



BC FINANCIAL  
SERVICES AUTHORITY

# Reporting Instructions: Capital Adequacy Return

B.C. Credit Unions

Effective April 2022

## Table of Contents

1	Introduction .....	2
1.1	Annual CAR Audit Expectations .....	2
2	Capital Adequacy Return (“CAR”) .....	2
2.1	Section 6000 – Capital Adequacy Ratio .....	2
2.2	Section 6010 – Capital Base .....	3
2.2.1	Primary Capital.....	3
2.2.2	Secondary Capital.....	5
2.2.3	Deductions from Capital .....	7
2.2.4	Calculation of Capital Base.....	10
2.2.5	Capital Items Subject to Discounting .....	10
2.3	Section 6020 – Balance Sheet Assets.....	11
2.3.1	Cash and Investments .....	11
2.3.2	Loans and Leases.....	13
2.3.3	Other Assets.....	18
2.4	Section 6030 – Off Balance Sheet Exposures.....	20
2.5	Section 6040 – Derivatives.....	24
2.6	Section 6050 – Concentration Risk Adjustments.....	25
2.7	Appendix 1 .....	27
2.7.1	CAR Audit Expectations.....	27
2.7.2	Sample Independent Auditor’s Report .....	30
2.8	Appendix 2 .....	31

## 1 Introduction

These reporting instructions provide guidance to B.C. credit unions (not including central credit unions) for reporting the Capital Adequacy Return (“CAR”) to the Superintendent of Financial Institutions at BC Financial Services Authority (“BCFSA”), as required by the *Financial Institutions Act* (“FIA”) and its Capital Requirements Regulation (“CRR”).

### 1.1 Annual CAR Audit Expectations

Credit unions are expected to submit an independent auditor’s report on the annual CAR within 90 days of the credit union’s fiscal year end. The audit report of the annual CAR must be prepared separately from the credit union’s annual audit report on the financial statements, by the same auditor engaged to do the latter. See Appendix 1 for details on the annual CAR audit expectations and a sample auditor’s report.

## 2 Capital Adequacy Return (“CAR”)

### 2.1 Section 6000 – Capital Adequacy Ratio

*Line 6000-100: Capital Base* is the sum of capital items (primary and secondary capital) after applying discounts, less deductions from capital as specified by the CRR and reported in Section 6010.

Total Risk-Weighted Assets (“RWA”) includes:

- *Line 6000-110: Risk-Weighted Balance Sheet Assets*, as specified by the CRR and reported in Section 6020;
- *Line 6000-120: Risk-Weighted Off Balance Sheet Exposures*, as determined by reference to the Capital Adequacy Requirements Guideline established by the Office of the Superintendent of Financial Institutions (“OSFI”) and reported in Section 6030;
- *Line 6000-130: Risk-Weighted Derivatives*, as determined by reference to the Capital Adequacy Requirements Guideline established by OSFI and reported in Section 6040; and
- *Line 6000-140: Concentration Risk Adjustments*, as specified by the CRR and reported in Section 6050.

*Line 6000-200: Capital Adequacy Ratio*

The formula for the calculation of the Capital Adequacy Ratio is as follows:

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital Base}}{\text{Total Risk Weighted Assets (RWA)}}$$

## 2.2 Section 6010 – Capital Base

Capital included in the capital base must have the following fundamental characteristics:

- permanent;
- free of fixed charges against earnings (i.e., there is no obligation to pay dividends or patronage allocations); and
- subordinate in its priority on liquidation to the rights of depositors and other creditors of the credit union.

Capital components are either primary capital or secondary capital, depending on the fundamental characteristics. Total secondary capital eligible for inclusion in the capital base cannot be more than total primary capital. Some capital items will be discounted. Other items are deducted from total capital to arrive at the capital base.

### 2.2.1 Primary Capital

#### Equity Shares – Primary Capital

Classes of equity shares that meet the following criteria (equity shares with no redemption rights or equity shares with limited redemption rights) qualify as primary capital:

- *equity shares with no redemption rights*
  - the shares have no right of redemption;
  - there is no contractual obligation to pay dividends; or
  - there is no priority over other classes of equity shares on payment of dividends.
- *equity shares with limited redemption rights*
  - any right to dividends is non-cumulative;
  - redemption rights attached to the shares are such that the credit union is not required to redeem, purchase, or otherwise acquire the shares of this class at the rate of more than 10% of issued and outstanding shares during any one year period (e.g., the credit union's rules enable the credit union to limit redemption at the board of director's discretion, to an amount no more than 10% of the issued and outstanding shares in any one year, and the membership does not have the right to require redemption over 10%); and
  - the shares may only be converted to other shares that would qualify as primary capital.

Equity Shares – Primary Capital include the following shares (whether active, dormant or inactive), that qualify as primary capital:

*Line 6010-100: Membership Shares*

*Line 6010-110: Investment Shares*

*Line 6010-120: Transaction Shares*

*Line 6010-130: Preferred Shares*

*Line 6010-140: All Other Equity Shares.*

The amount of equity shares included in the capital base is discounted if there is a fixed date for repayment or redemption. See instructions in the Capital Items Subject to Discounting section.

#### [Line 6010-150: CUDIC/SCCU Subordinated Debt](#)

Subordinated debt owed to the Credit Union Deposit Insurance Corporation of British Columbia (“CUDIC”) or Stabilization Central Credit Union of British Columbia (“SCCU”).

The amount eligible for inclusion in the capital base is subject to discounting if there is a fixed date for repayment or redemption. See instructions in the Capital Items Subject to Discounting section.

#### [Line 6010-160: Credit Union’s Retained Earnings \(Deficit\)](#)

The credit union’s retained earnings (deficit) must be adjusted by applying the equity method of accounting (see text box) for all equity investments representing 10% or greater ownership. This adjustment must be calculated for each investment that represents a 10% or greater share of ownership or control in a corporation – except a corporation that carries on the business of banking, insurance business (other than an insurance agent or insurance adjuster), trust business, deposit business, or brokerage or securities dealer/underwriter.

##### ***Equity Method of Accounting***

A simplified explanation of the equity method of accounting is given here. Other adjustments may be required. It is recommended that credit unions discuss the matter with their auditors.

If such an investment is valued on the books of the credit union using the equity method of accounting, then no adjustment is necessary. Otherwise, an adjustment must be calculated.

Under the equity method of accounting, the credit union initially records its investment in the subsidiary at the original cost of the investment. The recorded value of the investment is then adjusted to include the credit union’s pro-rata share of the net income earned (or losses incurred) by the subsidiary since the date of the acquisition, less goodwill and intangible assets impairment/amortization and dividends received from the subsidiary.

The credit union’s share of losses of each subsidiary is recognized to the extent of the value of the equity investment only, thus not to create a negative balance on the equity investment.

Credit unions with investments in subsidiaries are required to ensure that all asset and liability values of those subsidiaries are determined in accordance with the International Financial Reporting Standards (“IFRS”) for each reporting period; and that any impairment in values is properly reflected in investment carrying values.

**Equity Method of Accounting (cont'd)**

The value of the investment using the equity method of accounting and the adjustment are calculated as follows:

Acquisition cost .....	\$XXX
Add: Post-acquisition pro-rata share of net income (loss), including other impairment losses of the subsidiary at the reporting date .....	XXX
Less: Goodwill and intangible assets impairment/amortization .....	(XXX)
Less: Dividends received from subsidiary .....	(XXX)
Value of Equity Investment .....	XXX
Less: Book value (according to credit union's records) .....	(XXX)
Adjustment to retained earnings .....	<u>\$XXX</u>

Line 6010-170: Deferred Income Tax (Assets)/Liabilities

Deferred income tax resulting from differences between taxable and accounting income.

Deferred income tax assets are to be deducted from capital, and deferred income tax liabilities are to be added to capital. If the credit union has both on the balance sheet, a net debit balance must be deducted from capital and a net credit balance is added to capital.

Line 6010-180: Contributed Surplus

Contributed surplus from share capital transactions and business combinations.

