

Bourns Employees Federal Credit Union

INDEPENDENT AUDITOR'S REPORT ON
AUDITED FINANCIAL STATEMENTS

December 31, 2017 and 2016



Serving credit unions since 1967

RICHARDS & ASSOCIATES
Certified Public Accountants

21520 Yorba Linda Blvd., Ste. G-516
Yorba Linda, CA 92887
Msgs: (714) 287-6713
eFax: (714) 455-7082
[www. RichardsCPAs.com](http://www.RichardsCPAs.com)

BOURNS EMPLOYEES FEDERAL CREDIT UNION

FINANCIAL REPORT CONTENTS

December 31, 2017 and 2016

AUDITED FINANCIAL STATEMENTS

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Board of Directors and Supervisory Committee
Bourns Employees Federal Credit Union
Riverside, California

INDEPENDENT AUDITOR'S REPORT

Report on Financial Statements

We have audited the accompanying financial statements of Bourns Employees Federal Credit Union, which comprise the statements of financial condition as of December 31, 2017 and 2016, and the related statements of income, members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

INDEPENDENT AUDITOR'S REPORT - *continued*

Auditor's Responsibility - *continued*

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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 financial statements referred to above present fairly, in all material respects, the financial position of Bourns Employees Federal Credit Union as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

RICHARDS & ASSOCIATES
Certified Public Accountants



Michael E. Richards, CPA

Yorba Linda, California
March 30, 2018

BOURNS EMPLOYEES FEDERAL CREDIT UNION

STATEMENTS OF FINANCIAL CONDITION

December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
Cash and cash equivalents (Note 2)	\$ 1,228,204	\$ 755,612
Investments (Note 3)	14,505,978	11,620,599
Loans receivable, net of allowance for loan losses (Note 4)	28,703,187	24,485,615
Property & equipment (Note 5)	536,320	49,740
Accrued interest receivable	89,343	74,213
Share insurance deposit	386,071	304,782
Mortgage servicing rights (Note 12)	1,030,741	538,877
Core deposit intangible	149,091	-
Prepaid expenses and other assets	105,769	93,552
TOTAL ASSETS	<u>\$ 46,734,704</u>	<u>\$ 37,922,990</u>
LIABILITIES AND EQUITY		
Liabilities:		
Members' share and savings accounts (Note 6)	\$ 38,643,011	\$ 31,133,435
Accounts payable and other liabilities	771,054	544,044
TOTAL LIABILITIES	<u>39,414,065</u>	<u>31,677,479</u>
Commitments and contingent liabilities (Note 8)	-	-
Members' equity:		
Members' equity, substantially restricted		
Appropriated (regular reserve)	952,125	952,125
Unappropriated (undivided earnings)	5,829,706	5,334,782
Equity acquired through merger	549,410	-
	<u>7,331,241</u>	<u>6,286,907</u>
Accumulated other comprehensive income	(10,602)	(41,396)
TOTAL MEMBERS' EQUITY	<u>7,320,639</u>	<u>6,245,511</u>
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u>\$ 46,734,704</u>	<u>\$ 37,922,990</u>

The accompanying notes are an integral part of these financial statements.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

STATEMENTS OF INCOME

Years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
INTEREST INCOME		
Loans	\$ 1,058,452	\$ 880,809
Investments	270,195	214,030
TOTAL INTEREST INCOME	<u>1,328,647</u>	<u>1,094,839</u>
INTEREST EXPENSE		
Members' share and savings accounts	204,516	140,855
Borrowed funds	164	817
TOTAL INTEREST EXPENSE	<u>204,680</u>	<u>141,672</u>
NET INTEREST INCOME	1,123,967	953,167
PROVISION FOR LOAN LOSSES (CREDIT)	<u>(42,799)</u>	<u>(65,615)</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>1,166,766</u>	<u>1,018,782</u>
NON-INTEREST INCOME		
Service charges and other income	368,733	243,812
Rental income	9,925	-
Gain on sale of investments	-	1,325
Gain on bargain purchase	38,294	-
Gain on servicing assets	702,242	484,105
TOTAL NON-INTEREST INCOME	<u>1,119,194</u>	<u>729,242</u>
NON-INTEREST EXPENSE		
General and administrative expenses		
Compensation and benefits	970,818	786,283
Office operations	351,580	280,363
Other expenses	399,954	290,647
Loss on disposal of property and equipment	109	102
Other non-operating expenses	68,575	56,004
TOTAL NON-INTEREST EXPENSES	<u>1,791,036</u>	<u>1,413,399</u>
NET INCOME	<u>\$ 494,924</u>	<u>\$ 334,625</u>

The accompanying notes are an integral part of these financial statements.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

STATEMENTS OF MEMBERS' EQUITY

Years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
APPROPRIATED - REGULAR RESERVE		
Beginning / Ending balance	<u>\$ 952,125</u>	<u>\$ 952,125</u>
UNAPPROPRIATED - UNDIVIDED EARNINGS		
Beginning balance	5,334,782	5,000,157
Net income	494,924	334,625
Ending balance	<u>5,829,706</u>	<u>5,334,782</u>
EQUITY ACQUIRED THROUGH MERGER		
Beginning balance	-	-
Merger with Bakery Employees Credit Union	549,410	-
Ending balance	<u>549,410</u>	<u>-</u>
ACCUMULATED OTHER COMPREHENSIVE LOSS		
Beginning balance	(41,396)	(27,631)
Net change in unrealized gain (loss) on available-for-sale securities	30,794	(13,765)
Ending balance	<u>(10,602)</u>	<u>(41,396)</u>
TOTAL MEMBERS' EQUITY	<u><u>\$ 7,320,639</u></u>	<u><u>\$ 6,245,511</u></u>

The accompanying notes are an integral part of these financial statements.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

STATEMENTS OF CASH FLOWS
Years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 494,924	\$ 334,625
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses (credit)	(42,799)	(65,615)
Depreciation and amortization	37,777	21,737
Discount accretion net of premium amortization	(513)	37,002
Stock dividends added to investments	(5,667)	(9,831)
Capitalization of mortgage servicing rights	(702,242)	(484,105)
Amortization of mortgage servicing rights	210,378	112,931
Amortization of premium on loans	8,681	-
Amortization of core deposit intangible	12,089	-
Gain on merger	(38,294)	-
Gain on sale of investments	-	(1,325)
Loss on disposal of property and equipment	109	102
Changes in operating assets and liabilities:		
Increase in accrued interest receivable	(8,054)	(20,731)
Increase in prepaid expenses and other assets	(9,396)	(4,086)
Increase in share insurance deposit	(21,251)	(1,656)
Increase in accounts payable and other liabilities	143,754	200,372
Total adjustments	<u>(415,428)</u>	<u>(215,205)</u>
Net cash provided by operating activities	<u>79,496</u>	<u>119,420</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash acquired from merger with Bakery Employees Credit Union	1,965,957	-
Loans granted, net of principal collection	(2,574,708)	(3,946,318)
Purchase of capital stock at Federal Home Loan Bank of San Francisco	(18,900)	(7,300)
Sale or maturing of securities	(339,383)	1,549,296
Acquisition of securities	-	(515,492)
Decrease (increase) in deposits in financial institutions	240,000	(1,831,000)
Purchase of property and equipment, net of disposals	<u>(83,505)</u>	<u>(36,211)</u>
Net cash used in investing activities	<u>(810,539)</u>	<u>(4,787,025)</u>

The accompanying notes are an integral part of these financial statements.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

STATEMENTS OF CASH FLOWS - *continued*

Years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' share and savings accounts	\$ 1,203,635	\$ 555,593
Net cash provided by financing activities	<u>1,203,635</u>	<u>555,593</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	472,592	(4,112,012)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>755,612</u>	<u>4,867,624</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 1,228,204</u>	<u>\$ 755,612</u>
 SUPPLEMENTAL DISCLOSURES:		
Cash received during the year from interest on loans and investments	<u>\$ 1,323,094</u>	<u>\$ 1,101,279</u>
Cash paid during the year for dividends	<u>\$ 204,516</u>	<u>\$ 140,855</u>
Net change in unrealized gain or (loss) on available-for-sale securities	<u>\$ 30,794</u>	<u>\$ (13,765)</u>

The accompanying notes are an integral part of these financial statements.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization: Bourns Employees Federal Credit Union (Credit Union) is organized under the Federal Credit Union Act. Participation in the Credit Union is limited to those individuals who qualify for membership. The field of membership is defined in the Credit Union's bylaws.

Nature of business: The Credit Union provides a variety of financial services to its members, many of whom are employees or former employees of Bourns, Inc., individuals who live or work in the Riverside County area, selected employee groups, and their qualifying family members. The Credit Union's primary source of revenue is interest from loans and investments.

Use of estimates: The preparation of financial statements, in conformity with generally accepted accounting principles in the United States of America (GAAP), requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for loan losses and fair value of financial instruments.

Subsequent events: The Credit Union has evaluated subsequent events through March 30, 2018, which is the date the financial statements were available to be issued.

In February 2018, the National Credit Union Association (NCUA) Board unanimously approved share insurance distribution of \$736 million to eligible federally insured credit unions in the third quarter of 2018. The Credit Union will receive approximately \$33,000.

Cash and cash equivalents: For the purpose of the statements of financial condition and the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from financial institutions, and investments with original maturity of three months or less. Amounts due from financial institutions may, at times, exceed federally insured limits.

Investments: Certificates of deposit are generally non-negotiable and non-transferable, and may incur substantial penalties for withdrawal prior to maturity. Certificates of deposit investments are stated at cost and are federally insured up to a maximum of \$250,000 by the National Credit Union Administration (NCUA) or Federal Deposit Insurance Corporation (FDIC). Included with investments is a member capital account in a corporate credit union.

