REPORT OF INDEPENDENT AUDITORS AND
CONSOLIDATED FINANCIAL STATEMENTS

ARIZONA FEDERAL CREDIT UNION
AND SUBSIDIARIES

December 31, 2019 and 2018

MOSSADAMS

Table of Contents

MOSSADAMS

Report of Independent Auditors

Board of Directors and Supervisory Committee
Arizona Federal Credit Union and Subsidiaries

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Arizona Federal Credit Union and Subsidiaries (the "Credit Union"), which comprise the consolidated statements of financial condition as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 the consolidated financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Arizona Federal Credit Union and Subsidiaries as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Phoenix, Arizona
March 24, 2020

ASSETS

	December 31, 2019	December 31, 2018
ASSETS		
Cash and cash equivalents	$ 169,664,399	$ 70,423,254
Investments		
Securities available-for-sale	389,116,452	508,059,225
Other	19,547,010	27,542,064
Loans held-for-sale	1,327,989	-
Loans receivable, net	1,203,782,209	874,764,011
Accrued income receivable	5,668,317	5,175,973
Property held-for-sale	5,303,535	6,503,535
Property and equipment, net	46,880,316	47,440,272
National Credit Union Share Insurance Fund (NCUSIF) deposit	15,671,239	13,066,140
Goodwill	33,116,981	2,987,882
Other intangibles, net	1,261,659	978,890
Other assets	46,378,296	45,489,073
Total assets	$ 1,937,718,402	$ 1,602,430,319

LIABILITIES AND MEMBERS' EQUITY

	2019	2018
LIABILITIES		
Members' share accounts	$ 1,606,699,996	$ 1,316,930,524
Accrued expenses and other liabilities	28,727,025	26,560,855
Total liabilities	1,635,427,021	1,343,491,379
MEMBERS' EQUITY		
Regular reserve	30,424,552	30,424,552
Undivided earnings	273,164,878	238,565,655
Accumulated other comprehensive loss	(1,298,049)	(10,051,267)
Total members' equity	302,291,381	258,938,940
Total liabilities and members' equity	$ 1,937,718,402	$ 1,602,430,319

Arizona Federal Credit Union and Subsidiaries
Consolidated Statements of Income

	Years Ended December 31, 2019	2018
INTEREST INCOME		
Loans receivable	$ 46,107,530	$ 40,206,519
Investments and cash and cash equivalents	23,349,559	14,992,957
Total interest income	69,457,089	55,199,476
INTEREST EXPENSE		
Members' share accounts	7,560,765	7,747,126
Borrowed funds	5	1,135,503
Total interest expense	7,560,770	8,882,629
NET INTEREST INCOME	61,896,319	46,316,847
PROVISION FOR LOAN LOSSES	2,432,082	2,436,969
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	59,464,237	43,879,878
NONINTEREST INCOME		
Fees and charges	18,929,024	22,183,738
Other income	29,183,530	32,417,788
Gain (loss) on sale of investments	2,539	(91,313)
Gain (loss) on property held-for-sale	565,685	(350,470)
Gain (loss) on sale of loans	36,414	-
Loss on disposal of property and equipment	(23,174)	(63,837)
Total noninterest income	48,694,018	54,095,906
NONINTEREST EXPENSE		
Compensation and benefits	43,075,492	40,599,354
Operations	25,441,167	27,721,302
Occupancy	5,042,373	4,682,550
Total noninterest expense	73,559,032	73,003,206
NET INCOME	$ 34,599,223	$ 24,972,578

See accompanying notes.

	Years Ended December 31, 2019	Years Ended December 31, 2018
NET INCOME	$ 34,599,223	$ 24,972,578
OTHER COMPREHENSIVE INCOME (LOSS)		
Securities available-for-sale		
Unrealized holding gains (losses) arising during the year, net	8,755,757	(4,219,952)
Reclassification adjustment for realized losses (gains) included in net income	(2,539)	91,313
Total other comprehensive income (loss)	8,753,218	(4,128,639)
COMPREHENSIVE INCOME	$ 43,352,441	$ 20,843,939

See accompanying notes.

	Regular Reserve	Undivided Earnings	Accumulated Other Comprehensive Loss	Total
BALANCE, December 31, 2017	$ 30,424,552	$ 213,593,077	$ (5,922,628)	$ 238,095,001
Net income	-	24,972,578	-	24,972,578
Other comprehensive loss	-	-	(4,128,639)	(4,128,639)
BALANCE, December 31, 2018	30,424,552	238,565,655	(10,051,267)	258,938,940
Net income	-	34,599,223	-	34,599,223
Other comprehensive income	-	-	8,753,218	8,753,218
BALANCE, December 31, 2019	$ 30,424,552	$ 273,164,878	$ (1,298,049)	$ 302,291,381

 See accompanying notes.