Line 6010-190: Other Primary Capital

Reserves, not being held for future or potential claims and losses, and other primary capital not reported on other lines in the Primary Capital section.

Line 6010-200: Dividends to Be Paid as Primary Capital

Accrued but unpaid patronage refunds and dividends on non-equity shares, primary capital, and secondary capital that will be paid in the form of equity shares that qualify as primary capital.

**2.2.2 Secondary Capital**Line 6010-300: Proportion of System Retained Earnings x 50%

Half (50%) of the credit union's proportionate share of the retained earnings of Central 1 Credit Union ("Central 1"), SCCU, and CUDIC is eligible to include in the capital base as secondary capital.

The proportionate share is based on the credit union's total assets in relation to the credit union system's total assets, as reported in the credit unions' Financial and Statistical Return ("FSR"). BCFSa will provide this amount to credit unions.

### Equity Shares – Secondary Capital

All classes of equity shares that do not qualify as primary capital (whether active, dormant or inactive):

*Line 6010-310: Investment Shares*

*Line 6010-320: Transaction Shares*

*Line 6010-330: Preferred Shares*

*Line 6010-340: All Other Equity Shares*, including partner equity shares, which do not qualify as primary capital.

Equity shares eligible for inclusion in the capital base is discounted if there is a fixed date for repayment or redemption. See instructions in the Capital Items Subject to Discounting section.

### Line 6010-350: Other Debt Capital

Debt capital owed to parties other than CUDIC or SCCU.

To be included in capital, debt capital must meet the following requirements:

- the credit union is not required to repay, redeem, purchase, or otherwise acquire all or part of the debt prior to maturity; and
- the debt is not convertible into or exchangeable into a security instrument that does not qualify as capital.

If there is a fixed date for repayment or redemption of the debt, the amount included in the capital base is discounted. See instructions in the Capital Items Subject to Discounting section.

### Line 6010-360: Other Secondary Capital

Other secondary capital not reported on other lines in the Secondary Capital section.

### Line 6010-370: Dividends to Be Paid as Secondary Capital

All accrued but unpaid patronage refunds and dividends on non-equity shares, primary capital, and secondary capital that will be paid in the form of equity shares that qualify as secondary capital.

### Line 6010-390: Total Eligible Secondary Capital

The total secondary capital eligible for inclusion in the capital base is limited to an amount equal to the total primary capital.

Total Eligible Secondary Capital is the lesser of

- the Total Secondary Capital; or
- the Total Primary Capital.

### 2.2.3 Deductions from Capital

#### Line 6010-400: Goodwill and Intangible Assets (Credit Union)

Deductions from capital for goodwill and intangible assets are set out in the CRR. To determine the required deduction from capital, the current book value of goodwill and intangible assets must be compared with the maximum unamortized balance permitted by the CRR.

Note: The maximum amortization periods as set out in the CRR to determine the deductions from capital are for capital calculation purposes only, and an accounting change is not required in the credit union's books.

Goodwill and intangible assets (in the credit union's books) are to be deducted immediately to the full extent.

The following examples are provided for clarity (see text boxes).

#### **Example 1: Deduction from Capital – Software**

This example outlines a deduction from capital calculation for a credit union that has intangible assets to be deducted immediately to the full extent.

The credit union purchased computer software on January 1, 2020, for \$500,000 and the software has a definite useful life of 5 years. The software will be amortized on the credit union's books over 5 years.

#### **Per Regulation:**

Unamortized software – January 1, 2020 .....	\$500,000
As at December 31, 2021:	
Minimum software amort. ( $\$500,000 \times 100\%$ ) ....	\$500,000
Maximum unamortized software .....	$(\$500,000 - \$500,000)$ ..... \$0

#### **Per Credit Union Books:**

Unamortized software – January 1, 2020.....	\$500,000
divided by.....	5 years
Amortization per year .....	\$100,000
As at December 31, 2021:	
Software amort. ( $\$100,000 \times 2$ years) .....	\$200,000
Unamortized software .....	$(\$500,000 - \$200,000)$ ..... <u>\$300,000</u>

**Deduction from Capital – 2021**

**\$300,000**



**Example 2: Deduction from Capital – Software**

This example uses the same assumptions as in Example 1, except the software is determined to have an indefinite useful life. The software will not be amortized until its life is determined to be no longer indefinite.

**Per Regulation:**

Maximum unamortized software ..... (\$500,000 - \$500,000) ..... \$0

**Per Credit Union Books:**

No impairment loss was recognized during the period.

Fair value of software – December 31, 2021 ..... \$500,000

**Deduction from Capital – 2021** **\$500,000**

**Line 6010-410: Goodwill and Intangible Assets (Included in Equity Investments)**

Goodwill and intangible assets included in the carrying value of an investment in another entity (using the equity method of accounting) are to be deducted on a straight-line basis over a maximum of 5 years.

These types of goodwill and intangible assets would commonly apply to the credit union's subsidiary companies (e.g., insurance agencies).

The following example is provided for clarity (see text box).

**Example 3: Deduction from Capital – Goodwill**

This example outlines a deduction from capital calculation for a credit union that has an equity investment (valued under the equity method of accounting) in a wholly owned insurance agency subsidiary, and goodwill (acquired on January 1, 2018) is included in the carrying value of the investment:

**Per Regulation:**

Unamortized goodwill – January 1, 2018 ..... \$450,000

divided by ..... 5 years

Minimum amortization per year ..... \$90,000

As at December 31, 2021:

Minimum goodwill amort. (\$90,000 x 4 years) ... \$360,000

Maximum unamortized goodwill ..... (\$450,000 - \$360,000) ..... \$90,000

**Per Credit Union Books:**

Fair value of goodwill – December 31, 2021:

Fair value of goodwill – January 1, 2021 ..... \$350,000

Less: Goodwill impairment loss – 2021 ..... \$37,500 ..... \$312,500

**Deduction from Capital – 2021** **\$222,500**

[Line 6010-420: Investment – Banks, Trust, or Deposit Business](#)

Investments of 10% or more in the shares of a corporation that carries on banking, trust, or deposit business (plus investments in the debt of such a corporation that qualifies as a capital item) must be deducted from capital to the extent of an amount that is at least equal to the amount that constitutes an adequate capital base for such corporation.

A cooperative credit society or society as defined in the *Cooperative Credit Associations Act* (Canada), or a central credit union is not considered here as a trust or a deposit business.

[Line 6010-430: Investment – Insurance Business, Venture Capital Corporations, etc.](#)

Investments of 10% or more in the shares of a corporation that carries on an insurance or venture capital business (plus investments in the debt of such a corporation that qualifies as a capital item) must be deducted from capital.

*Insurance business* does not include an insurance agency or insurance adjuster. *Venture capital corporations* are defined in the FIA section 141. They include corporations whose activities are limited to providing corporate debt and equity financing, and financial and management consulting services to other corporations in which the venture capital corporation has a financial interest or is contemplating acquiring a financial interest.

Note: Investments in Credential Securities Inc. subordinated debentures must be included here.

[Line 6010-440: Excess Investment in Prescribed Businesses](#)

The aggregate amount of investments of 10% or more in the shares of a corporation which carries on business activities detailed in sections 6.2(1)(e) and (f) of the Investment and Lending Regulation and section 141(2)(c) of the FIA (plus investments in the debt of such corporations that qualifies as a capital item) which exceeds 2% of the credit union's total assets must be deducted from capital.

***Prescribed Business Activities in the Investment and Lending Regulation***

The following are the prescribed business activities listed in sections 6.2(1)(e) and (f) of the Investment and Lending Regulation:

- mutual fund investment;
- investment counseling;
- portfolio management;
- issuing and operation of credit cards and related services;
- real property acquisition, holding, development, selling or management;
- factoring;
- financial leasing;
- data processing or information services/systems;
- business management and advisory services;
- business of a financial agent;
- sale of tickets (lottery, transit or other); and
- acting as agent.

**Section 141(2)(c) of the FIA**

Section 141(2)(c) of the FIA refers to the investment in any corporation that carries on a business reasonably ancillary to the business of a financial institution, and which has received prior written consent of the Authority.