Negotiable securities are classified in accordance with the Credit Union's asset/liability management and investment policies. The following is a description of the classification and accounting procedures used for investments:

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES – *continued*

Investments – continued:

Available-for sale: Investments that are not purchased principally to be sold in the near term nor with the positive intent and ability to hold until maturity as well as those without a defined maturity and could be sold in response to rate changes, prepayment risk, liquidity, availability of and the yield on alternative investments and other market and economic factors are classified as available-for-sale. These securities are marked to market, with unrealized gains or losses not affecting earnings but shown as a separate component of the equity portion of the balance sheet. Unrealized gains and losses on available-for-sale securities are recognized as direct increases or decreases in other comprehensive income.

Purchase premiums and discounts are recognized in interest income over the term of the securities. Declines in the fair value of available-for-sale and held-to-maturity securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment (OTTI) losses, Management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Credit Union to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and the costs of securities sold are determined using the specific identification method.

The Credit Union does not maintain a trading portfolio. Other investments are classified separately, stated at cost and subject to OTTI evaluation.

Loans to members: The Credit Union originates mortgage loans both for sale and for its own portfolio. The Credit Union originated approximately \$49,850,000 and \$40,110,000 of first mortgage loans for its members in the years ended December 31, 2017 and 2016, respectively. Approximately \$46,520,000 and \$32,370,000 of mortgages were sold in the years ended December 31, 2017 and 2016, respectively.

Loans receivable: Loans receivable are stated at unpaid principal balance, net of any unamortized premiums or discounts less an allowance for loan losses. Interest on loans is recognized over the term of the loan and is calculated using the simple-interest method for consumer loans and home equity loans and the day count convention method for first mortgage real estate loans on principal amounts outstanding. When principal or interest is delinquent for sixty days or more, the Credit Union evaluates the loan for nonaccrual status.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES – *continued*

Loans receivable - continued: After a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Subsequent collections of interest payments on nonaccrual loans are recognized as interest income unless ultimate collectability of the loan is in doubt. Cash collections on loans where ultimate collectability remains in doubt are applied as reductions of the loan principal balance and no interest income is recognized until the principal balance has been collected.

Loan fees and certain direct loan origination costs are deferred, and the net cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans, adjusted for estimated prepayments based on the Credit Union's historical prepayment experience.

Allowance for loan losses: The allowance for loan losses reflects Management's judgment of probable loan losses inherent in the portfolio at the balance sheet date. The Credit Union uses a disciplined process and methodology to establish the allowance for loan losses each quarter. To determine the total allowance for loan losses, Management estimates the reserves needed for each segment of the portfolio, including loans analyzed individually and loans analyzed on a pooled basis. The allowance for loan losses consists of amounts applicable to: (i) the auto secured loans portfolio; (ii) the real estate loans portfolio; (iii) the consumer loans portfolio and (iv) the unsecured and credit card loans portfolio.

To determine the balance of the allowance account, loans are pooled by portfolio segment and losses are modeled using historical experience and quantitative and other mathematical techniques over the loss emergence period. Management exercises significant judgment in determining the estimation method that fits the credit risk characteristics of each portfolio segment. Management must use judgment in establishing additional input metrics for the modeling processes. The models and assumptions used to determine the allowance are independently validated and reviewed to ensure that their theoretical foundation, assumptions, data integrity, computational processes, reporting practices, and end-user controls are appropriate and properly documented.

The establishment of the allowance for loan losses relies on a consistent process that requires multiple layers of Management review and judgment and responds to changes in economic conditions, member behavior, and collateral value, among other influences. From time to time, events or economic factors may affect the loan portfolio, causing Management to provide additional amounts to or release balances from the allowance for loan losses. The Credit Union's allowance for loan losses is sensitive to risk ratings assigned to individually evaluated loans and economic assumptions and delinquency trends driving statistically modeled reserves. Individual loan risk ratings are evaluated based on each situation by experienced senior credit officers.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES – *continued*

Allowance for loan losses – continued: Management monitors differences between estimated and actual incurred loan losses. This monitoring process includes periodic assessments by Senior Management of the loan portfolios and the models used to estimate incurred losses in those portfolios. Additions to the allowance for loan losses are made by charges to provision for loan losses. Credit exposures deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged off amounts are credited to the allowance for loan losses.

Loan charge-offs: For consumer loans, the Credit Union generally fully or partially charges down to the fair value of collateral securing the asset when:

- Management judges the asset to be uncollectible;
- repayment is deemed to be protracted beyond reasonable time frames;
- the asset has been classified as a loss by either the Credit Union’s internal loan review process or external examiners;
- the member has filed bankruptcy and the loss becomes evident owing to a lack of assets;
- or
- the loan is one hundred eighty days past due unless both well secured and in the process of collection.

The Credit Union’s charge-off policies by segment of the loan portfolio are as follows:

- *Real Estate Loans* – The Credit Union generally writes down to the net realizable value when the loan is one hundred eighty days past due.
- *Auto Loans* – The Credit Union generally fully or partially charges down to the net realizable value when the loan is one hundred eighty days past due.
- *Unsecured Loans* – The Credit Union generally charges off when the loan is one hundred eighty days past due.
- *Credit Cards Loans* – The Credit Union generally fully charges off when the loan is one hundred eighty days past due.
- *Other Secured Loans* – The Credit Union generally fully or partially charges down to the net realizable value when the loan is one hundred eighty days past due.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES – *continued*

Troubled Debt Restructurings: In situations where, for economic or legal reasons related to a member's financial difficulties, the Credit Union grants a concession for other than an insignificant period of time to the member that the Credit Union would not otherwise consider, if applicable, the related loan is classified as a troubled debt restructuring (TDR). The Credit Union strives to identify members in financial difficulty early and works with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where the Credit Union grants the member new terms that provide for a reduction of either interest or principal, the Credit Union measures any impairment on the restructuring as previously noted for impaired loans.

In addition to the allowance for the pooled portfolios, the Credit Union develops a separate allowance for loans that are identified as impaired through a TDR. As soon as the Credit Union determines that a loan under TDR is current and performing under the restructured payment, and after review, the Credit Union believes the status will continue, the loan is moved back into the respective segment or class and the allowance is calculated using the pooling method for the respective pool.

Property and equipment: Land is carried at cost. Other fixed assets are carried at cost, less accumulated depreciation and amortization. Fixed assets are depreciated using the straight-line method over the estimated useful lives of the assets.

Transfers of Financial Assets: The Credit Union accounts for transfers and servicing of financial assets in accordance with FASB ASC 860, *Transfers and Servicing*. Transfers of financial assets are accounted for as sales only when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) assets have been isolated from the Credit Union, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Credit Union does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Servicing: Mortgage servicing assets are recognized separately when rights are acquired through purchase or through sale of financial assets. Servicing rights resulting from the sale or securitization of loans originated by the Credit Union are initially measured at fair value at the date of transfer. The Credit Union subsequently measures each class of servicing asset using either the fair value or the amortization method. The Credit Union has elected to initially and subsequently measure the mortgage servicing rights for consumer mortgage loans using the amortization method.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES – *continued*

Servicing – continued: Under the amortization method, servicing rights are amortized in proportion to and over the period of estimated net servicing income. The amortized assets are assessed for impairment or increased obligation based on the fair value at each reporting date.

Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. These variables change from quarter to quarter as market conditions and projected interest rates change, and may have an adverse impact on the value of the mortgage servicing right and may result in a reduction to noninterest income.

Valuation of long-lived assets: Long-lived assets and certain identifiable intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Management reviews all material assets semi-annually for possible impairment. If such assets are considered to be impaired, the impairment recognized is measured as the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

Share insurance deposit: Each member's share and savings account is insured up to \$250,000 by the National Credit Union Share Insurance Fund (NCUSIF). The deposit in the NCUSIF is in accordance with regulations set forth by the National Credit Union Administration (NCUA), which require the maintenance of a deposit by each insured credit union in an amount equal to one percent of its insured shares. The deposit would be refunded to the Credit Union if its insurance coverage is terminated, it converts to insurance coverage from another source, or the operations of the fund are transferred from the NCUA Board. The Credit Union is required to pay annual assessments as determined by the NCUA Board.

Individual deposits in excess of the NCUSIF insured limit are insured by a private insurance company, American Share Insurance Corporation (ASI), subject to their policy limit of \$250,000. There is no limitation as to the number of accounts a member can have under ASI's coverage. ASI requires the maintenance of a deposit by each insured credit union in an amount equal to 1% of the Credit Union's maximum limit liability of \$1,500,000. The Credit Union maintains a deposit with ASI in the amount of \$15,000.

NCUSIF Insurance Premiums: A credit union is required to pay an annual insurance premium based on a percent of its total insured shares, unless the payment is waived or reduced by the NCUA Board.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 1: ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES – *continued*

Members' share and savings accounts: Members' shares are the savings deposit accounts of the owners of the Credit Union. Share ownership entitles the members to vote in the annual elections of the Board of Directors and on other corporate matters. Irrespective of the amount of shares owned, no member has more than one vote. Members' shares are subordinated to all other liabilities of the Credit Union in the event of liquidation. Interest on share and savings accounts is based on available earnings at the end of an interest period and is not guaranteed by the Credit Union. Interest rates on share and savings accounts are set by the Board of Directors, based on an evaluation of current and future market conditions.

Members' equity: The Credit Union is required by regulation to maintain a statutory reserve. This reserve, which represents a regulatory restriction of retained earnings, is not available for the payment of interest.

Income taxes: The Credit Union is exempt, by statute, from federal and state income taxes under the provisions of the Internal Revenue Code.

Off-balance-sheet credit related financial instruments: In the ordinary course of business, the Credit Union has entered into commitments to extend credit. Such financial instruments are recorded when they are funded.