	Years Ended December 31, 2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 34,599,223	$ 24,972,578
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization of property and equipment	5,852,453	5,332,586
(Gain) loss on sale of property held-for-sale	(565,685)	350,470
Amortization of investments, net	3,824,959	5,142,596
Provision for loan losses	2,432,082	2,436,969
Amortization of intangible assets	625,605	448,181
Appreciation of credit union owned life insurance	(948,088)	(896,378)
(Gain) loss on sale of securities available-for-sale	(2,539)	91,313
Loss on disposal of property and equipment	23,174	63,837
(Gain) loss on sale of loans held for sale	(36,414)	-
Net change in operating assets and liabilities		
Loans held-for-sale	(28,016)	337,925
Accrued interest receivable	129,312	94,008
NCUSIF deposit	(2,605,099)	(358,807)
Other assets	(1,421,441)	(276,236)
Accrued expenses and other liabilities	(1,062,785)	(11,180,866)
Net cash provided by operating activities	40,816,741	26,558,176
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of securities available-for-sale	(70,292,518)	(43,818,514)
Proceeds from maturities and principal payments received on securities available-for-sale	119,143,739	132,973,006
Proceeds from sales of securities available-for-sale	75,024,789	9,537,190
Proceeds from note receivable, natural person credit union	-	12,000,000
(Redemption) Purchase of capital stock	207,000	(1,269,479)
Net change in other investments	8,756,354	(15,384,005)
Net increase in loans receivable	(71,639,690)	(111,130,195)
Purchase of loan participations	(75,842,121)	(44,276,417)
Purchase of credit union owned life insurance	-	(2,367,257)
Proceeds from redemption of credit union owned life insurance	3,315,358	3,308,143
Purchases of property and equipment	(4,538,399)	(7,469,233)
Proceeds from sale of property and equipment	-	10,000
Proceeds from sale of property held-for-sale	1,750,474	-
Liabilities assumed through business acquisitions	10,983,073	-
Net cash used in investing activities	(3,131,941)	(67,886,761)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in members' share accounts	61,556,347	55,330,068
Net cash provided by financing activities	61,556,347	55,330,068
CHANGE IN CASH AND CASH EQUIVALENTS	99,241,147	14,001,483
CASH AND CASH EQUIVALENTS, beginning of year	70,423,254	56,421,771
CASH AND CASH EQUIVALENTS, end of year	$ 169,664,401	$ 70,423,254

See accompanying notes.

	Years Ended December 31, 2019	2018
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Transfer of property to property held-for-sale	$ -	$ 23,747
Change in unrealized gain on investments available-for-sale	$ 8,753,218	$ (4,128,639)
Net assets acquired through acquisition of Pinnacle Bank,		
Assets acquired, net of cash received	$ 189,591,912	-
Liabilities assumed	$ 231,442,082	-
Cash consideration	$ 49,000,000	-
Goodwill	$ 29,484,577	-
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Dividends paid on members' share accounts	$ 7,560,765	$ 7,747,126
Interest paid on borrowed funds	$ 5	$ 1,135,503

Note 1 – Summary of Significant Accounting Policies

Principles of consolidation – The consolidated financial statements include the accounts of Arizona Federal Credit Union (the "Credit Union") and its wholly owned subsidiaries, Western States Financial Group, LLC (WSFG) and Arizona Federal Insurance Solutions, LLC (AFIS). WSFG is engaged in providing auto-buying services to members through third-party relationships. AFIS was formed and organized under the laws of the State of Arizona on November 21, 2005. AFIS is licensed to own and operate general property/casualty and life insurance agencies. AFIS operates principally in the Southwest Region of the United States. All significant intercompany accounts and transactions have been eliminated in consolidation.

Nature of business – The Credit Union is a federally chartered Credit Union organized under the Federal Credit Union Act and administratively responsible to the National Credit Union Administration (the "NCUA"). The primary purpose of the Credit Union is to promote thrift among and create a source of credit for its members. 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 charter and bylaws. The Credit Union's primary source of revenue is providing loans to its members.

Field of membership and sponsor – The Credit Union obtained a community charter from the NCUA; accordingly, the field of membership includes all persons who live, work, worship, or attend school in, and businesses and other legal entities located in, Maricopa and Pinal counties, Arizona, and the city of Tucson, Arizona.

Use of estimates – The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues 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.

Fair value – Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements*, provides a framework for measuring fair value that requires an entity to determine fair value based on the exit price in the principal market for the asset or liability being measured. Fair value is defined as the exchange price that would be received on the measurement date to sell an asset or the price paid to transfer a liability in the principal or most advantageous market available to the entity in an orderly transaction between market participants. The guidance also establishes a three-level fair value hierarchy that describes the inputs used to measure assets and liabilities.

> **Level 1** – asset and liability fair values are based on quoted prices in active markets for identical assets and liabilities;

Note 1 – Summary of Significant Accounting Policies (continued)

Level 2 – asset and liability fair values are based on observable inputs that include quoted market prices for similar assets or liabilities, quoted market prices that are not in an active market, or other inputs that are observable in the market and can be corroborated by observable market data for substantially the full term of the assets or liabilities;

Level 3 – assets and liabilities are financial instruments whose value is calculated by the use of pricing models and/or discounted cash flow methodologies, as well as financial instruments for which the determination of fair value requires significant management judgment or estimation.

The Credit Union's financial instruments and other accounts subject to fair value measurement and/or disclosure are summarized in Note 15.

Cash and cash equivalents – Cash consists of funds due from banks, Credit Unions cash, cash in vaults, ATMs, and cash on-hand. For purposes of the consolidated statements of cash flows, the Credit Union considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. Amounts due from financial institutions may, at times, exceed federally insured limits.

Investments – Debt securities that the Credit Union intends to hold for an indefinite period of time, but not necessarily to maturity, are classified as available-for-sale and carried at fair value. Unrealized gains and losses on securities available-for-sale are recognized as a direct increase or decrease in other comprehensive income. Amortization of purchased premiums are included in interest income from investments.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of individual securities available-for-sale below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. Management evaluates securities for other-than-temporary impairment (OTTI) on at least a quarterly basis and more frequently when economic or market concerns warrant such evaluation. In determining whether OTTI exists, management considers many factors, including (1) the length of time and 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 investments 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 determined using the specific-identification method.

Other investments are classified separately and stated at cost.