Line 6010-450: Other Deductions from Capital

Deductions from capital not reported on other lines in the Deductions from Capital section. Include the initial fair value gains or losses on the credit union's own use property.

Fair value gains or losses from the initial revaluation of the credit union's own use property upon transition to IFRS are to be deducted from regulatory capital, as these assets are not easily sold without disrupting the operations of the credit union. No adjustment to capital is required for subsequent revaluation gains that are in other comprehensive income, since accumulated other comprehensive income is not included in capital.

**2.2.4 Calculation of Capital Base**

*Line 6010-500: Total Capital Available* equals Total Primary Capital plus Total Eligible Secondary Capital minus Total Deductions from Capital.

*Line 6010-520: Total Capital Base* is the lesser of

- the Total Capital Available; or
- the Credit Union's Retained Earnings (including Contributed Surplus) divided by 35%.

**2.2.5 Capital Items Subject to Discounting**

The following capital items (including related accrued interest, unpaid cumulative dividends, and declared dividends) must be discounted if they have a fixed date for repayment or redemption:

- Equity Shares;
- CUDIC/SCCU Subordinated Debt; and
- Other Debt Capital.

To calculate the discount, multiply the gross amount by the appropriate discount percentage from the following table.

Years to date of repayment, redemption, purchase, or other acquisition	Discount	Proportion to be included in capital base
5 or more, or no specified date of redemption, purchase, or other acquisition	Nil	100%
4 or more, but less than 5	20%	80%
3 or more, but less than 4	40%	60%
2 or more, but less than 3	60%	40%

Years to date of repayment, redemption, purchase, or other acquisition	Discount	Proportion to be included in capital base
1 or more, but less than 2	80%	20%
Less than 1	100%	0%

## 2.3 Section 6020 – Balance Sheet Assets

Report the unweighted amounts. Risk-weighted amounts for on balance sheet assets are calculated by multiplying the unweighted amount by the risk-weighting factor.

The template uses predefined risk-weighting factors to calculate the risk-weighted amounts. For further details, risk-weighting factors are listed in the Table of On Balance Sheet Items in Appendix 2.

### 2.3.1 Cash and Investments

Amounts include accrued interest and are reported net of allowances for credit losses or impairment on the following lines. Liquid assets held in trust with Central 1, as statutory liquidity, should be reported on the appropriate lines in this section together with other liquid assets in the credit union's books.

#### [Line 6020-100: Cash](#)

Include cash on hand (cash that is physically on the premises of the credit union), cash in transit, cash in ATMs, and foreign currency held (valued at the current exchange rate).

#### [Line 6020-110: Central 1 Deposits](#)

Deposits held with Central 1, including the operating account.

#### [Line 6020-120: Deposits with Deposit Taking Institutions](#)

Demand and term deposits held with a deposit taking institution, central bank, or federally or provincially chartered trust company. This line does not include deposits with Central 1. Also include cash deposits held in trust with Central 1.

#### [Line 6020-130: Guaranteed Security Instruments](#)

Federal, provincial, and municipal securities, such as Treasury Bills and marketable bonds held by the credit union, debt securities of crown corporations and other government entities that are guaranteed unconditionally as to principal and interest.

#### [Debt Security Instruments](#)

##### *Line 6020-140: Financial Institutions*

Debt security instruments (other than subordinated debt security instruments) that are issued or guaranteed by a bank, financial institution, or extra-provincial corporation (e.g., bankers' acceptances, loans to banks, financial institutions, and extra-provincial corporations). This line does not include commercial paper.

*Line 6020-150: Other Debt Securities*

Corporate bonds and other debt securities not issued or guaranteed by a bank, financial institution, or extra-provincial corporation. This line does not include commercial paper.

Commercial Paper

Commercial paper is risk weighted based on Dominion Bond Rating Service (“DBRS”) rating or equivalent, and reported on the following lines:

*Line 6020-160: AAA to AA (low) or R1 (high)*

*Line 6020-170: A (high) to A (low) or R1 (middle)*

*Line 6020-180: BBB (high) to BB (low) or R1 (low) to R2 (low)/Unrated*

*Line 6020-190: Below BB (low) or Below R2 (low).*

Securities Secured by Mortgages

*Line 6020-200: Guaranteed by CMHC*

Securities that are secured by mortgages and guaranteed by the Canada Mortgage and Housing Corporation (“CMHC”), including the *National Housing Act* Mortgage Backed Securities (“NHA MBS”) and Canada Mortgage Bonds (“CMB”).

*Line 6020-210: All Other Securities Secured by Mortgages*

Securities that are secured by mortgages and not guaranteed by CMHC.

Line 6020-220: Equity Instruments

Common and preferred shares, and other equity instruments. This line does not include equity shares of Central 1 and SCCU.

Line 6020-230: Credit Union Centrals Equity Shares and CUDIC Debentures

The credit union’s investments in equity shares of Central 1 and SCCU plus any accrued dividends on these shares. Also include investments in CUDIC debentures.

Line 6020-240: CMB Principal and Interest Reinvestment

Eligible reinvestment assets held in principal and interest reinvestment accounts, as required under the CMB program.

Line 6020-250: All Other Investments

Other deposits and investments not reported on other lines in the Cash and Investments section.

### 2.3.2 Loans and Leases

The CRR defines residential mortgage, farm mortgage, as well as commercial loan and commercial lease (see text box).

#### **Definitions of Loans and Leases in the Capital Requirements Regulation**

The Capital Requirements Regulation defines:

- a *residential mortgage* as “a loan to an individual secured by a mortgage on land or on the lessee’s interest in a lease of land on which land, in either case, there are one or more buildings that are used or will be used, to the extent of at least 80% of the floor space, for residential purposes and
  - (a) that are owner occupied or are intended to be owner occupied and are ready for occupancy,
  - (b) that are under construction and are intended to be occupied by the borrower on completion, or
  - (c) that are residential rental dwellings, consisting of not more than 4 units, ready for occupancy, and includes
  - (d) a loan to an individual secured by a mortgage on a hobby farm or on a recreational property or on the lessee’s interest in a lease on either”
- a *farm mortgage* as “a loan secured by a mortgage on farmland, owned by an individual who is a farmer whose residence is on the land”
- a *commercial loan* as
  - “(a) a loan to an individual
    - (i) to finance commercial activity or a commercial investment, or
    - (ii) dependent on commercial sources for its repayment,
 other than a loan for the purchase of securities or for the operation of a small business so long as the debt can be serviced from independent employment income,
  - (b) a loan to an entity, partnership or joint venture for any purpose, or
  - (c) accounts receivable acquired in the course of factoring,
 but does not include
  - (d) a residential mortgage,
  - (e) a farm mortgage,
  - (f) a loan that under section 5(1)(b) must be deducted from the capital base of the lender if the lender is a credit union, or
  - (g) loans itemized in items 10 to 14 in Column 1 in the Table of On Balance Sheet Items”
- a *commercial lease* as
  - “(a) a lease made to an individual for a commercial activity, or
  - (b) a lease made to an entity, partnership or joint venture for any purpose”

Amounts include accrued interest and are reported net of allowances for credit losses on the following lines.

### Real Estate Secured – Insured

*Line 6020-300: Residential* includes:

- personal loans and lines of credit that are fully secured by mortgages on land and that have been approved or insured under the *National Housing Act (Canada)* (“NHA”) or by an insurer authorized to conduct mortgage insurance business under the NHA to the extent that such loans are guaranteed by the Government of Canada; and
- personal insured securitizations originated by the credit union that do not meet IFRS de-recognition criteria.

Where a mortgage is comprehensive-insured by a private sector mortgage insurer, the credit union may recognize the risk-weighting effect of the guarantee by reporting the portion of the exposure that is covered by the Government of Canada backstop, as if this portion were directly guaranteed by the Government of Canada. The remainder of the exposure must be treated as an uninsured mortgage and reported on the appropriate line.