Comprehensive income (loss): Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss) that includes unrealized gains and losses on securities available-for-sale.

Retirement plans: The Credit Union has a contributory 401(k) retirement plan for all employees who have met both tenure and minimum age requirements specified in the plan through Bourns, Inc.

Presentation of comparative financial statements: To more clearly illustrate the financial condition of the Credit Union and the results of its operations, the current year financial information is presented along with the previous year. Financial information presented for the previous year may be classified differently than originally disclosed. These reclassifications, which do not affect the auditor's report on those financial statements, were made for purposes of comparison.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 2: CASH AND CASH EQUIVALENTS

Cash and cash equivalents, including investments with original maturity of three months or less, are as follows:

	December 31,	
	2017	2016
Cash on hand	142,287	\$ 131,259
Cash on deposit	1,085,917	624,353
	\$ 1,228,204	\$ 755,612

NOTE 3: INVESTMENTS

The carrying and estimated fair values of investments are as follows:

	December 31,	
	2017	2016
CERTIFICATES OF DEPOSIT	\$ 11,975,000	\$ 8,784,000
	December 31,	
	2017	2016
CONTRIBUTED CAPITAL ACCOUNT	\$ 92,410	\$ 90,288

The member contributed capital account is invested in Catalyst Corporate Federal Credit Union. This deposit is a permanent capital contribution. This investment is not publicly traded; therefore, it is not practical to determine its fair value. The amortized cost approximates the fair value.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 3: INVESTMENTS – *continued*

NEGOTIABLE SECURITIES

	December 31, 2017			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<i>Available-for-sale:</i>				
Mortgage-backed securities guaranteed by U.S. government sponsored enterprises	\$ 2,088,428	\$ 39,212	\$ 49,814	\$ 2,077,826
Capital stock, Federal Home Loan Bank	177,700	-	-	177,700
Capital stock, credit union service organizations	183,042	-	-	183,042
	<u>\$ 2,449,170</u>	<u>\$ 39,212</u>	<u>\$ 49,814</u>	<u>\$ 2,438,568</u>

Included with mortgage backed securities guaranteed by U.S. Government sponsored enterprises above are collateralized mortgage obligations with net book value of \$155,157 and fair market value of \$178,617 as of December 31, 2017.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 3: INVESTMENTS – *continued*

NEGOTIABLE SECURITIES – *continued*

	December 30, 2016			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<i>Available-for-sale:</i>				
Mortgage-backed securities guaranteed by U.S. government sponsored enterprises	\$ 2,451,532	\$ 45,893	\$ 87,289	\$ 2,410,136
Capital stock, Federal Home Loan Bank	158,800	-	-	158,800
Capital stock, credit union service organizations	177,375	-	-	177,375
	\$ 2,787,707	\$ 45,893	\$ 87,289	\$ 2,746,311

Included with mortgage backed securities guaranteed by U.S. Government sponsored enterprises above are collateralized mortgage obligations with net book value of \$203,561 and fair market value of \$224,702 as of December 31, 2016.

Investments in Credit Union Service Organizations and Federal Home Loan Bank of San Francisco are not publicly traded; therefore, it is not practical to determine these fair values. The amortized cost approximates the fair value.

The credit union has \$120,000 invested in Member Business Lending LLC as of December 31, 2017. The investment is going to be written off by December 31, 2018.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 3: INVESTMENTS – *continued*

NEGOTIABLE SECURITIES – *continued*

Information pertaining to securities with gross unrealized losses as of December 31, 2017 and 2016, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, follows:

December 31, 2017				
Continuous Unrealized Losses Existing for				
Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses	
<i>Available-for-sale:</i>				
Mortgage-backed securities guaranteed by U.S. government sponsored enterprises	\$ 1,812,105	\$ 2,747	\$ 47,067	\$ 49,814
	\$ 1,812,105	\$ 2,747	\$ 47,067	\$ 49,814
December 31, 2016				
Continuous Unrealized Losses Existing for				
Fair Value	Less than 12 months	More than 12 months	Total Unrealized Losses	
<i>Available-for-sale:</i>				
Mortgage-backed securities guaranteed by U.S. government sponsored enterprises	\$ 2,066,848	\$ 75,617	\$ 11,672	\$ 87,289
	\$ 2,066,848	\$ 75,617	\$ 11,672	\$ 87,289

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 3: INVESTMENTS – *continued*

NEGOTIABLE SECURITIES – *continued*

The accounting standards provide a framework for measuring fair value and further defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Credit Union determines the fair values of its financial instruments based on the fair value hierarchy established in generally accepted accounting principles (GAAP), which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

This framework describes three levels of inputs that may be used to measure fair value. Financial instruments are considered level 1 when valuation can be based on quoted prices in active markets for identical assets or liabilities. Financial instruments are considered level 2 when they are generally valued using quoted prices for similar assets. The fair value of available-for-sale and held-to-maturity securities is based on quoted market prices or market prices for similar assets. Financial instruments are considered level 3 when valuation is calculated by the use of pricing models and/or discounted cash flow methodologies or valuation requires significant management judgment or estimation. The Credit Union does not use level 3 pricing.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given, among other things, to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Credit Union to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Market changes in interest rates and market changes in credit spreads will cause normal fluctuations in the market price of securities and the possibility of temporary unrealized losses. The reason for the temporary loss is that market interest rates are higher than when these securities were originally purchased. The Credit Union reviews all of its securities for impairment periodically. The Credit Union has determined that there was no other-than-temporary impairment associated with these securities as of December 31, 2017.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 3: INVESTMENTS - *continued*

NEGOTIABLE SECURITIES – *continued*

A summary of investments by contractual maturity is shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31,	
	2017	2016
Within one year	\$ 4,119,000	\$ 5,421,000
One to five years	7,760,000	3,267,000
Over five years	96,000	96,000
Investments with principal repayments	2,088,428	2,451,532
Subtotal	14,063,428	11,235,532
Investments without a defined maturity	453,152	426,463
	\$ 14,516,580	\$ 11,661,995

Accrued interest receivable on investments amounted to \$29,977 and \$21,744 as of December 31, 2017 and 2016, respectively.

NOTE 4: LOANS RECEIVABLE

The composition of loans receivable is as follows:

	December 31,	
	2017	2016
Real estate	\$ 17,965,907	\$ 16,890,440
Automobile	4,707,521	2,994,453
Credit cards	2,536,189	2,458,644
Home equity lines of credit	1,530,267	1,229,734
Other loans	1,295,696	569,101
Commercial loans	1,040,482	801,136
	29,076,062	24,943,508
Discount on loans, net of premium	(16,297)	-
Allowance for loan losses	(356,578)	(457,893)
	\$ 28,703,187	\$ 24,485,615

Accrued interest receivable on loans amounted to \$59,366 and \$52,469 as of December 31, 2017 and 2016, respectively.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 4: LOANS RECEIVABLE - *continued*

The acquisition of Bakery Employees Credit Union in February 2017 resulted in a net discount of \$14,931 which includes both an adjustment to the fair value of the loan portfolio and the estimated credit risk in the portfolio. There was a net loan charged off of \$7,315 for the year ending December 31, 2017. The Credit Union amortized \$8,681 from the loss on acquired loans for the year ending December 31, 2017. The net discount amounted to \$16,297 as of December 31, 2017.

Allowance for loan losses: The Credit Union has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the Credit Union's portfolio. For purposes of determining the allowance for loan losses, the Credit Union segments certain loans in its portfolio by product type. The Credit Union's loans are segmented into the following pools: auto loan portfolio, real estate loan portfolio, consumer secured loan portfolio, and consumer unsecured loan portfolio. The Credit Union also sub-segments three of these segments into classes based on the associated risks within those segments. Real estate loans are divided into the following six classes: (a) first mortgage loans with fixed interest rate, (b) first mortgage loans with variable interest rate, (c) first mortgage for investment property loans, (d) second mortgage loans, (e) home equity lines of credit loans, and (f) mortgage loans under modification. Consumer secured loans are divided into the following two classes: (a) share secured loans and (b) miscellaneous secured loans. Consumer unsecured loans are divided into the following five classes: (a) classic credit card loans, (b) gold credit card loans, (c) platinum credit card loans, (d) signature loans, and (e) consumer loans under modification. Each class of loans requires significant judgment to determine the estimation method that fits the credit risk characteristic of its portfolio segment. Management must use judgment in establishing additional input metrics for the modeling processes. The models and assumptions that the Credit Union uses to determine the allowance are independently validated and reviewed to ensure that their theoretical foundation, assumptions, data integrity, computational processes, reporting practices, and end-user controls are appropriate and properly documented.

The following are the factors that the Credit Union uses to determine the balance of the allowance account for each segment or class of loans.

Auto loans: Auto loans include loans secured by new auto or used auto. These loans are not assessed at an underlying class level. A historical loss percentage is applied to the segment. The historical loss percentage is calculated using a twelve months, twenty-four months, and thirty-six months ratio and the period with the highest historical loss percentage is used. The historical loss period as of December 31, 2017 was thirty-six months.

Based on the Credit Union's assessment on credit risk and analysis of leading predictors of losses, the Credit Union may apply additional loss multipliers to loan balances. As of December 31, 2017, the Credit Union considered additional loss estimations based on the loan delinquency category, bankruptcy category, and collateral value.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 4: LOANS RECEIVABLE - *continued*

Allowance for loan losses - continued:

Real estate loans: Real estate loans are pooled by portfolio class and a historical loss percentage is applied to each class. Historical loss percentage time frames may vary between classes. These time frames are based on historical loss experience modeling and other quantitative and mathematical migration techniques over the loss emergence period. The historical loss percentage is calculated using a twelve months, twenty-four months, and thirty-six months ratio and the period with the highest historical loss percentage is used. The historical loss period as of December 31, 2017 was thirty-six months.