Federal Home Loan Bank (FHLB) stock – The Credit Union, as a member of the FHLB system, is required to maintain an investment in restricted capital stock of the FHLB in an amount equal to the greater of 1% of its Membership Asset Value, subject to a cap of $15 million or 2.7% of advances from the FHLB. There is no ready market for the restricted FHLB stock; therefore, it has no quoted market value and is reported on the consolidated statements of financial condition at cost. FHLB stock is periodically reviewed for impairment based on the ultimate recovery of par value (cost). Both cash and stock dividends are included in interest income from investments.

Note 1 – Summary of Significant Accounting Policies (continued)

Loans held-for-sale – Mortgage loans originated with the intent to sell on the secondary market are classified as loans held-for-sale and are carried at the lower of cost or estimated market value in aggregate. All sales are made without recourse, other than the industry standard representations and warranties. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Loans receivable, net – Loans that the Credit Union has the intent and ability to hold for the foreseeable future are stated at unpaid principal balances, less an allowance for loan losses and net deferred loan origination fees and costs. Interest on loans is recognized over the term of the loan and calculated using the simple-interest method on principal amounts outstanding, other than the industry standard representations and warranties.

The accrual of interest on loans is discontinued at the time the loan is 91 days delinquent. Loans are typically charged-off no later than 180 days past due. Past-due status is based on the contractual terms of the loan and the actual number of days since the last payment date. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if management believes, after considering economic conditions, business conditions, and collection efforts, that collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for using the cash-basis method until the loans qualify for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Certain loan fees and direct loan origination costs are deferred, and the net fee or 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.

Troubled debt restructurings (TDRs) – In situations where, for economic or legal reasons related to a member's financial difficulties, the Credit Union grants a concession to a member for other than an insignificant period of time that the Credit Union would not otherwise consider, the related loan is classified as a TDR. The Credit Union strives to identify members in financial difficulty early and work 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 avoid foreclosure or repossession of the collateral. In cases where the Credit Union grants a member new terms that provide for a reduction of interest or principal, the Credit Union measures any impairment on the restructuring using the methodology for individually impaired loans. Loans classified as TDRs are reported as impaired loans.

Allowance for loan losses – The Credit Union maintains an allowance for loan losses to absorb losses inherent in the loan portfolio. The allowance is based on ongoing monthly assessments of the probable estimated losses inherent in the loan portfolio. The allowance is increased by the provision for loan losses and decreased by charge-offs when management believes the uncollectibility of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Note 1 – Summary of Significant Accounting Policies (continued)

Management develops and documents its systematic methodology for determining the allowance for loan losses by first dividing its portfolio into three segments: commercial, residential real estate, and consumer. The Credit Union further divides the portfolio segments into classes based on initial measurement attributes, risk characteristics or its method of monitoring and assessing credit risk. The commercial portfolio segment is comprised of commercial real estate and non-real estate loans. The classes within the residential real estate portfolio segment are first mortgage and home equity line of credit (HELOC) and other mortgages. The classes within the consumer portfolio segment are automobile, credit card, and other consumer.

The allowance for loan losses consists of the specific loan loss allowance for impaired loans and the general loan loss allowance. The Credit Union evaluates the residential real estate and consumer segments for impairment on a pooled basis, unless they represent TDRs, as part of the general loan loss allowance and evaluates the commercial segment individually. Impaired loans are subject to the specific loan loss allowance. Loans are considered impaired when the individual evaluation of current information regarding the borrower's financial condition, loan collateral, and cash flows indicates that the Credit Union will be unable to collect all amounts due according to the contractual terms of the loan agreement, including interest payments. Impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or, as an expedient, at the loan's observable market price or the fair value of the collateral, less costs to sell, if the loan is collateral dependent.

A general loan loss allowance is provided for loans not specifically identified as impaired. The allowance is determined by pooling residential real estate, consumer, and non-impaired commercial loans by portfolio class and applying a historical loss percentage to each class. The Credit Union's historical loss percentage may be adjusted for significant qualitative and environmental factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. The conditions evaluated for qualitative and environmental factors may include existing general economic and business conditions affecting the key lending areas and products of the Credit Union, credit quality trends and risk identification, collateral values, loan volumes, underwriting standards and concentrations, specific industry conditions within portfolio segments, recent loss experience in particular classes of the portfolio, and duration of the current business cycle.

In estimating the allowance for loan losses, the significant risk characteristics considered for the residential real estate segment were historical and expected future charge-offs, borrower's credit, and property collateral. The significant characteristics considered for the commercial segment were type of property, geographical concentrations and risks, and individual borrower financial condition.

Other real estate owned – Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at fair value less estimated selling costs at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and property held-for-sale is carried at the lower of the initial cost basis or fair value less costs to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed.

Note 1 – Summary of Significant Accounting Policies (continued)

Transfers of financial assets – Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to have been surrendered when: (1) the assets have been isolated from the Credit Union, (2) the transferee obtains the 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 maturity.

Property and equipment – Land is carried at cost. Buildings, furniture and equipment, and leasehold improvements are carried at cost, less accumulated depreciation and amortization. Buildings, furniture, and equipment are depreciated using the straight-line method over the estimated useful lives of the assets, which range from 1 to 50 years. The cost of leasehold improvements is amortized using the straight-line method over the terms of the related leases.

Valuation of long-lived assets – The Credit Union evaluates long-lived assets and certain identifiable intangible assets 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 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.

NCUSIF deposit – The deposit in the NCUSIF is in accordance with NCUA regulations, which require the maintenance of a deposit by each insured Credit Union in an amount equal to 1% of its insured shares. The deposit would be refunded to the Credit Union if its insurance coverage is terminated, it converts insurance coverage to another source, or if the operations of the fund are transferred from the NCUA Board.