*Line 6020-310: Commercial* includes:

- commercial loans and lines of credit that are fully secured by mortgages on land and that have been approved or insured under the *National Housing Act (Canada)* (“NHA”) or by an insurer authorized to conduct mortgage insurance business under the NHA to the extent that such loans are guaranteed by Government of Canada; and
- commercial insured securitizations originated by the credit union that do not meet IFRS de-recognition criteria.

### Personal – Real Estate Secured – Uninsured – Residential ≤ 75% of FMV

Uninsured residential mortgage loans, including

- farm mortgage loans, where the outstanding balance on each loan is 75% or less of the fair market value (“FMV”) of the property;
- uninsured residential mortgage secured lines of credit, where the authorized limit on each line of credit is 75% or less of the FMV of the property;
- certificate of title loans, interim construction mortgage financing on residential property where the outstanding balance is 75% or less of the FMV of the property; and
- personal uninsured securitizations originated by the credit union that do not meet IFRS de-recognition criteria and where the outstanding balance is 75% or less of the FMV of the property.

The FMV must be at the date of mortgage origination unless an adjustment is permitted. An adjustment to the FMV is permitted at the addition of a new mortgage on the property, mortgage renewal, mortgage blend and extend, and mortgage re-advancement. The FMV and permitted FMV adjustments must be supported by an appraisal or other objective evidence of value.

The percentage of FMV, or loan to value (“LTV”) ratio, calculation must include all loans and lines of credit secured on the same property. The following example is provided for clarity (see text box).

**Example: LTV Ratio Calculation**

If a property with FMV of \$500,000 supports an uninsured mortgage of \$200,000, and a line of credit with outstanding balance of \$50,000 and authorized limit of \$100,000, then the LTV is 60%  $[(200,000+100,000)/500,000]$ .

The outstanding amount of \$250,000 (200,000+50,000) should be reported on the appropriate Real Estate Secured – Uninsured – Residential  $\leq 75\%$  of FMV line.

Personal – Real Estate Secured – Uninsured – Residential  $\leq 75\%$  of FMV loans and lines of credit described above must be included in the following lines, as appropriate.

*Line 6020-320: Current or Past Due  $\leq 90$  Days*

Loans and lines of credit (and accrued interest) that are current or past due by 90 days or less, net of any loan loss provisions.

*Line 6020-330: Past Due  $> 90$  Days, Net of Specific Provision  $\geq 20\%$*

Loans and lines of credit (and accrued interest) that are past due by more than 90 days, net of any specific loan loss provisions that are greater than or equal to 20% of these loans and lines of credit.

*Line 6020-340: Past Due  $> 90$  Days, Net of Specific Provision  $< 20\%$*

Loans and lines of credit (and accrued interest) that are past due more than 90 days, net of any specific loan loss provisions that are less than 20% of these loans and lines of credit.

All Other Loans and Leases – Current or Past Due  $\leq 90$  Days and Past Due  $> 90$  Days, Secured Portion

All other loans (including lines of credit) and leases must be risk-weighted in accordance with their individual payment status. Loans (including lines of credit) and leases that are more than 90 days past due must be split into their secured and unsecured portions. Only the secured portions are to be included in this section. The unsecured portions, net of specific loss provisions, are to be included in the next section under All Other Loans and Leases – Past Due  $> 90$  Days, Unsecured Portion. However, if the amount of a specific loss provision is greater than the unsecured portion, then that provision must be netted instead against the secured portion.

Amounts include accrued interest and are reported net of allowances for credit losses on the following lines, as appropriate.



*Line 6020-350: Personal – Real Estate Secured – Uninsured – Residential > 75% of FMV*

Uninsured residential mortgage loans, including

- farm mortgage loans, where the outstanding balance on each loan exceeds 75% of the FMV of the property;
- uninsured residential mortgage secured lines of credit, where the authorized limit on each line of credit exceeds 75% of the FMV of the property;
- certificate of title loans, interim construction mortgage financing on residential property where the outstanding balance exceeds 75% of the FMV of the property; and
- personal uninsured securitizations originated by the credit union that do not meet IFRS de-recognition criteria and where the outstanding balance exceeds 75% of the FMV of the property.

The LTV ratio calculation must incorporate all loans and lines of credit secured on the same property (see Example: LTV Ratio Calculation text box above). If the LTV ratio is over 75%, the entire uninsured loan must be included in this line. As the outstanding balance of an uninsured loan reduces, and the LTV ratio becomes 75% or less, the loan balance can be transferred to the appropriate Personal – Real Estate Secured – Uninsured – Residential Loans ≤ 75% of FMV lines.

Note: If the LTV cannot be calculated for an uninsured residential mortgage loan, the loan must be included in this line.

*Line 6020-360: Personal – Guaranteed by Government or Fully Secured by Deposits and Government Securities*

Personal loans and lines of credit that:

- are guaranteed by the Government of Canada, a province, a municipality, or a central government of an Organization for Economic Cooperation and Development (“OECD”) country to the extent the loans are guaranteed, including the guaranteed portions of Canada Student Loans;
- are fully secured by pledged extra-provincial trust corporation or credit union deposits and non-equity shares; or
- are fully secured by federal, provincial, and municipal government securities, such as Canada Savings Bonds or Treasury Bills.

Note: The non-guaranteed portion of the above loans and lines of credit must be reported on other lines in this section, as appropriate.

*Line 6020-370: Personal – Fully Secured by Deposits with DTI or OECD Central Bank*

Personal loans and lines of credit that:

- are fully secured by deposits at a deposit taking institution (“DTI”) or a central bank of an OECD country;
- are fully secured by pledged credit union deposits and non-equity shares; or
- are fully secured by pledged bank deposits.

*Line 6020-380: All Other Personal Loans and Leases*

Other personal loans (including lines of credit) and personal leases not reported on other lines in the Loans and Leases section.

*Line 6020-390: Commercial – Real Estate Secured – Uninsured – Residential ≤ 75% of FMV*

Commercial loans that are secured by residential property, where the outstanding balance on each loan is 75% or less of the FMV of the property.

*Residential property* includes any property that would qualify for a residential or farm mortgage as defined in the CRR (see *Definitions of Loans and Leases in the Capital Requirements Regulation* text box above).

Note: A residential rental property of four or fewer rental units is considered a residential property, and a residential rental property of more than four rental units is considered a commercial property.

*Line 6020-400: Commercial – Guaranteed by Government or Fully Secured by Deposits and Government Securities*

Commercial loans and lines of credit that:

- are guaranteed by the Government of Canada, a province, a municipality, or a central government of an OECD country, including the guaranteed portions of Business Improvement Loans granted under the *Canada Small Business Financing Act*;
- are fully secured by pledged extra-provincial trust corporation or credit union deposits and non-equity shares; or
- are fully secured by federal, provincial, and municipal government securities, such as Canada Savings Bonds or Treasury Bills.

Note: The non-guaranteed portion of the above loans and lines of credit must be reported on other lines in this section, as appropriate.

*Line 6020-410: Commercial – Fully Secured by Deposits with DTI or OECD Central Bank*

Commercial loans and lines of credit that:

- are fully secured by deposits at a deposit taking institution (“DTI”) or a central bank of an OECD country;
- are fully secured by pledged credit union deposits and non-equity shares; or
- are fully secured by pledged bank deposits.

*Line 6020-420: Loans to Governments and Municipalities*

Commercial loans and lines of credit to the federal or provincial governments and municipalities.

*Line 6020-430: All Other Commercial Loans and Leases*

Other commercial loans (including lines of credit) and commercial leases not reported on other lines in the Loans and Leases section.

All Other Loans and Leases – Past Due > 90 Days, Unsecured Portion, Net of Specific Provision

All other loans (including lines of credit) and leases that are more than 90 days past due must be split into their secured and unsecured portions. Only the unsecured portions, net of specific loss provisions, are included in this section. The secured portions are included in the previous section under All Other Loans and Leases – Current or Past Due ≤ 90 Days and Past Due > 90 Days, Secured Portion. If a specific loss provision is greater than the unsecured portion, then that provision must be netted instead against the secured portion.