The Credit Union estimates an additional component of the allowance for loan losses for the non-impaired real estate segment through the application of loss factors to loans grouped by their individual credit risk rating categories. These ratings reflect the estimated default probability and quality of underlying collateral. The loss factors used are statistically derived through the observation of losses incurred for loans within each internal credit risk rating over a specified period of time.

In addition, based on the Credit Union's analysis of leading predictors of losses, the Credit Union may apply additional loss multipliers to the loan balances. Currently, the Credit Union may consider additional loss estimations based on the average foreclosure rate where the properties are located, the loan delinquency category, bankruptcy category, and collateral value.

Consumer secured portfolio: Consumer secured loans include loans secured by shares or other collateral. Consumer secured loans are pooled by portfolio class and a historical loss percentage is applied to each class. The historical loss percentage is calculated using a twelve months, twenty-four months, and thirty-six months ratio and the period with the highest historical loss percentage is used. As of December 31, 2017, the historical loss time frame for each class was twelve months.

Based on the Credit Union's assessment on credit risk and analysis of leading predictors of losses, the Credit Union may apply additional loss multipliers to loan balances. As of December 31, 2017, the Credit Union considered additional loss estimations based on the loan delinquency category, bankruptcy category, and collateral value.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 4: LOANS RECEIVABLE - *continued*

Allowance for loan losses - continued:

Consumer unsecured portfolio: Unsecured consumer loans are pooled by portfolio class and a historical loss percentage is applied to each class. Historical loss percentage time frames may vary between classes. These time frames are based on historical loss experience modeling and other quantitative and mathematical migration techniques over the loss emergence period. The historical loss percentage is calculated using a twelve months, twenty-four months, and thirty-six months ratio and the period with the highest historical loss percentage is used. As of December 31, 2017, the historical loss time frame for each class was as follows:

Classic credit card loans – twelve months
Gold credit card loans – twelve months
Platinum credit card loans – twenty-four months
Signature loans – twelve months
Consumer loans under modification – twenty-four months

Based on the Credit Union's assessment on credit risk and analysis of leading predictors of losses, the Credit Union may apply additional loss multipliers to loan balances. As of December 31, 2017, the Credit Union considered additional loss estimations based on the loan delinquency category and bankruptcy category.

The Credit Union's estimation process: The Credit Union estimates loan losses under multiple economic scenarios to establish a range of potential outcomes for each criterion the Credit Union applies to the allowance calculation. Management applies judgment to develop its own view of loss probability within that range, using external and internal parameters with the objective of establishing an allowance for the losses inherent within these portfolios as of the reporting date.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 4: LOANS RECEIVABLE - *continued*

Allowance for loan losses - continued:

Loans by Segment: The total allowance reflects Management's estimate of loan losses inherent in the loan portfolio as of December 31, 2017 and 2016. The Credit Union considers the allowance for loan losses of \$356,578 and \$457,893 adequate to cover loan losses inherent in the loan portfolio as of December 31, 2017 and 2016, respectively. The following tables present by portfolio segment, the changes in the allowance for loan losses and the loans receivable.

Allowance for Loan Losses and Receivable in Loans				
For the Year Ended December 31, 2017				
	Real Estate	Other Consumer	Credit Cards	Total
<u>Allowance for Loan Losses:</u>				
Beginning balance	\$ 312,798	\$ 33,878	\$ 111,217	\$ 457,893
Charge-offs	-	(20,382)	(60,022)	(80,404)
Recoveries	-	9,800	12,088	21,888
Provision for loan losses (credit)	(136,744)	87,954	5,991	(42,799)
Ending balance	<u>\$ 176,054</u>	<u>\$ 111,250</u>	<u>\$ 69,274</u>	<u>\$ 356,578</u>
Ending balance:				
• individually evaluated for impairment	176,054	83,427	20,934	280,415
• collectively evaluated for impairment	-	27,823	48,340	76,163
	<u>\$ 176,054</u>	<u>\$ 111,250</u>	<u>\$ 69,274</u>	<u>\$ 356,578</u>
<u>Loans Receivable:</u>				
Ending balance:				
• individually evaluated for impairment	2,095,286	107,900	20,934	2,224,120
• collectively evaluated for impairment	18,441,370	5,895,317	2,515,255	26,851,942
	<u>\$ 20,536,656</u>	<u>\$ 6,003,217</u>	<u>\$ 2,536,189</u>	<u>\$ 29,076,062</u>

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 4: LOANS RECEIVABLE - *continued*

Allowance for loan losses - continued:

Loans by Segment - continued:

	Allowance for Loan Losses and Receivable in Loans For the Year Ended December 31, 2016			
	Real Estate	Other Consumer	Credit Cards	Total
<u>Allowance for Loan Losses:</u>				
Beginning balance	\$ 532,922	\$ 20,995	\$ 44,821	\$ 598,738
Charge-offs	-	(35,917)	(59,271)	(95,188)
Recoveries	-	10,324	9,634	19,958
Provision for loan losses (credit)	(220,124)	38,476	116,033	(65,615)
Ending balance	<u>\$ 312,798</u>	<u>\$ 33,878</u>	<u>\$ 111,217</u>	<u>\$ 457,893</u>
Ending balance:				
• individually evaluated for impairment	312,798	12,587	50,417	375,802
• collectively evaluated for impairment	-	21,291	60,800	82,091
	<u>\$ 312,798</u>	<u>\$ 33,878</u>	<u>\$ 111,217</u>	<u>\$ 457,893</u>
<u>Loans Receivable:</u>				
Ending balance:				
• individually evaluated for impairment	4,817,079	64,664	54,798	4,936,541
• collectively evaluated for impairment	14,104,231	3,498,890	2,403,846	20,006,967
	<u>\$ 18,921,310</u>	<u>\$ 3,563,554</u>	<u>\$ 2,458,644</u>	<u>\$ 24,943,508</u>

Changes in accounting methodology: For the year ended December 31, 2017, there were no significant changes in the accounting methodology for the allowance for loan losses.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 4: LOANS RECEIVABLE - *continued*

Credit quality information: Payment activity is reviewed by Management periodically to determine how loans are performing. Loans are considered to be nonperforming when days delinquent is greater than sixty days.

Nonperforming loans would also include certain loans that have been modified in TDRs where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Credit Union's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs would be classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period. There were no non-performing real estate loans as of December 31, 2017.

Age analysis of past due loans receivable by class: Following are tables which include an aging analysis of past due loans receivable as of December 31, 2017 and 2016.

Credit Quality Information					
Age Analysis of Past Due Loans Receivable by Class					
As of December 31, 2017					
	30-59 Days Past Due	60 Days Past Due or Greater	Total Past Due	Current	Total Loans Receivable
Real estate	\$ -	\$ -	\$ -	\$ 20,536,656	\$ 20,536,656
Consumer	124,436	48,253	172,689	5,830,528	6,003,217
Credit cards	7,071	20,934	28,005	2,508,184	2,536,189
Total	\$ 131,507	\$ 69,187	\$ 200,694	\$ 28,875,368	\$ 29,076,062

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 4: LOANS RECEIVABLE - *continued*

Age analysis of past due loans receivable by class - continued:

Credit Quality Information					
Age Analysis of Past Due Loans Receivable by Class					
As of December 31, 2016					
	60 Days Past				
	30-59 Days Past Due	Due or Greater	Total Past Due	Current	Total Loans Receivable
Real estate	\$ 222,303	\$ 269,331	\$ 491,634	\$ 18,429,676	\$ 18,921,310
Consumer	28,248	64,664	92,912	3,470,642	3,563,554
Credit cards	932	54,798	55,730	2,402,914	2,458,644
Total	<u>\$ 251,483</u>	<u>\$ 388,793</u>	<u>\$ 640,276</u>	<u>\$ 24,303,232</u>	<u>\$ 24,943,508</u>

Impaired loans: The Credit Union considers a loan to be impaired when, based on current information and events, the Credit Union determines that it will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When the Credit Union identifies a loan as impaired, the Credit Union measures the impairment based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, the Credit Union uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of discounted cash flows. If the Credit Union determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), the Credit Union recognizes impairment through an allowance estimate or a charge-off to the allowance. The Credit Union determines impairment based on a sixty-day default period and all loans classified as TDRs.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

Nonaccrual loans: The Credit Union generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loans reach sixty days past due.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 4: LOANS RECEIVABLE - *continued*

Nonaccrual loans - continued: When the Credit Union places a loan on nonaccrual status, the Credit Union reverses the accrued unpaid interest receivable against interest income and accounts for the loan on the cash basis method, until it qualifies for return to accrual status. Generally, the Credit Union returns a loan to accrual status when (a) all delinquent interest and principal become current under the terms of the loan agreement or (b) the loan is both well-secured and in the process of collection and collectability is no longer doubtful.

The Credit Union has determined that the entire balance of a loan is contractually delinquent for all classes if the minimum payment is not received by the specified due date on the member's statement. Interest and fees continue to accrue on past due loans until the date the loan goes into nonaccrual status, if applicable. As of December 31, 2017, \$28,617 of loans were placed on nonaccrual status with approximately \$700 of accrued interest not recognized in the financial statements.

NOTE 5: PROPERTY AND EQUIPMENT

Property and equipment are summarized as follows:

	December 31,	
	<u>2017</u>	<u>2016</u>
Land	\$ 250,000	\$ -
Building and improvements	190,059	-
Furniture, fixtures, and equipment	224,360	151,551
Subtotal	<u>664,419</u>	<u>151,551</u>
Accumulated depreciation and amortization	<u>(128,099)</u>	<u>(101,811)</u>
	<u>\$ 536,320</u>	<u>\$ 49,740</u>

Depreciation and amortization expense amounted to \$37,777 and \$21,737 for the years ended December 31, 2017 and 2016, respectively.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 6: MEMBERS' SHARE AND SAVINGS ACCOUNTS

Shares and savings accounts are summarized as follows:

	December 31,	
	<u>2017</u>	<u>2016</u>
Share drafts	\$ 2,590,726	\$ 2,428,425
Share savings	20,398,982	14,149,634
Other deposits	15,653,303	14,555,376
	<u>\$ 38,643,011</u>	<u>\$ 31,133,435</u>

The aggregate amounts of uninsured members' share and savings accounts were approximately \$860,000 and \$250,000 as of December 31, 2017 and 2016, respectively.