NCUSIF insurance premiums and Temporary Corporate Credit Union Stabilization Fund (TCCUSF) assessment – The Credit Union is required to pay an annual insurance premium based on a percentage of its total insured shares, unless the payment is waived or reduced by the NCUA Board. The NCUA did not approve an assessment during the years ended December 31, 2019 and 2018. On May 21, 2019, the NCUA approved a $160.1 million Share Insurance Fund equity distribution applied pro rata to each of the 5,500 eligible institutions. The Credit Union received a related dividend of $218,750 and $1,023,844 during the years ended December 31, 2019 and 2018, respectively.

Goodwill and intangible assets – Goodwill and intangible assets that have indefinite useful lives are not amortized, but rather are tested at least annually for impairment. If impairment has occurred, the asset will be reduced to the fair value, which is determined using the net present value of anticipated cash flows. Intangibles with a finite useful life are amortized over their useful lives.

Note 1 – Summary of Significant Accounting Policies (continued)

Accounts receivable from insurance – Accounts receivable of AFIS represent billed insurance premiums and commissions for insurance coverage provided by various insurance carriers represented by AFIS. Trade credit is generally extended on a short-term basis; thus, trade receivables do not bear interest. It also includes a contract asset generated by implementation of ASU No. 2014-09 and a receivable which represents the bonus and contingent commissions revenues estimated to be received during 2020. The total amount of accounts receivable of AFIS included in other assets on the consolidated statements of financial condition is $2,158,957 and $841,726 as of December 31, 2019 and 2018, respectively.

AFIS follows the direct write-off method of recognizing uncollectible accounts receivable, which management believes approximates the allowance method. The direct write-off method recognizes a bad debt expense only when a specific account is determined to be uncollectible. Under certain circumstances, uncollectible accounts receivable are charged directly against a producer's commissions. In the opinion of the management of AFIS, no existing accounts receivable are deemed uncollectible. For the years ended December 31, 2019 and 2018, AFIS had no bad debt expense.

Credit union owned life insurance – The carrying amount of credit-union-owned life insurance approximates its fair value, net of any surrender charges.

Members' share accounts – Members' share accounts are subordinated to all other liabilities of the Credit Union upon liquidation. Dividends on members' share accounts are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union. Interest rates on members' share 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 regular reserve. This reserve, which represents a regulatory restriction of retained earnings, is not available for the payment of dividends.

Income taxes – The Credit Union is exempt by statute from federal and state income taxes. Income from WSFG and AFIS flows through to the Credit Union and, therefore, is not subject to federal and state income taxes.

Advertising costs – Advertising costs are generally charged to operations when incurred. Certain advertising costs related to prepaid marketing campaigns are capitalized and expensed as the advertising takes place.

Comprehensive income – Accounting principles generally require that recognized revenue, expenses, and gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available-for-sale, are reported as a separate component of the equity section on the consolidated statements of financial condition.

Note 1 – Summary of Significant Accounting Policies (continued)

Adoption of New Accounting Standards – On January 1, 2019, the Credit Union adopted ASU 2014-09 *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, “ASC 606”), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of the Credit Union’s revenues come from interest income and other sources, including loans, leases, and securities, that are outside the scope of ASC 606. The Credit Unions’ services that fall within the scope of ASC 606 are presented within Noninterest Income and are recognized as revenue as the Credit Union satisfies its obligation to the customer. Services within the scope of ASC 606 include service charges on members’ share accounts, interchange income, and the sale of OREO.

The Credit Union adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2019. Results for reporting periods beginning after January 1, 2019, are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a material change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before the consolidated financial statements are available to be issued. The Credit Union recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Credit Union’s consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before the consolidated financial statements are available to be issued. The Credit Union has evaluated subsequent events through March 24, 2020, which is the date the consolidated financial statements became available to issue.

The Credit Union evaluated its December 31, 2019 consolidated financial statements for subsequent events through the date the consolidated financial statements were issued. As a result of the spread of the COVID-19 coronavirus, economic uncertainties have arisen which are likely to negatively impact net interest income. Other financial impact could occur though such potential impact is unknown at this time.

Reclassifications – Certain reclassifications have been made to the prior years’ consolidated financial statements to conform with current year presentation. These reclassifications had no impact on previously reported net income or members’ equity.

Note 2 – Investments

The amortized cost and fair value of securities available-for-sale at December 31 are as follows:

2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Federal agency securities	$ 29,633,475	$ 17,076	$ (394,912)	$ 29,255,639
Collateralized mortgage obligations	26,818,140	30,483	(93,390)	26,755,233
Mortgage-backed and asset-backed securities	324,301,949	1,406,419	(2,308,181)	323,400,187
Commercial mortgage-backed securities	9,660,936	44,457	-	9,705,393
	$ 390,414,500	$ 1,498,435	$ (2,796,483)	$ 389,116,452

2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Federal agency securities	$ 39,076,045	$ 572	$ (548,291)	$ 38,528,326
Collateralized mortgage obligations	20,537,129	-	(391,334)	20,145,795
Mortgage-backed and asset-backed securities	448,360,974	448,190	(9,492,197)	439,316,967
Commercial mortgage-backed securities	10,136,344	-	(68,207)	10,068,137
	$ 518,110,492	$ 448,762	$ (10,500,029)	$ 508,059,225

Note 2 – Investments (continued)

Gross unrealized losses and fair value by length of time the individual securities have been in a continuous unrealized loss position at December 31, are as follows:

		Continuous Unrealized Losses Existing for		
2019	Fair Value	Less than 12 months	12 Months or Longer	Total Unrealized Losses
Federal agency securities	$ 24,813,075	$ (82,569)	$ (312,343)	$ (394,912)
Collateralized mortgage obligations	15,849,616	(93,390)	-	(93,390)
Mortgage-backed and asset-backed securities	201,542,600	(402,891)	(1,905,290)	(2,308,181)
	$ 242,205,291	$ (578,850)	$ (2,217,633)	$ (2,796,483)
2018				
Federal agency securities	$ 36,339,463	$ (133,024)	$ (415,267)	$ (548,291)
Collateralized mortgage obligations	20,145,795	-	(391,334)	(391,334)
Mortgage-backed and asset-backed securities	374,748,574	(61,010)	(9,431,187)	(9,492,197)
Commercial mortgage-backed securities	10,068,137	-	(68,207)	(68,207)
	$ 441,301,969	$ (194,034)	$ (10,305,995)	$ (10,500,029)

As of December 31, 2019, eight investments had been in a continuous unrealized loss position for less than 12 months and forty-five had been in a continuous unrealized loss position for 12 months or longer. As of December 31, 2018, twelve investments had been in a continuous unrealized loss position for less than 12 months and eighty-one had been in a continuous unrealized loss position for 12 months or longer. The unrealized losses associated with these investments are considered temporary, as the Credit Union has the ability to hold these investments for a period of time sufficient to allow for any anticipated recovery in fair value.

Other investments at December 31, consist of the following:

	2019	2018
Note receivable, natural-person credit union	$ 6,448,000	$ -
Federal Home Loan Bank stock	9,266,400	8,505,100
Central Liquidity Facility (CLF) stock	3,812,610	3,632,959
Certificates of deposit	-	15,384,005
Other	20,000	20,000
	$ 19,547,010	$ 27,542,064

Note 2 – Investments (continued)

The Credit Union is a member of the CLF, where it maintains capital stock of the CLF and has a credit facility as described in Note 8.

The amortized cost and fair value of investments by contractual maturity are shown below. Because borrowers may prepay obligations with or without call or prepayment penalties, the expected maturities of mortgage-backed securities and collateralized mortgage obligations may differ from the contractual maturities. Mortgage-backed securities and collateralized mortgage obligations are therefore classified separately with no specific maturity date.

	Available-for-Sale		
2019	Amortized Cost	Fair Value	Other
No contractual maturity	$ -	$ -	$ 20,000
Less than one year	-	-	5,704,000
One to five years	3,337,898	3,311,811	13,823,010
Five to ten years	4,587,223	4,514,117	-
More than ten years	21,708,354	21,429,711	-
	29,633,475	29,255,639	19,547,010
Mortgage-backed, commercial mortgage-backed asset-backed securities, and collateralized mortgage obligations	360,781,025	359,860,814	-
	$ 390,414,500	$ 389,116,453	$ 19,547,010
2018			
No contractual maturity	$ -	$ -	$ 12,158,059
One to five years	-	-	10,416,005
Five to ten years	7,172,503	7,096,270	4,968,000
More than ten years	31,903,542	31,432,056	-
	39,076,045	38,528,326	27,542,064
Mortgage-backed and asset-backed securities, and collateralized mortgage obligations	479,034,447	469,530,899	-
	$ 518,110,492	$ 508,059,225	$ 27,542,064

Proceeds from sale securities, gross gain/losses – During the year ended December 31, 2019, the Credit Union sold securities totaling $75,024,789 with gross gains totaling $234,551 and gross losses totaling $232,012. During the year ended December 31, 2018, the Credit Union sold securities totaling $9,537,190 with gross gains totaling $38,021 and gross losses totaling $129,334.

Note 3 – Loans Receivable, Net

Total loans outstanding by portfolio segment and class of loan at December 31, are as follows:

	2019	2018
Commercial:		
Commercial - non real estate	$ 11,300,329	$ -
Commercial real estate	237,053,501	56,310,729
	248,353,830	56,310,729
Residential real estate:		
First mortgage	221,148,932	123,874,834
HELOC and other mortgage	120,424,793	140,321,180
	341,573,725	264,196,014
Consumer:		
Automobile	467,193,413	397,737,461
Credit card	118,840,758	123,402,776
Other consumer	36,107,500	37,371,078
	622,141,671	558,511,315
Total loans	1,212,069,226	879,018,058
Net deferred loan origination costs	1,689,277	1,766,736
Unamortized (discount) premiums, net on loans acquired	(2,863,586)	1,122,658
Allowance for loan losses	(7,112,708)	(7,143,441)
Total loans receivable, net	$ 1,203,782,209	$ 874,764,011

Note 3 – Loans Receivable, Net (continued)

The allowance for loan losses and loans outstanding, by portfolio segment, at December 31, are as follows:

2019	Commercial	Residential Real Estate	Consumer	Total
Allowance for loan losses:				
Beginning balance	$ 1,022,400	$ 1,300,381	$ 4,820,660	$ 7,143,441
Charge-offs	-	(64,739)	(6,484,845)	(6,549,584)
Provision (credit) for loan losses	79,205	(529,667)	2,882,544	2,432,082
Recoveries	-	938,137	3,148,632	4,086,769
Ending balance	$ 1,101,605	$ 1,644,112	$ 4,366,991	$ 7,112,708
Ending balance: individually evaluated for impairment	$ -	$ 947,376	$ 20,587	$ 967,963
Ending balance: collectively evaluated for impairment	1,101,605	696,736	4,346,404	6,144,745
Ending balance	$ 1,101,605	$ 1,644,112	$ 4,366,991	$ 7,112,708
Recorded investment in loans:				
Ending balance: individually evaluated for impairment	$ -	$ 4,833,985	$ 370,825	$ 5,204,810
Ending balance: collectively evaluated for impairment	248,353,830	336,739,740	621,770,846	1,206,864,416
Ending balance	$ 248,353,830	$ 341,573,725	$ 622,141,671	$1,212,069,226