The unsecured portions of all other loans (including lines of credit) and leases that are more than 90 days past due, must be risk-weighted based on the level of specific loss provision for each individual loan, line of credit, or lease, and included in the following lines, as appropriate.

*Line 6020-440: Net of Specific Provision ≥ 20%*

Loans, lines of credit, and leases (and accrued interest) that are more than 90 days past due, net of any specific loan loss provisions equal to or greater than 20% of these loans, lines of credit, and leases.

*Line 6020-450: Net of Specific Provision < 20%*

Loans, lines of credit, and leases (and accrued interest) that are past due greater than 90 days, net of any specific loan loss provisions less than 20% of these loans, lines of credit, and leases.

**2.3.3 Other Assets**Line 6020-500: Premises and Equipment

Net book value, after accumulated depreciation and impairment, of the credit union's fixed assets, such as land, buildings, leasehold improvements, furniture and equipment (computer and non-computer), automobiles, and ATMs (owned or leased).

Net book value, after accumulated depreciation and impairment, of the credit union's right-of-use assets representing the right to use the underlying leased fixed assets for the lease term, is also included in this line.

Note: To adjust the net book value reported, fair value gains or losses from the initial revaluation of the credit union's own use property upon transition to IFRS, that are deducted from the capital base, should be deducted from this line to the same amount.

[Line 6020-510: Property Acquired in Settlement of Loans and Leases](#)

Property, including land and buildings, acquired in settlement or partial settlement of loans and leases and held for less than 7 years, net of any allowance for property losses and accumulated depreciation.

[Line 6020-520: Property Held for Investments](#)

Property, including land and buildings, acquired for investment purposes or in settlement of loans and held for more than 7 years, net of any allowance for property losses and accumulated depreciation.

Right-of-use assets representing the right to use the underlying leased investment property for the lease term, net of any allowance for property losses and accumulated depreciation, are also included in this line.

[Equity Investments](#)*Line 6020-530: Less than 10% Ownership*

Equity investments (using the cost basis of accounting) in corporations where credit union ownership and control is less than 10%.

*Line 6020-540: 10% or Greater Ownership*

Equity investments (using the equity method of accounting) in corporations where credit union ownership or control is greater than or equal to 10% (e.g., insurance agencies, real estate subsidiaries), to the extent the investment has not been deducted from the capital base.

If the equity method of accounting is not used to account for equity investments on the credit union's books, the book value must be adjusted on the CAR. The equity method of accounting to calculate the value of the equity investments that represent 10% or greater ownership is detailed in the Primary Capital section.

Note: To adjust the value of equity investments reported, investments that have been deducted from the capital base, and the goodwill and intangible assets included in the carrying value of an investment in another entity (using the equity method of accounting), that have been deducted from the capital base, should be deducted from this line to the same amount.

[Line 6020-550: Deductions from Capital](#)

Equals Total Deductions from Capital from Section 6010 – Capital Base.

[Line 6020-560: Derivative Financial Instruments](#)

Amounts relating to derivative instruments, including unrealized gains (losses are to be offset against gains, only as permitted by IFSR), margin requirements and premiums paid.

[Line 6020-570: Deferred Income Tax Assets](#)

Deferred income tax assets from differences between taxable and accounting income.

### [Line 6020-580: All Other Assets](#)

Other assets recorded on the books of the credit union, and not reported on other lines (e.g., deferred charges, prepaid expenses, accounts receivable, current income taxes receivable).

## 2.4 Section 6030 – Off Balance Sheet Exposures

Off balance sheet exposures are business not reported on the balance sheet of the credit union, such as credit commitments, and transaction-related contingencies.

For risk-weighting off balance sheet exposures, section 14(3) of the CRR adopts OSFI's Capital Adequacy Requirements Guideline; for clarification refer to this OSFI guideline.

Commitments are arrangements that obligate the credit union, at a member's request, to:

- extend credit in the form of loans or participation in loans, lease financing receivables, mortgages (including undrawn portion of HELOCs), overdrafts, acceptances, letters of credit, guarantees or loan substitutes; or
- purchase loans, securities, or other assets.

Normally, commitments involve a written contract or agreement and some form of consideration, such as a commitment fee.

Unfunded mortgage commitments are treated as commitments for risk-based capital purposes when the member has accepted the commitment extended by the credit union and all conditions related to the commitment has been fully satisfied.

Report the unweighted amounts and the appropriate risk-weighting factors. Risk-weighted amounts for off balance sheet assets are calculated by multiplying the unweighted amount by the credit conversion factor (to convert the item to its credit risk equivalent), and then multiplying by the risk-weighting factor. The formula is as follows:

$$\text{Risk Weighted \$} = \text{Unweighted \$} * \text{Credit Conversion Factor} * \text{Risk Weighting Factor}$$

The risk-weighting factor for an off balance sheet asset is determined based on the risk-weighting factor of the equivalent on balance sheet asset. The following examples are provided for clarity (see text box).

#### ***Examples: Risk-weighting Factors for Off Balance Sheet Assets***

Example 1 – Commercial Exposure:

The approved but unfunded portion of an unsecured commercial loan (off balance sheet portion) should be risk-weighted 100%, equivalent to the on balance sheet risk-weighting factor of unsecured commercial loans.

For further details, risk-weighting factors are listed in the Table of On Balance Sheet Items in Appendix 2.

**Examples: Risk-weighting Factors for Off Balance Sheet Assets (cont'd)****Example 2 – Residential Exposure:**

The undrawn portion of a residential HELOC (off balance sheet portion) should be risk-weighted 75% or 35% based on the risk-weighting factor of the equivalent drawn portion of the HELOC (on balance sheet portion). The risk-weighting factor is 0.75, unless the authorized limit of the HELOC is 75% or less of the FMV of the property, then the risk-weighting factor is 0.35.

For each reporting line, if more than one risk-weighting factor applies to the off balance sheet assets, report the weighted average of the risk-weighting factors, calculated by using the unweighted dollar amounts and the applicable risk-weighting factors of the off balance sheet items included in the same line. BCFSa may request a schedule showing the detailed calculations.

The template uses predefined credit conversion factors to calculate the risk-weighted amounts. Credit conversion factors (“CCF”) are shown in the following table.

Credit Conversion Factors
<b>100% Conversion Factor</b>
<ul style="list-style-type: none"> <li>• Direct credit substitutes (general guarantees of indebtedness and guarantee-type instruments, including standby letters of credit serving as financial guarantees for, or supporting, loans and securities)</li> <li>• Bankers’ acceptances, acquisitions of the credit union’s participations in bankers’ acceptances and participations in direct credit substitutes (e.g., standby letters of credit)</li> <li>• Sale and repurchase agreements and asset sales with recourse</li> <li>• Forward agreements (contractual obligations) to purchase assets, including financing facilities with certain drawdown</li> <li>• Written put options on specified assets with the character of a credit enhancement (except for written put options expressed in terms of market rates for currencies or financial instruments bearing no credit risk)</li> </ul>
<b>50% Conversion Factor</b>
<ul style="list-style-type: none"> <li>• Transaction-related contingencies (e.g., bid bonds, performance bonds, warranties, standby letters of credit related to a particular transaction)</li> <li>• Commitments with an original maturity exceeding 1 year, including underwriting commitments and commercial credit lines</li> <li>• Revolving underwriting facilities (“RUFs”), note issuance facilities (“NIFs”), and other similar arrangements</li> </ul>
<b>20% Conversion Factor</b>
<ul style="list-style-type: none"> <li>• Short-term self-liquidating trade-related contingencies, including commercial/documentary letters of credit</li> <li>• Commitments with an original maturity of 1 year or less</li> </ul>

Credit Conversion Factors
0% Conversion Factor
<ul style="list-style-type: none"> <li>• Commitments that are unconditionally cancellable at any time without prior notice</li> </ul>

#### [Line 6030-100: Guarantees of Indebtedness](#)

Any written undertaking by the credit union to stand behind the financial obligations of a third party should the third party fail to meet them. 100% credit conversion factor applies.