A summary by maturity of members' share and savings accounts is as follows:

	December 31,	
	<u>2017</u>	<u>2016</u>
No contractual maturity	\$ 25,996,374	\$ 19,482,010
Within one year	8,715,733	8,649,891
One to three years	3,231,182	2,386,174
Over three years	699,722	615,360
	<u>\$ 38,643,011</u>	<u>\$ 31,133,435</u>

Interest rates are set by the Board of Directors, based on an evaluation of current and future market conditions.

NOTE 7: BORROWED FUNDS

The Credit Union maintains a line of credit agreement with Catalyst Corporate Federal Credit Union at a rate to be determined by the lender when funds are borrowed. As of December 31, 2017 and 2016, the Credit Union had no outstanding balance on the line of credit but could borrow up to \$2,500,000.

NOTE 8: COMMITMENTS AND CONTINGENT LIABILITIES

The Credit Union is a party to various legal actions normally associated with financial institutions, the aggregate effect of which, in Management's and legal counsel's opinion, would not be material to the Credit Union's financial condition.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 8: COMMITMENTS AND CONTINGENT LIABILITIES - *continued*

The principal commitments of the Credit Union are as follows:

Financial instruments with off-balance sheet risk: The Credit Union is a party to conditional commitments to lend funds in the normal course of business to meet the financing needs of its members. These commitments represent financial instruments to extend credit which include lines of credit, credit cards, and home equity lines that involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the financial statements.

The Credit Union's exposure to credit loss is represented by the contractual notional amount of these instruments. The Credit Union uses the same credit policies in making commitments as it does for loans recorded in the financial statements.

These financial instruments include commitments for lines of credit, credit cards, and home equity lines of credit. The contract amounts represent credit risk totaling approximately \$9,220,000 and \$8,550,000 as of December 31, 2017 and 2016, respectively.

Commitments to extend credit are agreements to lend to a member as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Credit Union evaluates each member's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Credit Union upon extension of credit, is based on Management's credit evaluation of the counterparty. Collateral held generally consists of certificates of deposit, share accounts, automobiles and real estate.

Unfunded commitments under revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing members. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Credit Union is committed.

Financial instruments with concentration of credit risk: The Credit Union's lending activity is with its members as previously described in Note 1. The Credit Union's policy is to obtain collateral whenever necessary.

A substantial portion of the cash equivalents portfolio is comprised of deposits in Catalyst Corporate Federal Credit Union. As of December 31, 2017, the deposit exceeds the insured amount by approximately \$670,000 for Catalyst Corporate Federal Credit Union.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 9: RELATED-PARTY TRANSACTIONS

In the normal course of business, the Credit Union extends credit to directors, supervisory committee members and executive officers. The aggregate loans as of December 31, 2017 and 2016 amounted to approximately \$2,480,000 and \$2,180,000, respectively. The aggregate amounts of these loans were not significant to the financial statements. Deposits from those related parties as of December 31, 2017 and 2016 amounted to approximately \$360,000 and \$550,000, respectively.

Bourns, Inc. provided support and services, including personnel and related benefit costs, office space, data processing, and various other operating expenses for the benefit of the members of Bourns Employees Federal Credit Union. The Credit Union reimburses these costs. Any unpaid amount are recorded as part of liabilities as of December 31, 2017.

NOTE 10: RETIREMENT PLAN

401(k) Retirement plan: The Credit Union has a 401(k) retirement plan through Bourns, Inc., for all employees who have met both the tenure and minimum age requirements specified in the plan. The Credit Union contributions are based on a percentage of employee compensation and totaled \$18,715 and \$12,887 for the years ended December 31, 2017 and 2016, respectively.

NOTE 11: REGULATORY CAPITAL

The Credit Union is subject to various regulatory capital requirements administered by the National Credit Union Administration. Failure to meet minimum net worth requirements can initiate certain mandatory (and possibly additional discretionary) actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Credit Union must meet specific net worth guidelines that involve quantitative measures of the Credit Union's assets and liabilities, as calculated under generally accepted accounting principles. The Credit Union's capital amounts and net worth classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Credit Union to maintain minimum amount and ratios (set forth in the table below) of net worth (as defined in the regulations) to assets (as defined). Credit Unions are also required to calculate a Risk-Based Net Worth Requirement (RBNWR), which establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNWR ratio as calculated by the NCUA as of December 31, 2017 is 6.08%. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes that as of December 31, 2017, the Credit Union meets all capital adequacy requirements to which it is subject.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 11: REGULATORY CAPITAL - *continued*

As of December 31, 2017, the most recent call reporting period, NCUA categorized the Credit Union as “well-capitalized” under the regulatory framework for prompt corrective action. To be categorized as “well-capitalized,” the Credit Union must maintain a minimum net worth ratio of 7% of assets and meet any applicable RBNWR. There are no conditions or events since that notification that Management believes have changed the Credit Union’s category.

The Credit Union’s actual capital amounts and ratios as of December 31, 2017 are also presented in the table, as follows:

Actual		For Capital Adequacy Purposes		To be Well-Capitalized per Prompt Corrective Action Provisions	
<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
\$ 7,331,241	15.7%	\$ 2,804,082	6.0%	\$ 3,271,429	7.0%

The calculations above are made without including other comprehensive income.

Because the RBNWR is less than the net worth ratio, the Credit Union retains its original category. Furthermore, in performing its calculation of total assets, the Credit Union used the quarter-end option, as permitted by regulation.

NOTE 12: MORTGAGE SERVICING RIGHTS

Mortgage loans serviced for Federal National Mortgage Association (FNMA or Fannie Mae) are not included in the accompanying statements of financial condition. The unpaid principal balance of the loans being serviced was \$83,729,888 and \$42,795,140 as of December 31, 2017 and 2016, respectively.

A summary of the changes in the balance of mortgage servicing rights for the period ended December 31, 2017 and 2016 is as follows:

	December 31,	
	<u>2017</u>	<u>2016</u>
Balance, beginning of year	\$ 538,877	\$ 167,703
Servicing assets recognized	702,242	484,105
Amortization of servicing assets	(210,378)	(112,931)
Balance, end of year	<u>\$ 1,030,741</u>	<u>\$ 538,877</u>

BOURNS EMPLOYEES FEDERAL CREDIT UNION

NOTES TO FINANCIAL STATEMENTS

December 31, 2017 and 2016

NOTE 13: ACQUISITION AND MERGER

In February 2017, Bourns Employees Federal Credit Union acquired the assets and assumed the liabilities of Bakery Employees Credit Union. The fair value of assets acquired from Bakery Employees Credit Union totaled to \$6.98 million.

Non-cash investing activity due to acquisition with Bakery Employees Credit Union is as follows:

Fair value of investments, property, and other assets acquired	3,241,018
Fair value of loans receivable acquired	1,608,746
Fair value of members' share accounts assumed	6,305,941
Fair value of liabilities assumed	83,256

Board of Directors and Supervisory Committee
Bourns Employees Federal Credit Union
Riverside, California

INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

We have audited the financial statements of Bourns Employees Federal Credit Union as of and for the year ended December 31, 2017, and our report thereon dated March 30, 2018, which expressed an unmodified opinion on those financial statements, appears on page AFS-1 and page AFS-2. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying information listed below is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of Management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the accompanying information presented herein is fairly stated in all material respects in relation to the financial statements taken as a whole.

Schedule of Other General and Administrative Expenses

Summary of Reclassifying Entries

Review of Financial Trends

RICHARDS & ASSOCIATES
Certified Public Accountants



Michael E. Richards, CPA

Yorba Linda, California
March 30, 2018

BOURNS EMPLOYEES FEDERAL CREDIT UNION

SCHEDULE OF OTHER GENERAL AND ADMINISTRATIVE EXPENSES

Years ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Loan servicing	\$ 181,144	\$ 145,534
Office occupancy	57,100	31,979
Education and promotion	44,171	27,740
Outsourced services	43,300	33,830
Travel and conference	30,927	18,380
Association dues	12,139	8,684
Regulatory supervision	8,734	6,686
Members' insurance	480	480
Miscellaneous expenses	<u>21,959</u>	<u>17,334</u>
	<u>\$ 399,954</u>	<u>\$ 290,647</u>

This schedule is supplemental information only.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

SUMMARY OF RECLASSIFYING ENTRIES

Year ended December 31, 2017

	<u>DEBIT</u>	<u>CREDIT</u>
<i>RECLASSIFYING ENTRY 1</i>		
Other income	\$ 5,667	
Income from investments		\$ 5,667

To reclassify income from credit union service organizations.

RECLASSIFYING ENTRY 2

Investments	\$ 183,042	
Other assets		\$ 183,042

To reclassify investments in credit union service organizations.

RECLASSIFYING ENTRY 3

Undivided earnings	\$ 497	
Equity acquired through merger		\$ 497

To reclassify the net income from Bakery Employees Federal Credit Union in February 2017.

RECLASSIFYING ENTRY 4

Share insurance deposit	\$ 15,000	
Other assets		\$ 15,000

To reclassify share insurance deposit balance at American Share Insurance as of December 31, 2017.

