liquid assets of not less than 10% of the total amount of member deposits in and borrowings of the credit union as follows: 9% shall be invested in eligible financial instruments of Atlantic Central; 6% of assets, or other such amount as may be determined by Central from time to time, shall be maintained in the segregated liquidity account. The remainder will be invested in: current account, cash management account, and term deposits that have a remaining term to maturity of not more than one year.

7. ACCOUNTS RECEIVABLE

	2018	2017
Miscellaneous receivables	**$ 1,689,074**	$ 7,495,850
Accrued interest - loans and mortgages	**636,226**	683,732
Accrued interest - investments	**57,900**	193,167
	$ 2,383,200	$ 8,372,749

8. MEMBER LOANS AND MORTGAGES

2018	Total loans	Loan allowance	Net loans
Mortgages	$115,582,663	$ (96,048)	$115,486,615
Commercial	121,870,611	(37,469)	121,833,142
Concentra mortgage syndication	25,436,518	(2,299)	25,434,219
Indirect auto	16,396,961	(68,871)	16,328,090
Lines of credit and overdrafts	16,932,656	(102,559)	16,830,097
Personal	7,412,180	(16,106)	7,396,074
Farming and fishing	8,970,132	-	8,970,132
League Savings & Mortgage high ratio mortgages	1,973,680	-	1,973,680
Omista mortgage pool	1,873,184	-	1,873,184
	$316,448,585	$ (323,352)	$316,125,233

2017	Total loans	Loan allowance	Net loans
Mortgages	$102,070,393	$ (118,095)	$101,952,298
Commercial	87,960,188	(40,526)	87,919,662
Concentra mortgage syndication	23,906,589	(17,791)	23,888,798
Indirect auto	16,545,151	(34,324)	16,510,827
Lines of credit and overdrafts	13,881,665	(140,863)	13,740,802
Personal	7,926,888	(32,602)	7,894,286
Farming and fishing	8,450,657	-	8,450,657
League Savings & Mortgage high ratio mortgages	2,517,131	-	2,517,131
Omista mortgage pool	2,069,637	-	2,069,637
	$265,328,299	$ (384,201)	$264,944,098

9. PROVISION FOR IMPAIRED LOANS

	2018	2017
Provision for impaired loans - beginning of year	$ 384,201	$ 377,531
Provision for impaired loans	10,012	56,079
Recovery of loans written off	44,524	40,540
Loans written off - current year	(115,385)	(89,949)
Provision for impaired loans - end of year	$ 323,352	$ 384,201

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	$ 286,984	$ 199,217
61 to 90 days	57,822	240
91 to 180 days	13,707	723
Over 180 days	1,596	-
	$ 360,109	$ 200,180

11. DEFERRED TAX ASSET

Deferred income taxes reflects 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 assets are as follows:

	2018	2017
Property and equipment	$ 118,111	$ 128,686
Retirement allowance	156,393	191,158
	$ 274,504	$ 319,844

12. DUE FROM CU PEI INVESTMENT CORP.

Provincial Credit Union Limited owns Class A and B common shares of CU PEI Investment Corp. The amount due from CU PEI Investment Corp. bears interest at 1% and there are no set terms of repayment. Interest earned on the investment during the year was $26,981 (2017 - $24,213).

13. MEMBER DEPOSITS

	2018	2017
Chequing accounts	**$ 98,869,112**	$ 87,414,990
Call deposits	**56,996,915**	36,138,515
Term deposits	**52,081,155**	55,950,374
Registered Retirement Savings Plan (RRSP) deposits	**41,234,140**	44,006,613
Tax Free Savings Account (TFSA) deposits	**31,559,256**	27,134,317
Registered Retirement Income Fund (RRIF) deposits	**18,969,185**	17,334,207
	$299,709,763	$267,979,016

14. CONTINGENT LIABILITIES

Provincial Credit Union Limited has provided letters of credit on behalf of members in the amount of $247,553.

15. MEMBERS' SHARES

	Number of shares	December 31 2018	Number of shares	December 31 2017
Balance - beginning of year	**15,164**	**$ 75,820**	15,502	$ 77,510
Shares issued (redeemed), net	**(288)**	**(1,440)**	(338)	(1,690)
Balance - end of year	**14,876**	**$ 74,380**	15,164	$ 75,820

16. INCOME TAXES

The income tax provision recorded differs from the income tax obtained by applying the statutory income tax rate of 31.05% (2017 - 31.00%) to the income for the year and is reconciled as follows:

	2018	2017
Income before income taxes	**$ 2,425,225**	$ 1,748,000
Income tax expense at the combined basic federal and provincial tax rate:	**$ 753,032**	$ 541,880
Increase (decrease) resulting from:		
Financial statement loss in excess of taxable loss	**-**	724
Capital cost allowance claimed in excess of amortization	**(10,591)**	(2,396)
Dividends	**(19,018)**	-
Non-deductible expenses	**(17,867)**	1,058
Provision for loan loss reserve	**3,109**	17,384
Recovery of loans previously written off	**13,825**	12,567
Loans written off in the current year	**(35,827)**	(27,884)
Effective tax expense	**$ 686,663**	$ 543,333

The effective income tax rate is 28.31% (2017 - 31.08%).

17. LINE OF CREDIT AVAILABILITY

Provincial Credit Union Limited has an approved line of credit with Atlantic Central Credit Union Limited for $8,600,000 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 less 0.5% and is secured by a general security agreement.