#### [Line 6030-110: Letters of Credit \(Short-term\)](#)

Any written undertaking by the credit union authorizing a third party to call upon the credit union for payment under specific terms of the undertaking. These include short-term, self-liquidating trade-related items, such as commercial and documentary letters of credit issued by the institution that are, or are to be, collateralized by the underlying shipment.

Letters of credit issued on behalf of a counterparty back-to-back with letters of credit of which the counterparty is a beneficiary (“back-to-back” letters) should be reported as documentary letters of credit.

#### [Line 6030-120: Letters of Credit \(Transaction\)](#)

Any written undertaking by the credit union authorizing a third party to call upon the credit union for payment under specific terms of the undertaking that include transaction-related contingencies (e.g., standby letters of credit related to a particular transaction).

#### [Line 6030-130: Letters of Credit \(Standby\)](#)

Any written undertaking by the credit union authorizing a third party to call upon the credit union for payment under specific terms of the undertaking. These include direct credit substitutes (e.g., standby letters of credit serving as financial guarantees for, or supporting, loans and securities).

#### [Line 6030-140: Performance and Bid Bonds](#)

Any contingency that is related to the performance of a specific transaction or act.

#### [Line 6030-150: Commitments \(Unconditionally Cancellable\)](#)

Commitments that are unconditionally cancellable at any time by the credit union without notice or that effectively provide for automatic cancellation due to deterioration in the member’s credit worthiness. This implies that the credit union conducts a formal review of the facility at least annually, thus giving it an opportunity to take note of any perceived deterioration in credit quality. Retail commitments are unconditionally cancellable if the term permits the credit union to cancel them to the full extent allowable under consumer protection and related legislation.

Undated or open-ended commitments that are unconditionally cancellable by the credit union at any time, such as unused credit card lines, personal lines of credit, and overdraft protection for personal chequing accounts are reported on this line.

Evergreen or open-ended commitments that are cancellable by the credit union at any time subject to a notice period do not constitute unconditionally cancellable commitments and must be reported on the Commitments (Original Maturity > 1 Year) line.

#### [Line 6030-160: Commitments \(Original Maturity ≤ 1 Year\)](#)

Commitments with an original maturity of one year and less.

The original maturity of a commitment should be measured from the date when the commitment was accepted by the member (regardless of whether the commitment is revocable or irrevocable, conditional or unconditional) until the earliest date on which:

- the commitment is scheduled to expire; or
- the credit union can, at its option, unconditionally cancel the commitment.

A material adverse change clause is not considered to give sufficient protection for a commitment to be considered unconditionally cancellable.

Where the credit union commits to granting a facility at a future date (a forward commitment), the original maturity of the commitment is to be measured from the date the commitment is accepted until the final date that drawdowns are permitted.

#### [Line 6030-170: Commitments \(Original Maturity > 1 Year\)](#)

Commitments with an original maturity over one year.

A 50% credit conversion factor is applied to a commitment to provide a loan (or purchase an asset) to be drawn down in a number of tranches, some one year and under and some over one year. In these cases, the ability to renegotiate the terms of later tranches should be regarded as immaterial. Often these commitments are provided for development projects from which the credit union may find it difficult to withdraw without jeopardizing its investment.

Where the facility involves unrelated tranches, and where conversions are permitted between the over and under one year tranches (i.e., where the member may make ongoing selections as to how much of the commitment is under one year and how much is over), then a 50% conversion factor applies to the entire commitment.

Where the facility involves unrelated tranches with no conversion between the over and under one year tranches, each tranche may be converted separately, depending on its maturity.

#### [Line 6030-180: Other Exposures \(50% CCF\)](#)

Other off balance sheet exposures with 50% credit conversion factor not reported on other lines in the Off Balance Sheet Exposures section.



Line 6030-190: Other Exposures (100% CCF)

Other off balance sheet exposures with 100% credit conversion factor not reported on other lines in the Off Balance Sheet Exposures section.

## 2.5 Section 6040 – Derivatives

For risk-weighting derivatives, section 14(3) of the CRR adopts OSFI’s Capital Adequacy Requirements Guideline; for clarification refer to this OSFI’s guideline.

In case of derivatives the credit union is not exposed to credit risk for the full notional principal of its contracts, but to the potential cost of replacing the expected cash flows on contracts if the counterparty defaults.

The risk-weighted exposure of a derivative contract is determined by calculating the credit equivalent amount using the current exposure method, and then assigning the risk-weight appropriate to the counterparty. Under the current exposure method, the credit equivalent amount is equal to the sum of the positive market value and the potential future credit exposure. The potential future credit exposure is calculated by multiplying the notional principal of the derivative contract by the applicable add-on factor from the following table.

Current Exposure Method Add-on Factors			
Contract Type	Residual Maturity		
	1 year or less	1 - 5 years	Over 5 years
Interest Rate	0.0%	0.5%	1.5%
Foreign Exchange and Gold	1.0%	5.0%	7.5%
Equity	6.0%	8.0%	10.0%
Precious Metals Except Gold	7.0%	7.0%	8.0%
Other Commodities	10.0%	12.0%	15.0%

Report the notional principal, the appropriate add-on factor, and the positive market value. Risk-weighted amounts for derivatives are calculated by first multiplying the notional principal by the add-on factor and then adding the positive market value amount to determine the credit equivalent amount, and then multiplying the credit equivalent amount by the counterparty risk-weighting factor. The formula is as follows:

$$\text{Risk Weighted \$} = [(\text{Notional Principal \$} * \text{Add on Factor}) + \text{Positive Market Value \$}] * \text{Counterparty Risk Weighting Factor}$$

For each reporting line, if more than one add-on factor applies, report the weighted average of the add-on factors, calculated by using the notional principal dollar amounts and the applicable add-on factors of the derivative contracts included in the same line. BCFSa may request a schedule showing the detailed calculations.

The template uses predefined counterparty risk-weighting factors to calculate the risk-weighted amounts:

- Where *Central 1* is the counterparty of a derivative, the risk-weight is 0%.
- Where a *Canadian Deposit Taking Institution* is the counterparty of a derivative, the risk-weight is 20%. Canadian deposit taking institutions include federally and provincially regulated institutions that take deposits and lend money. These include banks, trust or loan companies and co-operative credit societies.

Note: If Central 1 transfers its counterparty risk back to the credit union, then the counterparty risk-weight of the third-party financial institution applies (20%). For example, swaps purchased by the credit union through Central 1 for index-linked term deposits would require a counterparty risk-weight of 20%, where Central 1 arranges swap transactions with a bank and the risk of default by the bank is transferred from Central 1 to the credit union. In this case report the swaps in the appropriate Canadian Deposit Taking Institutions line with a counterparty risk-weight of 20%.

#### [Lines 6040-100 to 6040-110: Interest Rate Contracts](#)

Interest rate contracts include interest rate swaps, forward rate agreements, purchased options, and similar derivative contracts.

#### [Line 6040-120 to 6040-130: Foreign Exchange Rate Contracts](#)

Agreements for the purchase or sale of a fixed amount of a foreign currency at a fixed-exchange rate on a specified date, or an option to purchase or sell.

#### [Lines 6040-140 to 6040-150: Equity Contracts](#)

Equity contracts include futures, forwards, swaps, purchased options, and similar contracts based on both individual equities as well as on equity indices.

#### [Lines 6040-160 to 6040-170: Other Derivative Contracts](#)

Other derivative contracts not reported on other lines in the Derivatives section.

## 2.6 Section 6050 – Concentration Risk Adjustments

In circumstances where the credit union's portfolio is not well diversified, concentration risk factors are applied. For example, an additional risk-weighting factor is applied to commercial loan investments above a base amount.

Report the unweighted amounts. The template uses predefined risk-weighting factors to calculate the risk-weighted amounts. Risk-weighted amounts for concentration risk adjustments are calculated by multiplying the unweighted excess amount by the risk-weighting factor.