This schedule is supplemental information only.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

SUMMARY OF RECLASSIFYING ENTRIES - *continued*

Year ended December 31, 2017

	<u>DEBIT</u>	<u>CREDIT</u>
<i>RECLASSIFYING ENTRY 5</i>		
Loans receivable	\$ 3,487	
Members' share and savings accounts		\$ 3,487

To reclassify negative shares to loans receivable.

RECLASSIFYING ENTRY 6

Other assets	\$ 1,300	
Loans receivable		\$ 1,300

To reclassify cash advance in process as of December 31, 2017.

RECLASSIFYING ENTRY 7

Other non-operating income	\$ 702,242	
Gain on servicing assets		\$ 702,242

To reclassify the gain on servicing assets.

RECLASSIFYING ENTRY 8

Other non-operating income	\$ 9,925	
Rental income		\$ 9,925

To reclassify rental income.

This schedule is supplemental information only.

BOURNS EMPLOYEES FEDERAL CREDIT UNION

SUMMARY OF RECLASSIFYING ENTRIES - *continued*

Year ended December 31, 2017

	<u>DEBIT</u>	<u>CREDIT</u>
<i>RECLASSIFYING ENTRY 9</i>		
Cash and cash equivalents	\$ 112,389	
Other liabilities		\$ 112,389

To reclassify clearing account with a credit balance as of December 31, 2017.

RECLASSIFYING ENTRY 10

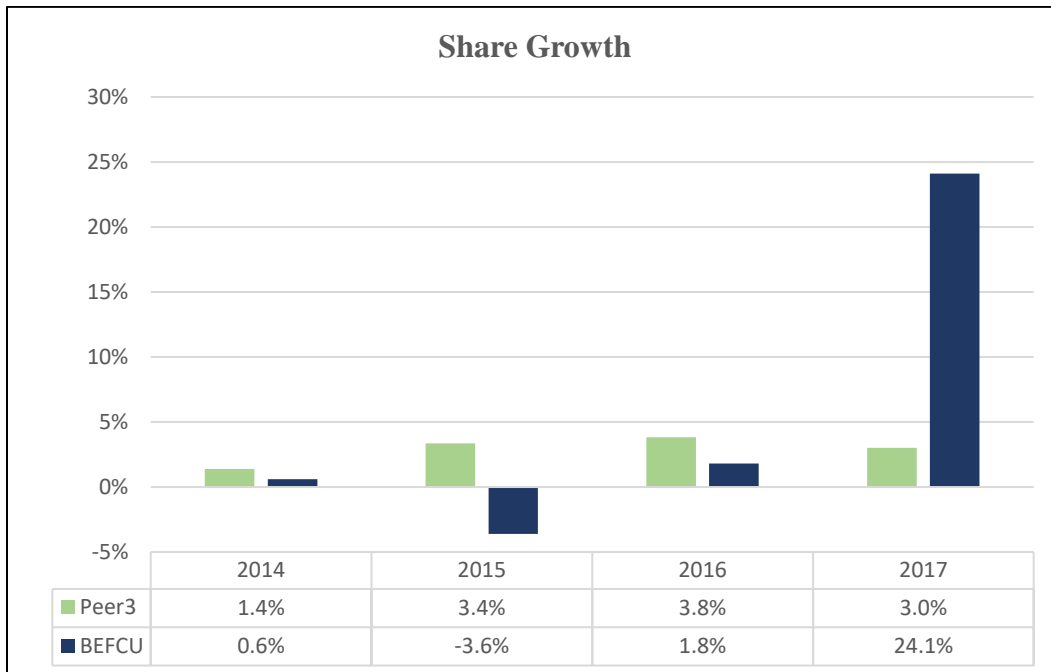
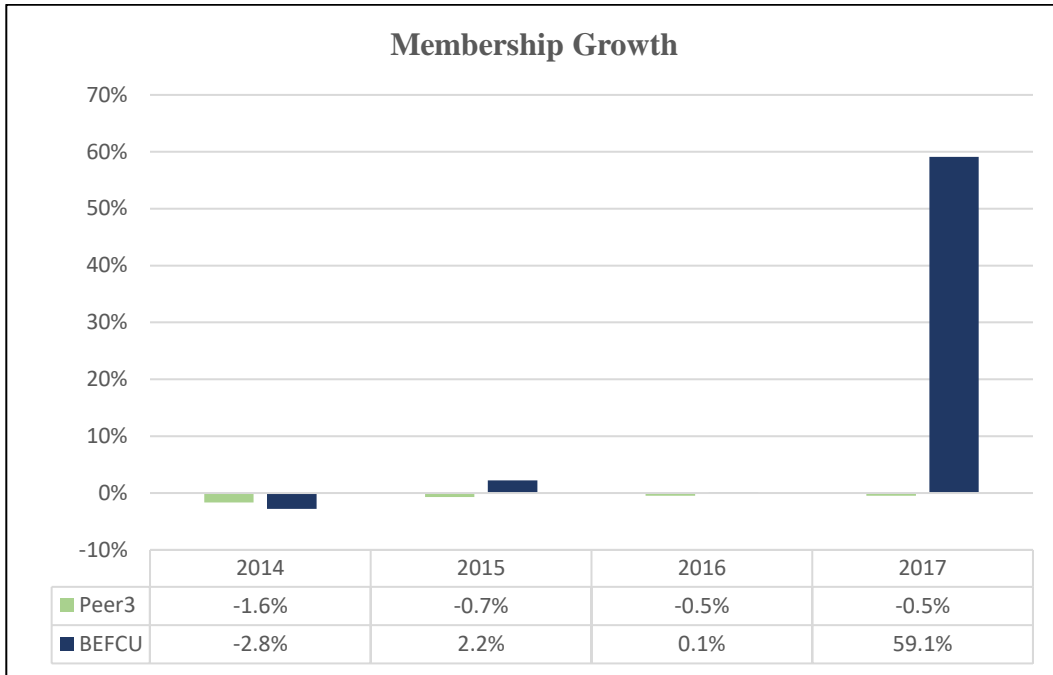
Other assets	\$ 22,943	
Cash and cash equivalents		\$ 22,943

To reclassify clearing accounts with debit balances as of December 31, 2017.

This schedule is supplemental information only.

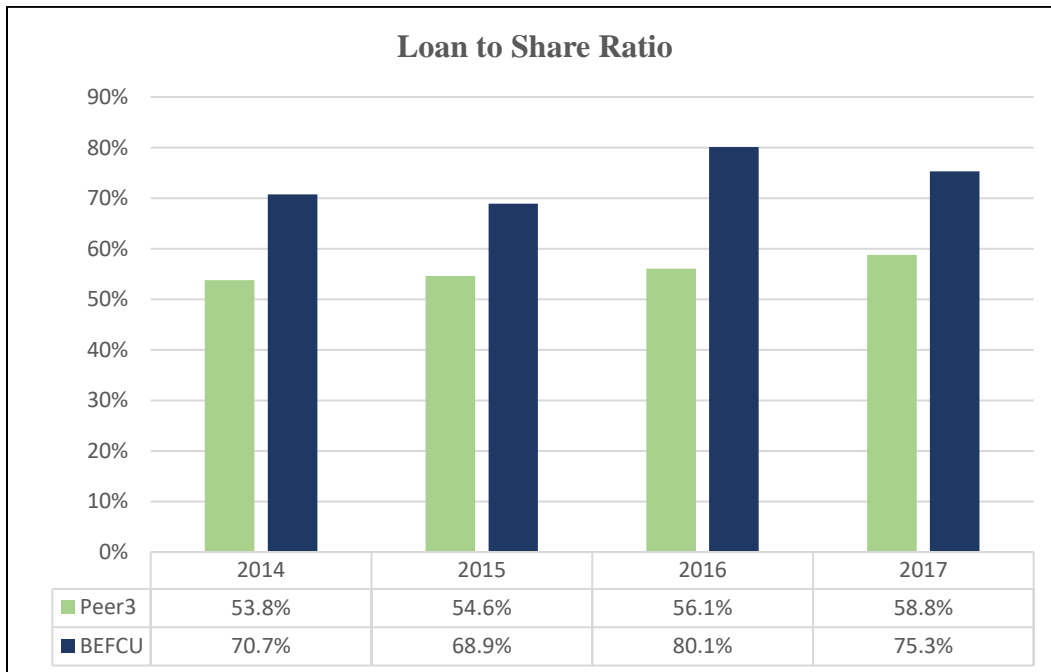
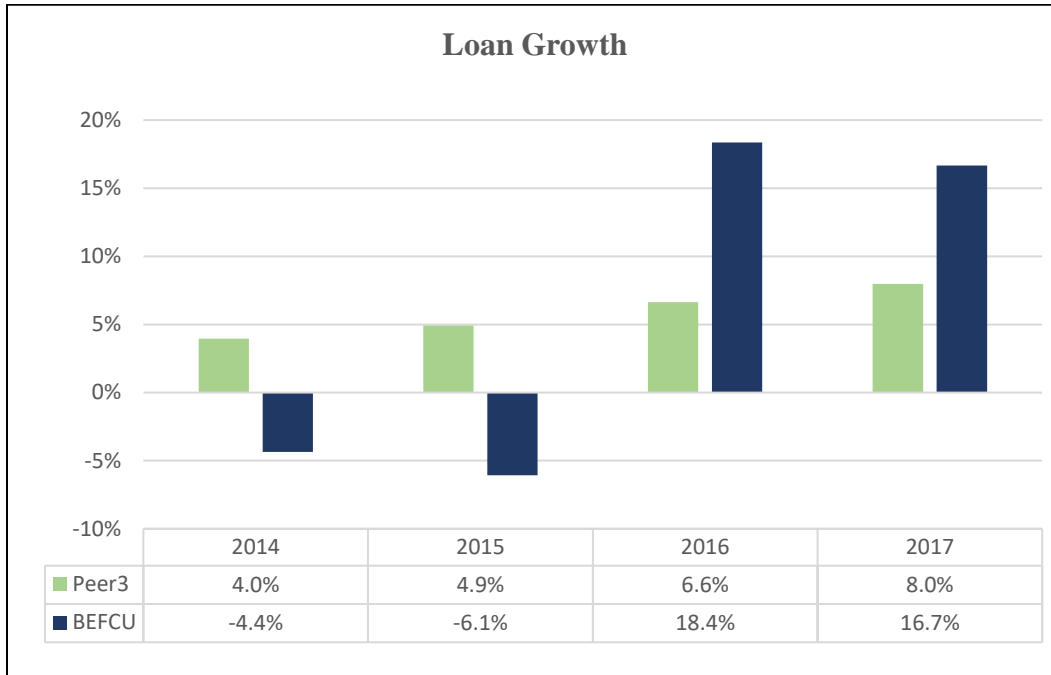
**Bourns Employees Federal Credit Union
REVIEW OF FINANCIAL TRENDS
December 31, 2017**

The Peer group is the aggregate ratio for all credit unions of similar asset size in the Western United States.