18. RELATED PARTY TRANSACTIONS

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

Key management personnel include the CEO and other senior officers of the Credit Union. The components of total compensation received by key management personnel and balances due to and from key management personnel including only non-joint accounts are as follows:

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18. RELATED PARTY TRANSACTIONS *(continued)*

	2018	2017
Short-term employee benefits	**$ 1,101,495**	$ 1,154,509
Contributions to a retirement pension plan	**55,739**	59,664
Mortgages, loan balances, and lines of credit due from key management at December 31	**21,412**	135,053
Deposit balances due to key management at December 31	**163,662**	132,475

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.

19. 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.

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.

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19. RISK MANAGEMENT *(continued)*

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 take possession of collateral held as security against loans and advances and sold assets for $24,600.

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 judgment. 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.

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 expected credit loss. 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.

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19. RISK MANAGEMENT *(continued)*

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.

(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.

20. CAPITAL MANAGEMENT

Provincial 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 CEO and lending personnel within the established parameters. Total lending activities managed by the Credit Union at December 31, 2018 amounted to $316,448,585 (2017 - $265,328,299).

Consistent with other Prince Edward Island Credit Unions, Provincial 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 year plus the operating surplus in the current year and members' shares, divided by the total assets of the Credit Union.

	2018	2017
Undistributed earnings	**$ 33,684,498**	$ 31,991,276
Members' shares	**74,380**	75,820
Total regulatory equity	**33,758,878**	32,067,096
Total assets	**377,330,172**	345,962,726
	8.95 %	9.27 %

Credit Union bylaws require Provincial 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	**$377,330,172**	$345,962,726
Liquid assets	**55,334,504**	75,183,173
	14.66 %	21.73 %

PROVINCIAL CREDIT UNION LIMITED
Schedules to Financial Statements **(Schedule 1)**
Statement of Property and Equipment
Year Ended December 31, 2018

	Cost beginning of year	Additions	Disposals	Cost end of year	Amort beginning in year	Amort in year	Disposals	Amort end of year	NBV Dec 31, 2018	NBV Dec 31, 2017
Land	$ 685,431	$ -	$ -	$ 685,431	$ -	$ -	$ -	$ -	$ 685,431	$ 685,431
Buildings	3,976,113	-	-	3,976,113	2,207,024	88,454	-	2,295,478	1,680,635	1,769,089
Equipment	1,803,479	16,043	-	1,819,521	1,632,023	35,896	-	1,667,919	151,603	171,456
ATMs	618,105	93,047	180,448	530,704	568,973	12,412	(180,448)	400,937	129,767	49,132
Computer hardware	797,055	-	-	797,055	787,841	4,592	-	792,433	4,622	9,214
Pavement	83,480	-	-	83,480	39,039	3,556	-	42,595	40,885	44,441
Computer software	35,263	-	-	35,263	35,263	-	-	35,263	-	-
	$7,998,926	$ 109,090	$ 180,448	$7,927,567	$5,270,163	$ 144,910	$ (180,448)	$5,234,625	$2,692,943	$2,728,763

Notes 1 - 20 are an integral part of these 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	$ 111,111	$ -	$ -	$ 12,576,303	$ 12,687,414
Effective interest rate	1.57 %	- %	- %	- %	
Investments	35,465,327	-	-	4,798,564	40,263,891
Effective interest rate	1.85 %	- %	- %	- %	
Accounts receivable	-	-	-	2,383,200	2,383,200
Personal and commerical loans and mortgages	78,612,389	223,668,626	5,125,527	427,878	307,834,420
Effective interest rate	4.01 %	3.77 %	4.92 %	- %	
Lines of credit and overdrafts	8,290,813	-	-	-	8,290,813
Effective interest rate	6.71 %	- %	- %	- %	
Prepaid expense	-	-	-	176,988	176,988
Deferred tax asset	-	-	-	274,504	274,504
Property and equipment	-	-	-	2,692,943	2,692,943
Due from CU PEI Investment Corp.	2,675,999	-	-	-	2,675,999
Effective interest rate	1.00 %	- %	- %	- %	
Property held for resale	-	-	-	50,000	50,000
	$125,155,639	$223,668,626	$ 5,125,527	$ 23,380,380	$377,330,172
LIABILITIES AND MEMBERS' EQUITY					
Accounts payable and accrued liabilities	$ -	$ -	$ -	$ 424,258	$ 424,258
Employee benefits payable	-	-	-	1,094,823	1,094,823
Accrued interest payable	-	-	-	1,651,223	1,651,223
Income taxes payable	-	-	-	143,330	143,330
Member deposits	138,011,163	64,191,752	-	97,506,848	299,709,763
Effective interest rate	1.26 %	2.10 %	- %	- %	
Share deposits	40,547,897	-	-	-	40,547,897
Effective interest rate	0.70 %	- %	- %	- %	
Members' shares	74,380	-	-	-	74,380
Effective interest rate	0.70 %	- %	- %	- %	
Undistributed earnings	-	-	-	33,684,498	33,684,498
	$178,633,440	$ 64,191,752	$ -	$134,504,980	$377,330,172

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, personal and commerical loans and mortgages are shown at contractual maturity but could prepay earlier.

As at December 31, 2018, Provincial Credit Union Limited's net interest spread was 2.08%. 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 - 20 are an integral part of these financial statements

CREDIT UNION

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