[Line 6050-100: Excess Commercial Loans and Leases \(>30% & ≤35%\)](#)

If the credit union's total commercial loans and leases<sup>1</sup> exceeds 30% of the credit union's total assets, an additional risk-weighting factor of 0.5 is applied to the amount exceeding 30% but not exceeding 35%.

Calculated as follows:

$$\text{Excess} = \text{Min (Total commercial loans and leases, 35\% of Total assets) } - 30\% \text{ of Total assets}$$

[Line 6050-110: Excess Commercial Loans and Leases \(>35%\)](#)

If the credit union's total commercial loans and leases<sup>1</sup> exceeds 35% of the credit union's total assets, an additional risk-weighting factor of 1.0 is applied to the amount exceeding 35%.

Calculated as follows:

$$\text{Excess} = \text{Total commercial loans and leases} - 35\% \text{ of Total assets}$$

[Line 6050-120: Excess Investment in Land](#)

If the credit union's total investments in land (including land used for investment or revenue purposes, or land acquired in settlement of loans and held for more than 7 years) exceeds 5% of the credit union's total assets, an additional risk-weighting factor of 1.0 is applied to the amount exceeding 5%.

Calculated as follows:

$$\text{Excess} = \text{Property held for investment} - 5\% \text{ of Total assets}$$

[Line 6050-130: Excess Investment in Single Land Parcels](#)

If the value of investment in a single parcel of land (including the the value of buildings and other improvements to the land) exceeds 1% of the credit union's total assets, an additional risk-weighting factor of 1.0 is applied to the amount exceeding 1%.

Calculated as follows for each parcel of land:

$$\text{Excess} = \text{Value of parcel of land} - 1\% \text{ of Total assets}$$

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<sup>1</sup> Total commercial loans and leases calculation excludes loans that are risk weighted 0% (insured mortgages, loans guaranteed by government or fully secured by deposits and government securities, and loans to governments and municipalities), and loans that are fully secured by deposits with DTIs or OECD central banks.

[Line 6050-140: Excess 3rd and Subsequent Mortgages](#)

If the total of all third or subsequent mortgages held by the credit union exceeds 2% of the credit union's total assets, an additional risk-weighting factor of 1.0 is applied to the amount exceeding 2%.

Calculated as follows:

$$\text{Excess} = \text{Total of 3rd and subsequent mortgages} - 2\% \text{ of Total assets}$$

## 2.7 Appendix 1

### 2.7.1 CAR Audit Expectations

BCFSA expects credit unions to submit the annual CAR that has been audited, and an independent auditor's report on the CAR within 90 days of their fiscal year end. BCFSA may make further enquiry where credit unions do not undergo a CAR audit.

The intent of this appendix is not to direct the audit process, but rather to provide clarification to credit unions to ensure accuracy of the CAR.

The external auditors should develop an approach consistent with Canadian Auditing Standards ("CAS"). The CAS contains guidance explaining what constitutes audit evidence. It deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

Audit procedures should focus on the key risk areas which are generally identified through a risk analysis process. If the audit testing indicates a high level of error(s) the audit process may require changes to ensure an adequate level of assurance can be obtained.

In preparing or reviewing the CAR, credit unions might consider having their Internal Audit review the compilation process. The involvement of Internal Audit could assist credit unions in identifying and resolving reporting issues prior to the external auditors commencing their testing. External auditors may use work conducted by Internal Audit as part of their audit process and as a source of potential audit evidence.

#### [Audit Requirement](#)

Credit unions are expected to engage their auditor appointed pursuant to FIA section 113 to report annually on the CAR prepared as at fiscal year end, in accordance with the relevant standards for such assurance engagements as promulgated by the Canadian Auditing and Assurance Standards Board.

The audit report of the CAR must be prepared via a separate engagement from the credit union's annual audit report on the financial statements, by the same auditor engaged to do the latter. The audit opinion provided must pertain to the current fiscal year end for the CAR.

### Auditor Qualifications

The qualifications of an auditor are stated in section 3 of the FIA's Audit and Audit Committee Regulation. In addition, the external auditor should be a member in good standing with the Chartered Professional Accountants of British Columbia ("CPABC").

### Audit Opinion

The audit opinion should include the following characteristics:

- it should be addressed to the Superintendent of Financial Institutions for British Columbia;
- it should clearly state the credit union's legal name;
- it should clearly state the date at which the opinion is being made; and
- it should clearly state that the CAR is prepared in accordance with the provision set forth in the Capital Requirements Regulation of the FIA.

A sample auditor's report has been provided for reference at the end of this appendix.

### Establishing Materiality

In accordance with the CAS, a materiality level will need to be applied to the CAR audit process.

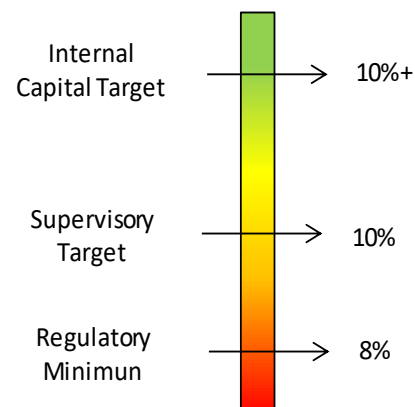
The concept of materiality recognizes that some matters, either individually or in aggregate, are important for fair presentation of financial information, while other matters are not important. In performing the audit, the auditor is concerned with matters that, either individually or in aggregate, could be material to the financial information being presented. The auditor's responsibility is to plan and perform the audit to obtain reasonable assurance that material misstatements, whether caused by errors or fraud, are detected.

The auditor's consideration of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of users of financial statements.

The materiality level for the CAR will differentiate from the materiality level established for the audit of the credit union's financial statements.

Given this degree of differentiation, there is still an expectation that the following general principles apply:

- misstatements, including omissions, are considered to be material if they, individually or in aggregate, could reasonably be expected to influence decisions made on the basis of the financial return; and
- judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both.



### Scope and Degree of Testing

The scope of the auditor's assessment and the granularity of testing should commensurate with the current capital adequacy position and the degree of change in the capital adequacy position that has occurred since the last fiscal year end.

### Capital Position

When determining the scope and extent of testing the credit union and auditors should consider the current capital adequacy position. As the credit union's capital position approaches closer to their Regulatory Minimum, the scope and intensity of testing should increase as the importance of accuracy in the figure is heightened.

### Capital Position Change

Another important consideration in establishing the scope and degree of testing is the amount of change the ratio experiences over the fiscal year. Since significant changes in the capital adequacy position can be a result of classification issues, it is imperative the root cause of the change is validated. Regardless of whether the position change positively or negatively affects the ratio, the scope and degree of testing should be sufficient to ensure the accuracy of the capital adequacy position.

The combination of a level approaching one of the aforementioned thresholds and a significant year-over-year change should result in testing to confirm the accuracy of the capital adequacy ratio.

### Capital Base

In confirming the Capital Base, auditors should obtain reasonable assurance of the control and classification systems in place at the credit union. Auditors should pay particular attention to the classification of equity shares, the allocation of dividends to be paid, and the appropriateness of deductions of goodwill and intangibles.

### Risk-Weighted Assets

In confirming Risk-Weighted Assets ("RWAs"), auditors should obtain reasonable assurance of the control and classification systems in place at the credit union. RWAs are historically an area where classification errors have occurred.

Depending on the evaluation of the quality of the internal controls over the loan portfolio, including loan classification to determine risk-weighting, the auditors may have to complete substantive testing, via sampling by loan types, to be assured of the accuracy of the loan classification processes and results.

Preparation of the RWAs calculation is most likely an automated process relying on data transfer from the banking system database to the accounting/reporting process. Particular attention should be paid to the quality and accuracy of the information being transferred to determine the validity of the RWAs calculation.

*If under any circumstance the classification of items cannot be determined using the CAR Reporting Instructions these items should be placed on the line numbers that have more conservative capital risk weightings.*

### Off Balance Sheet Items

Auditors should be aware that under the Capital Requirements Regulation, the weighted value of off-balance sheet exposures must be determined according to the requirements issued by OSFI. Specifically, reference should be made to OSFI's Capital Adequacy Requirements Guideline, Chapter 3.