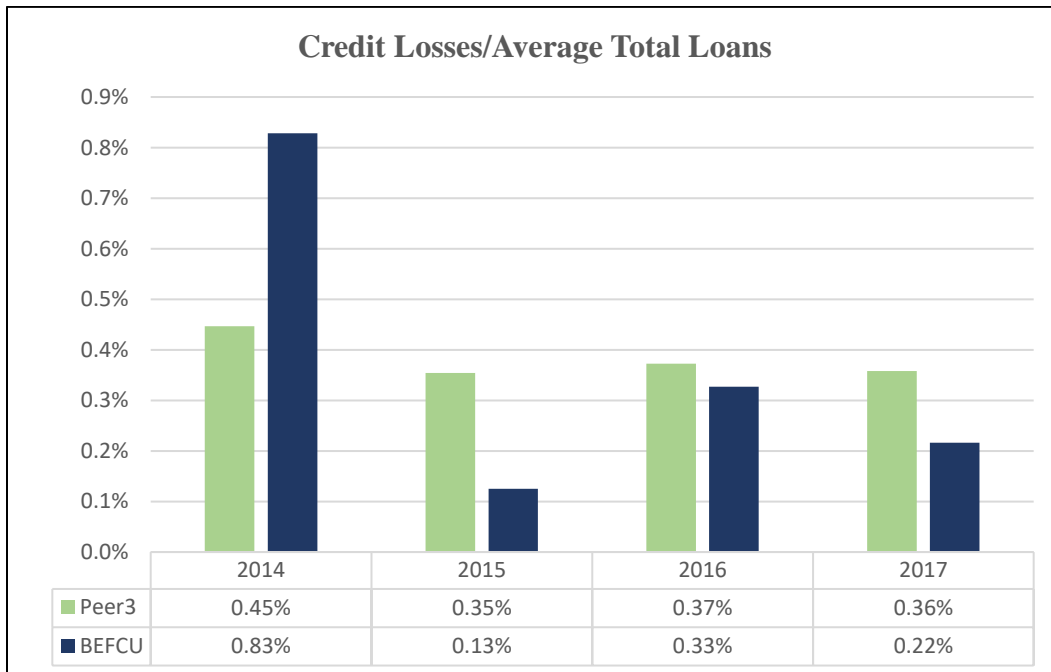
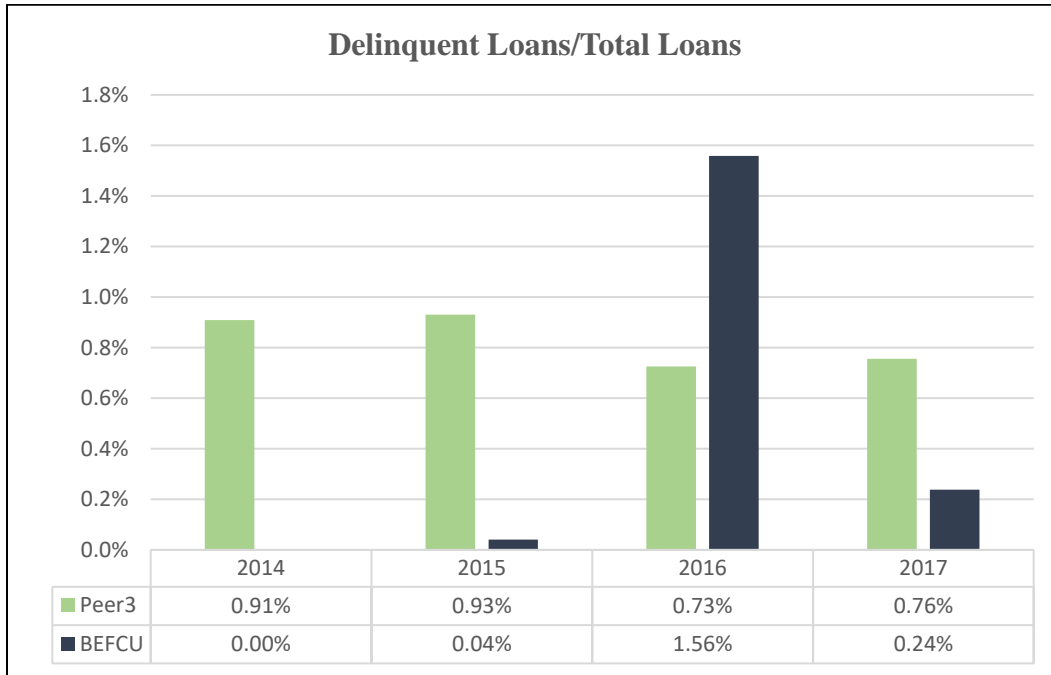
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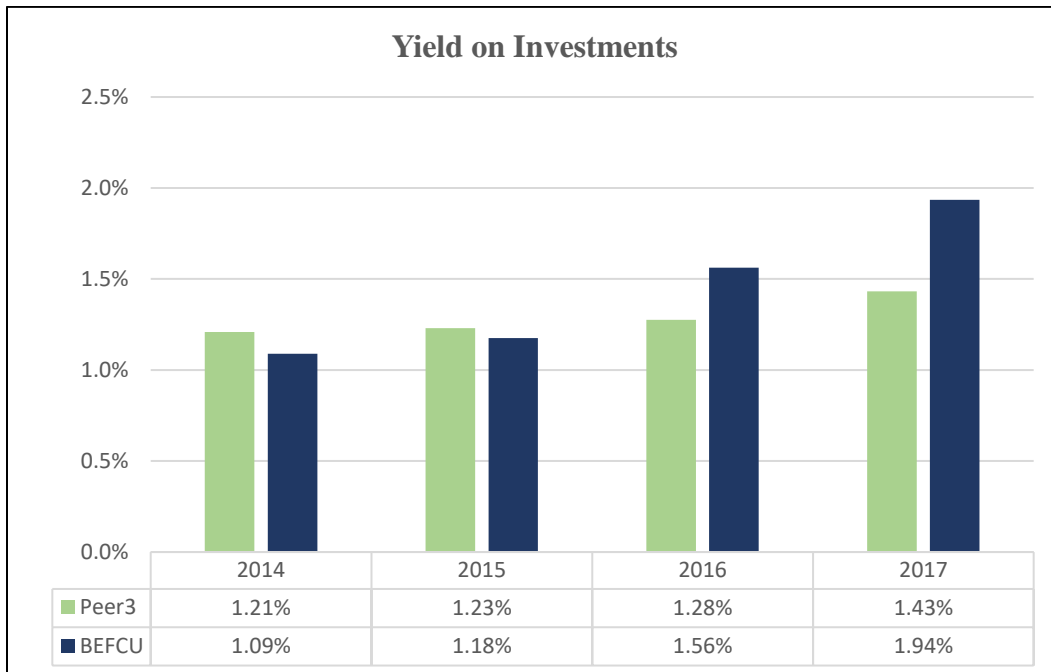
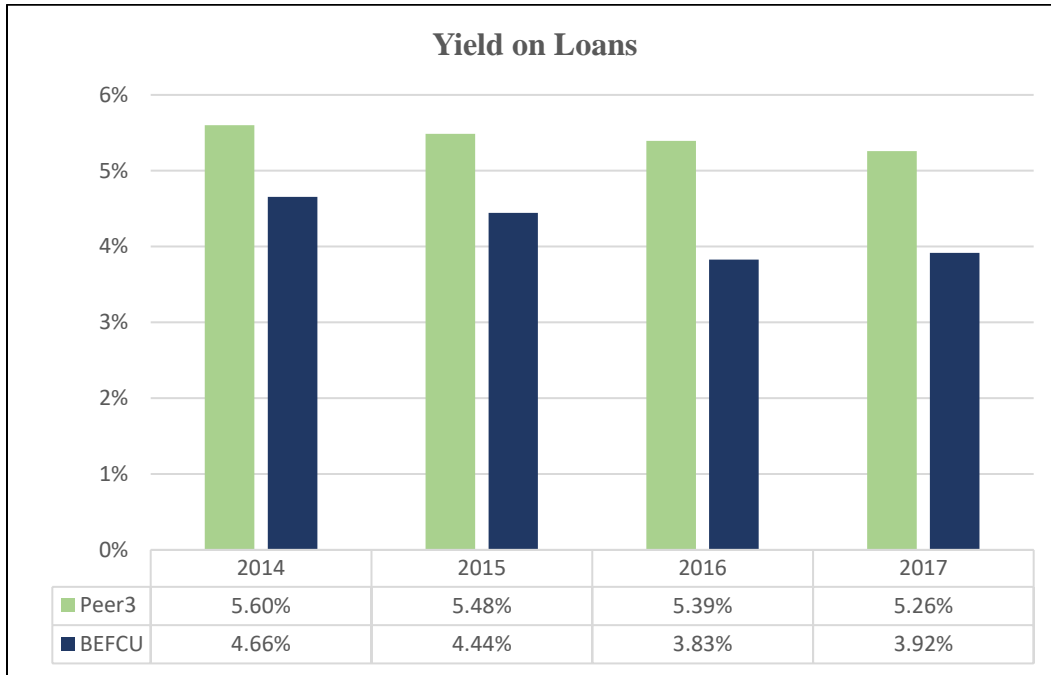
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