2018	Commercial	Residential Real Estate	Consumer	Total
Allowance for loan losses:				
Beginning balance	$ 1,086,379	$ 1,789,862	$ 4,730,374	$ 7,606,615
Charge-offs	-	(294,687)	(6,609,454)	(6,904,141)
Provision (credit) for loan losses	(76,103)	(1,305,369)	3,818,441	2,436,969
Recoveries	12,124	1,110,575	2,881,299	4,003,998
Ending balance	$ 1,022,400	$ 1,300,381	$ 4,820,660	$ 7,143,441
Ending balance: individually evaluated for impairment	$ -	$ 745,263	$ 78,090	$ 823,353
Ending balance: collectively evaluated for impairment	1,022,400	555,118	4,742,570	6,320,088
Ending balance	$ 1,022,400	$ 1,300,381	$ 4,820,660	$ 7,143,441
Recorded investment in loans:				
Ending balance: individually evaluated for impairment	$ -	$ 5,114,444	$ 627,255	$ 5,741,699
Ending balance: collectively evaluated for impairment	56,310,729	259,081,570	557,884,060	873,276,359
Ending balance	$ 56,310,729	$ 264,196,014	$ 558,511,315	$ 879,018,058

Note 3 – Loans Receivable, Net (continued)

Credit quality indicators – The Credit Union assesses the credit quality of its commercial loans with an eight-grade risk rating system whereby a higher grade represents a higher level of credit risk. The eight-grade risk rating system can generally be classified into the following categories: pass or watch, special mention, substandard, doubtful, and loss. The risk ratings reflect the relative strength of the sources of repayment.

Pass or watch loans are generally considered to have sufficient sources of repayment in order to repay the loan in full in accordance with all terms and conditions. These borrowers may have some credit risk that requires monitoring, but full repayment is expected. Special mention loans are considered to have potential weaknesses that warrant close attention by management. Special mention is considered a transitory grade, and generally, the Credit Union has not had a loan remain categorized as special mention for longer than six months. If any potential weaknesses are resolved, the loan is upgraded to a pass or watch grade. If negative trends in the borrower's financial status or other information is presented indicating that the repayment sources may become inadequate, the loan is downgraded to substandard. Substandard loans are considered to have well-defined weaknesses that jeopardize the full and timely repayment of the loan. Substandard loans have a distinct possibility of loss if the deficiencies are not corrected. Additionally, when management has assessed a potential for loss but a distinct possibility of loss is not recognizable, the loan is still classified as substandard. Doubtful loans have insufficient sources of repayment and a high probability of loss. Loss loans are considered to be uncollectible and are therefore charged-off. These internal risk ratings are reviewed continuously and adjusted for changes in borrower status and the likelihood of loan repayment.

The credit quality of each class of commercial loan based on the internal risk grading system at December 31 is as follows:

2019	Pass/Watch	Special Mention	Substandard	Doubtful	Total
Commercial	$ 248,353,830	$ -	$ -	$ -	$ 248,353,830

2018	Pass/Watch	Special Mention	Substandard	Doubtful	Total
Commercial	$ 49,235,294	$ 855,731	$ 6,219,704	$ -	$ 56,310,729

The Credit Union assesses the credit quality of its residential real estate and consumer loans by delinquency status, recent FICO score, and loan-to-value (LTV) ratio.

FICO scores – The Credit Union obtains FICO scores at loan origination, and most scores are updated quarterly with the most recent update as of December 31, 2019. Loans that trend toward higher levels are generally associated with a lower risk factor, whereas loans that migrate toward lower ratings will generally result in a higher risk factor being applied to the related loan balances.

Note 3 – Loans Receivable, Net (continued)

The FICO score distribution at December 31, is as follows:

2019	First Mortgage	HELOC and Other Mortgage	Automobile	Credit Card	Other Consumer	Total
740 and above	$ 105,968,244	$ 72,805,192	$ 272,215,013	$ 51,115,605	$ 14,661,895	$ 516,765,949
680 to 739	41,486,444	27,116,783	120,907,108	38,187,974	10,610,449	238,308,758
660 to 679	4,880,964	5,128,009	24,386,971	8,493,175	2,734,973	45,624,092
640 to 659	2,435,641	4,667,840	16,238,452	6,478,881	1,932,145	31,752,959
620 to 639	1,428,908	2,589,733	11,556,394	4,796,521	1,333,335	21,704,891
600 to 619	862,818	1,743,685	7,051,728	3,180,260	960,188	13,798,679
599 and below	1,755,639	4,275,620	13,673,453	5,813,083	1,905,993	27,423,788
Unknown	62,330,274	2,097,931	1,164,294	775,259	1,968,522	68,336,280
	$ 221,148,932	$ 120,424,793	$ 467,193,413	$ 118,840,758	$ 36,107,500	$ 963,715,396

2018	First Mortgage	HELOC and Other Mortgage	Automobile	Credit Card	Other Consumer	Total
740 and above	$ 81,302,797	$ 81,515,497	$ 219,764,809	$ 52,351,324	$ 14,155,108	$ 449,089,535
680 to 739	35,433,387	34,413,038	109,330,343	40,764,735	11,693,739	231,635,242
660 to 679	3,956,776	7,992,263	21,951,744	9,489,792	2,841,446	46,232,021
640 to 659	1,392,031	4,908,609	15,869,697	6,677,881	2,214,544	31,062,762
620 to 639	420,551	3,316,710	10,272,408	4,456,962	1,596,645	20,063,276
600 to 619	325,199	2,793,776	6,560,835	3,116,201	1,114,274	13,910,285
599 and below	1,044,093	5,321,951	12,945,413	5,707,448	2,032,321	27,051,226
Unknown	-	59,336	1,042,212	838,433	1,723,001	3,662,982
	$ 123,874,834	$ 140,321,180	$ 397,737,461	$ 123,402,776	$ 37,371,078	$ 822,707,329

LTV ratio – Residential real estate loans are assessed for credit quality by LTV, the ratio of the loan's unpaid principal balance to the value of the collateral securing repayment of the loan. If the Credit Union is in a junior lien position, only the excess collateral value over the amounts necessary to retire any senior lien positions is considered. LTVs are updated quarterly using a proprietary model developed by Quest, a third-party business analytics firm.