## 2.7.2 Sample Independent Auditor's Report

### **To the Superintendent of Financial Institutions for British Columbia**

We have audited the accompanying Capital Adequacy Return for British Columbia Credit Unions [the "Capital Adequacy Return"] of **name of Credit Union** [the "Credit Union"] as at Month-Day-Year [Year-End Date]. The Capital Adequacy Return has been prepared by management based on the financial reporting provisions of the Capital Requirements Regulation of the *Financial Institutions Act*, B.C. Reg. 315/90 [the "Regulation"].

### **Management's responsibility for the Capital Adequacy Return for British Columbia Credit Unions**

Management is responsible for the preparation of the Capital Adequacy Return in accordance with the financial reporting provisions of the Capital Requirements Regulation of the *Financial Institutions Act*, B.C. Reg. 315/90, and for such internal controls as management determines is necessary to enable the preparation of Capital Adequacy Return that is free from material misstatement, whether due to fraud or error.

### **Auditor's responsibility**

Our responsibility is to express an opinion on Capital Adequacy Return based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Capital Adequacy Return is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Capital Adequacy Return. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Capital Adequacy Return, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the Capital Adequacy Return 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Capital Adequacy Return.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the Capital Adequacy Return of the **name of Credit Union** as at Month-Day-Year [Year-End Date] is prepared, in all material respects, in accordance with the financial reporting provisions of the Capital Requirements Regulation of the *Financial Institutions Act*, B.C. Reg. 315/90.

## Basis of accounting and restriction on use

Without modifying our opinion, we draw attention to the fact that the Capital Adequacy Return has been prepared in accordance with the basis of accounting set out in the Regulation. The Capital Adequacy Return is prepared to assist the **name of Credit Union** to meet the requirements of the Superintendent of Financial Institutions for British Columbia. As a result, the Capital Adequacy Return may not be suitable for another purpose.

Our report is intended solely for the use of the **name of Credit Union** and the Superintendent of Financial Institutions for British Columbia and should not be used by parties other than the **name of Credit Union** or the Superintendent of Financial Institutions for British Columbia.

Auditor's Signature

Date of Auditor's Report

Auditor's Address

## 2.8 Appendix 2

Table of On Balance Sheet Items under section 14(3) of the CRR

On Balance Sheet Items' Risk-Weighting Factors			CAR
Item	Asset Category	Weighting Factor	Line# in Sec. 6020
1	Cash	0.0	100
2	Security instruments issued or guaranteed by the Government of Canada, by a province, by a municipality, or by a central government of an OECD country.	0.0	130, 200, 240
3	Loans to the Government of Canada, to a province, to a municipality or to a central government of an OECD country, and accrued interest under the loans.	0.0	420
4	Deposits in a deposit taking institution or in a central bank of an OECD country other than a cooperative credit society or association as defined in the Cooperative Credit Associations Act (Canada) or a central credit union described in item 7, plus accrued interest under the deposits.	0.2	120
5	Non-equity shares plus accrued dividends in credit unions.	0.2	140
6	Deposits with a cooperative credit society or an association, as defined in the Cooperative Credit Associations Act (Canada)	0.0	110



On Balance Sheet Items' Risk-Weighting Factors			CAR
Item	Asset Category	Weighting Factor	Line# in Sec. 6020
	whose capital base if determined under this regulation would exceed 10% of what the calculated value of its risk-weighted assets would be if determined under this regulation.		
7	Deposits with a central credit union that has a capital base in excess of 10% of the calculated value of its risk-weighted assets, as determined by reference to this section and sections 15 to 20.	0.0	110
8	Debt security instruments, other than subordinated debt security instruments, issued or guaranteed by a bank, a financial institution, or an extra-provincial corporation.	0.2	140
9	Commercial paper that has one of the following Dominion Bond Rating Service ratings or equivalent:		
	(a) AAA to AA (low) or R1 (high)	0.2	160
	(b) A (high) to A (low) or R1 (middle)	0.5	170
	(c and e) BBB (high) to BB (low) or R1 (low) to R2 (low) and unrated	1.0	180
	(d) below BB (low) or below R2 (low)	1.5	190
10	Loans fully secured by deposits with a deposit taking institution or by a central bank of an OECD country, and accrued interest under the loans.	0.2	370, 410
11	Loans fully secured by deposits with the extra-provincial trust corporation or credit union, and accrued interest under the loans.	0.0	360, 400
12	Loans fully secured by security instruments issued by the government of Canada, by a province, by a municipality or by the central government of an OECD country and accrued interest under the loans.	0.0	360, 400
13	Loans guaranteed by the government of Canada, by a province, by a municipality or by the central government of an OECD country and accrued interest under the loans, to the extent that the loans and interest are guaranteed.	0.0	360, 400
14	Loans fully secured by mortgages on land that are approved or insured under the National Housing Act (Canada), or an insurer authorized to conduct mortgage insurance business under the Act, to the extent that such loans are guaranteed by the government of Canada, and accrued interest under the loans.	0.0	300, 310

On Balance Sheet Items' Risk-Weighting Factors			CAR
Item	Asset Category	Weighting Factor	Line# in Sec. 6020
15	Uninsured residential or farm mortgages other than those itemized in items 14 and 16, and accrued interest under the loans.	0.35	320
15.1	Loans secured by residential property where the outstanding amount of the loan, together with any prior or equal ranking encumbrances plus any accrued interest under the loan is less than or equal to 75% of the fair market value of the property at the date of the loan.	0.35	390
16	Uninsured residential or farm mortgages if the outstanding amount of the loan, together with any prior or equal ranking encumbrances plus any accrued interest under the loans is in excess of 75% of the fair market value of the property at the date of the mortgage.	0.75	350
17	Loans or leases to individuals other than (a) commercial loans or commercial leases, (b) residential mortgages, or (c) farm mortgages, and accrued interest on the loans and leases.	0.75	380
18	Commercial loans, other than those itemized in item 15.1, and commercial leases and accrued interest on the loans and leases.	1.0	430
18.1	The unsecured portion of any loan (other than mortgages described in items 14 and 15) that is past due for more than 90 days, net of specific provisions, will be risk-weighted at		
	(a) when specific provisions are less than 20% of the outstanding loan	1.5	450
	(b) when specific provisions are no less than 20% of the outstanding amount of the loan.	1.0	440
18.2	A mortgage described in item 15 that is past due for more than 90 days, net of specific provisions, will be risk-weighted at		
	(a) when specific provisions are less than 20% of the outstanding mortgage	1.0	340
	(b) when specific provisions are no less than 20% of the outstanding mortgage.	0.5	330
19	Equity shares in a cooperative credit society or association as defined in the Cooperative Credit Associations Act (Canada), or	1.0	230

On Balance Sheet Items' Risk-Weighting Factors			CAR
Item	Asset Category	Weighting Factor	Line# in Sec. 6020
	a central credit union and debentures issued by Credit Union Deposit Insurance Corporation of British Columbia.		
20	Fixed business assets, including premises, land, buildings, leasehold improvements, equipment or comparable assets at book value.	1.0	500
21	Equity investment in another corporation, plus share of the retained earnings of the corporation calculated by the equity method of accounting, where the financial institution has a share of ownership or control of greater than 10% and to the extent the investment has not been deducted from the capital base.	1.0	540
22	Equity investment in another corporation which has been deducted from the capital base of the financial institution to the extent deducted.	0.0	550
23	Equity investment in another corporation where the financial institution has a share of ownership and control of less than 10%.	1.0	530
24	At book value, land (a) used for investment or revenue purposes, or (b) acquired in settlement or partial settlement of loans and held for more than 7 years.	1.5	520
25	Land acquired in settlement or partial settlement of loans and held for less than 7 years, at book value.	1.0	510
26	Deferred charges.	1.0	580
27	Prepaid expenses.	1.0	580
28	All other assets recorded on the books of the financial institution.	1.0	150, 210, 220, 250, 570, 580