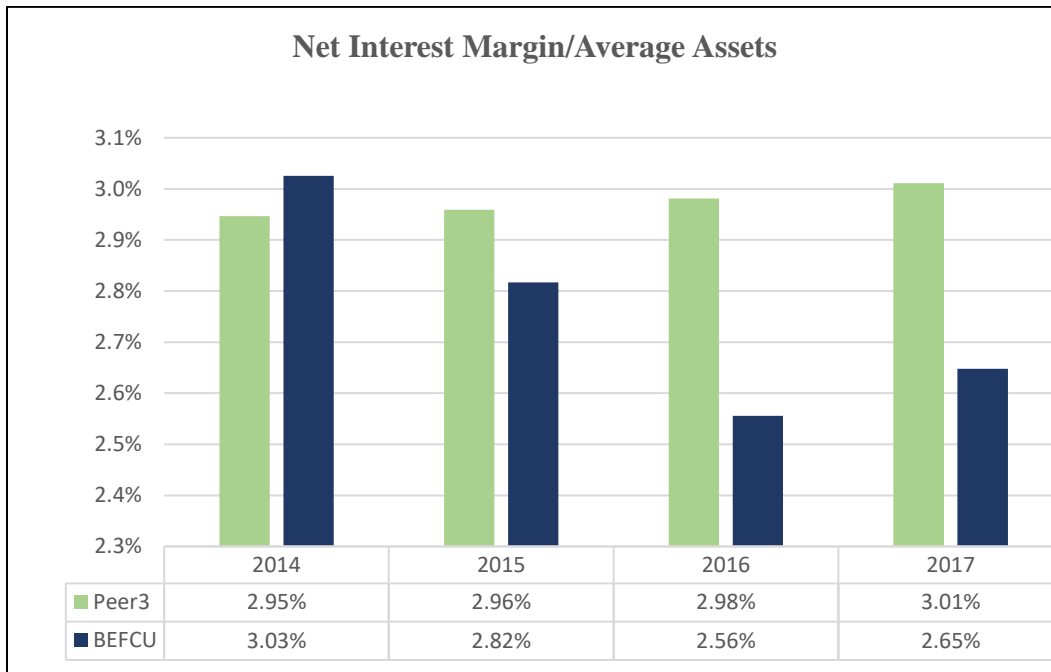
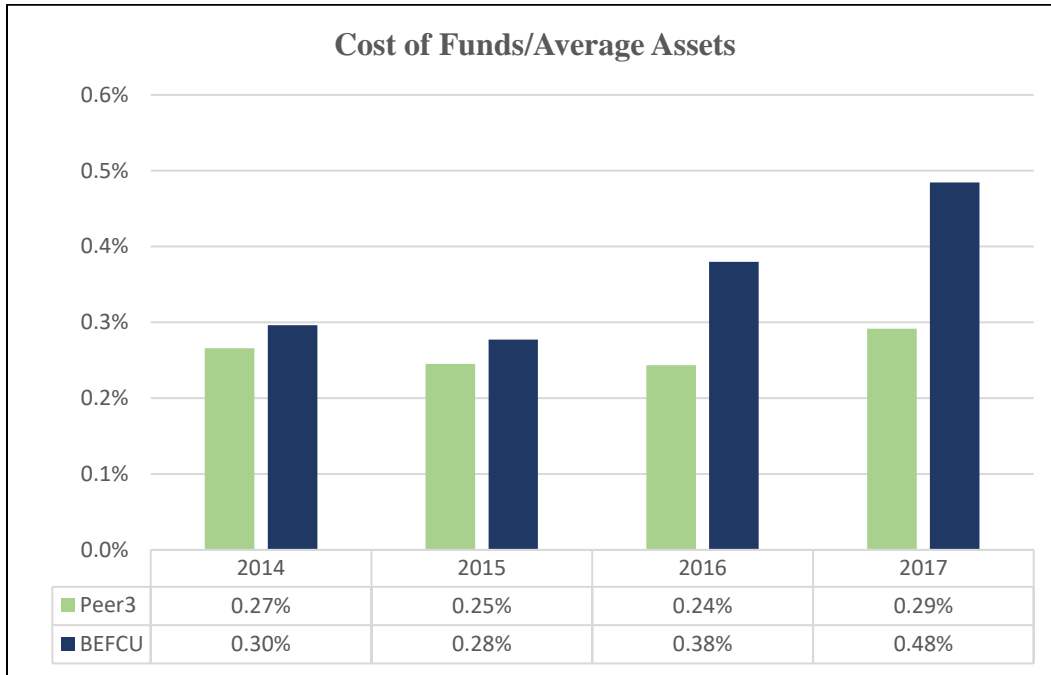
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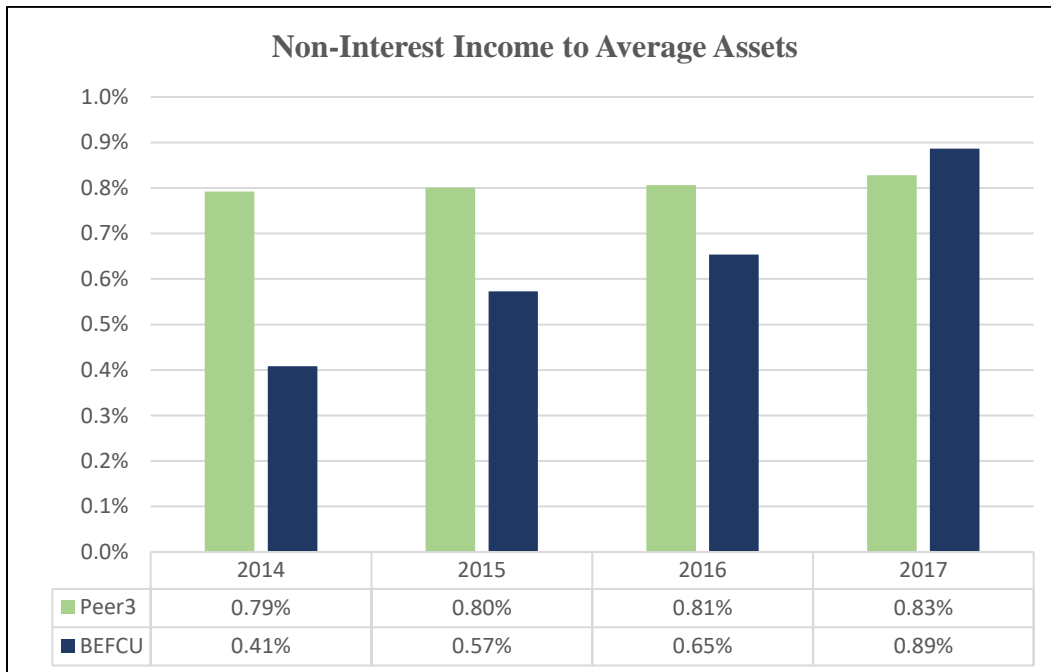
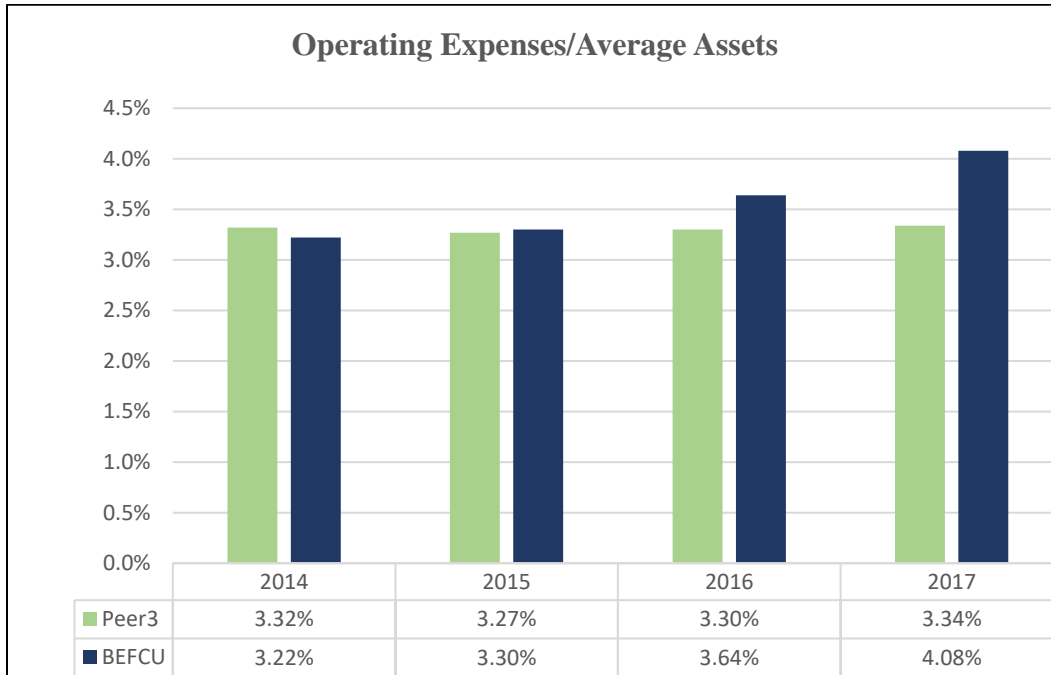
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