Although residential real estate markets experienced significant declines in property values several years ago, recent analysis, as shown in the table below, highlights improvement in all mortgage categories. Some markets in which the Credit Union serves have seen significant improvements in property values over the past year or two. These trends are considered in the way the Credit Union monitors credit risk and establishes the residential real estate allowance for loan losses. LTV does not necessarily reflect the likelihood of performance of a given loan but does provide an indication of collateral value. In the event of default, any loss to the Credit Union should be approximately limited to the portion of the loan amount in excess of the net realizable value of the underlying real estate collateral. The LTV values presented below were most recently updated as of December 31, 2019.

Note 3 – Loans Receivable, Net (continued)

The LTV distribution of first mortgage and HELOC and other mortgage at December 31, is as follows:

2019	Less Than 80%	80%-89%	90%-100%	Greater Than 100%	Unknown	Total
First mortgage	$ 154,530,662	$ 3,328,231	$ -	$ 238,228	$ 63,051,811	$ 221,148,932
HELOC and other mortgage	110,520,165	5,180,515	198,843	1,152,925	3,372,345	120,424,793
	$ 265,050,827	$ 8,508,746	$ 198,843	$ 1,391,153	$ 66,424,156	$ 341,573,725

2018	Less Than 80%	80%-89%	90%-100%	Greater Than 100%	Unknown	Total
First mortgage	$ 116,010,729	$ 6,825,140	$ -	$ -	$ 1,038,965	$ 123,874,834
HELOC and other mortgage	103,400,660	5,796,809	702,273	2,036,603	28,384,835	140,321,180
	$ 219,610,008	$ 12,621,949	$ 702,273	$ 2,036,603	$ 29,423,800	$ 264,196,014

Nonaccrual and past due loans – Information relating to the age and nonaccrual status of the loans by class at December 31, is as follows:

2019	Current	30-59 Days Past Due	60 Days or more Past Due	Total	Loans on Nonaccrual Status
Commercial real estate	$ 241,097,050	$ 6,385,819	$ 870,961	$ 248,353,830	$ 283,569
First mortgage	216,383,076	2,524,862	2,240,994	221,148,932	318,852
HELOC and other mortgage	119,278,887	616,170	529,736	120,424,793	280,502
Automobile	465,005,758	1,609,659	577,996	467,193,413	297,307
Credit card	118,148,439	345,682	346,637	118,840,758	109,377
Other consumer	35,727,680	283,421	96,399	36,107,500	77,870
	$1,195,640,890	$ 11,765,613	$ 4,662,723	$1,212,069,226	$ 1,367,477

2018	Current	30-59 Days Past Due	60 Days or more Past Due	Total	Loans on Nonaccrual Status
Commercial real estate	$ 56,310,729	$ -	$ -	$ 56,310,729	$ -
First mortgage	121,529,359	2,186,493	158,982	123,874,834	158,982
HELOC and other mortgage	139,366,171	541,186	413,823	140,321,180	151,508
Automobile	395,797,921	1,198,067	741,473	397,737,461	363,213
Credit card	122,826,273	346,090	230,413	123,402,776	90,529
Other consumer	36,849,788	340,657	180,633	37,371,078	55,991
	$ 872,680,241	$ 4,612,493	$ 1,725,324	$ 879,018,058	$ 820,223

There were no loans 91 days or more past due and still accruing interest as of December 31, 2019 and 2018.

Note 3 – Loans Receivable, Net (continued)

Impaired loans – Impaired loans individually evaluated for impairment at December 31, are as follows:

	2019		2018	
	Loans Outstanding	Related Allowance	Loans Outstanding	Related Allowance
With an allowance recorded:				
HELOC and other mortgage	$ 4,833,985	$ 947,376	$ 5,114,444	$ 745,263
Automobile	56,060	5,740	488,955	64,254
Other consumer	314,765	14,847	138,300	13,836
	$ 5,204,810	$ 967,963	$ 5,741,699	$ 823,353

There were no impaired loans without a specific allowance recorded as of December 31, 2019 and 2018.

There were no loans modified as TDRs during the year ended December 31, 2019. There were four loans modified as TDRs during the year ended December 31, 2018. There were no commitments to fund and TDRs at December 31, 2019 or 2018.

There were no loans restructured during the years ended December 31, 2019 and 2018, for which there was a payment default subsequent to, but within 12 months of, the restructuring.

During the years ended December 31, 2019 and 2018, the Credit Union purchased $75,842,121 and $44,276,417 of fully guaranteed commercial loan participations, respectively. The loans are guaranteed by the United States government through the U.S. Small Business Administration (SBA) or the U.S. Department of Agriculture Rural Development (USDA). As the loans are fully guaranteed by the U.S. government through the respective program, the Credit Union does not maintain an allowance for loan loss against these guaranteed loans. Total loan participation guaranteed under the SBA or USDA programs as of December 31, 2019, was $110,522,444 and $42,716,220 as of December 31, 2018.

Note 4 – Business Combination

Business combination

On December 1, 2019, the Credit Union acquired 100% of the operations of Pinnacle Bank. Under the terms of the acquisition $49,000,000 was paid in cash for distribution to the shareholders. With the acquisition, the Credit Union is now able to offer commercial lending including SBA loans, broader residential mortgage products and enhance business services.

Note 4 – Business Combination (continued)

The following table summarizes the fair value of the consideration transferred to the sellers as part of this transaction on December 1, 2019:

Cash	$ 49,000,000
Fair value of total consideration transferred	$ 49,000,000

Goodwill of $29,484,577 arising from the acquisition consisted of a fair market discount of $5,863,423 on the loan portfolio, a fair market premium of $640,750, and a core deposit intangible asset of $174,378 on the deposit portfolio.

Recognized amounts of identifiable assets acquired and liabilities assumed:

Cash and cash equivalents	$ 61,365,593
Federal Home Loan Bank stock	968,300
Loans	185,232,966
Premises and equipment	759,560
Real estate owned	347,951
Other assets	2,283,135
Total assets acquired	250,957,505
Deposits	228,591,884
Other liabilities	2,850,198
Total liabilities assumed	231,442,082
Total identifiable net assets	19,515,423
Goodwill	$ 29,484,577

The fair value of net assets acquired includes fair value adjustments to certain receivables that were not considered impaired as of the acquisition date. The fair value adjustments were determined using discounted contractual cash flows. However, the Credit Union believes that all contractual cash flows related to these financial instruments will be collected. As such, these receivables were not considered impaired at the acquisition date and were not subject to the guidance relating to purchased credit-impaired loans, which have shown evidence of credit deterioration since origination. Receivables acquired that were not subject to these requirements include cash and stock of the Federal Home Loan Bank $61,365,593 and $968,300 on the date of acquisition, respectively.

Note 5 – Property and Equipment

The composition of property and equipment at December 31, is summarized as follows:

	2019	2018
Land	$ 11,970,235	$ 11,970,234
Buildings	46,327,104	41,208,723
Furniture and equipment	36,626,839	33,527,072
Leasehold improvements	1,851,338	1,572,231
	96,775,516	88,278,260
Construction in progress	1,698,850	4,470,379
Accumulated depreciation and amortization	(51,594,050)	(45,308,367)
	$ 46,880,316	$ 47,440,272

Property held-for-sale represents four parcels of land and two buildings, which are reported at the lower of cost or net realizable value. As of December 31, 2019 and 2018, property held-for sale was valued at $5,303,535 and $6,503,535, respectively. The Credit Union recognized impairment losses on property held-for sale of $0 and $350,470 for the years ended December 31, 2019 and 2018, respectively

Note 6 – Members' Share Accounts

Members' share accounts at December 31, are summarized as follows:

	2019	2018
Regular share	$ 359,864,805	$ 322,736,299
Share draft	518,604,288	410,197,513
Money market	574,207,418	478,791,038
Share and Individual Retirement Account (IRA) certificate	154,023,485	105,205,674
	$ 1,606,699,996	$ 1,316,930,524

Note 6 – Members' Share Accounts (continued)

The scheduled maturities of share and IRA certificates are as follows:

Years Ending December 31,	
2020	$ 77,088,187
2021	27,996,884
2022	15,848,579
2023	24,154,160
2024	8,935,675
	$ 154,023,485

Dividend rates are set by the Board of Directors, and dividends are charged to operations. The aggregate amounts of share and IRA certificate accounts in denominations that met or exceeded the NCUSIF insurance limit were approximately $9,568,934 and $3,498,000 at December 31, 2019 and 2018, respectively.

Note 7 – Lease Commitments

The Credit Union leases certain office facilities and branches under non-cancelable operating lease agreements expiring through December 2024, with monthly payments ranging from approximately $3,750 to $19,100.

Minimum rental payments under operating leases are as follows:

Years Ending December 31,	
2020	$ 883,853
2021	788,621
2022	485,300
2023	299,927
2024	178,526
	$ 2,636,227

Rent expense was approximately $349,000 and $472,000 for the years ended December 31, 2019 and 2018, respectively.

Note 8 – Intangible Assets and Goodwill

Intangible assets and goodwill at December 31, are summarized as follows:

	2019	2018
Intangible assets	$ 7,261,958	$ 6,530,908
Accumulated amortization	(6,000,299)	(5,552,018)
	1,261,659	978,890
Goodwill	33,116,981	2,987,882
	$ 34,378,640	$ 3,966,772

Goodwill increased $29,484,577 from the acquisition of Pinnacle Bank and $644,520 from the acquisition of Vanyo Insurance Group, Inc. by Arizona Federal Insurance Solutions in 2019.

On October 1, 2019 Arizona Federal Insurance Solution (AFIS) acquired Vanyo Insurance Group for cash in the amount of $1,170,000 and future earn-out consideration of $375,000. A valuation to estimate the fair value of the assets purchased pursuant to ASC 805 was performed. That valuation assigned the following values to the various assets purchased; Customer relationships $730,000, Trade names and trademarks $2,000, and Goodwill $644,520.

Intangible assets subject to amortization are reviewed for potential impairment whenever events or circumstances indicate that the carrying amounts may not be recoverable. Goodwill is assigned to specific reporting units and reviewed for possible impairment at least annually or more frequently upon the occurrence of an event or when circumstances indicate that a reporting unit's carrying amount is greater than its fair value.

Future amortization expense for years ended December 31:

2020	$ 532,086
2021	139,795
2022	75,461
2023	66,364
2024	66,364
Thereafter	381,589
	$ 1,261,659

Note 9 – Borrowed Funds

Line of credit with the FHLB – The Credit Union maintains an advances and security agreement with the FHLB of San Francisco. The agreement requires the Credit Union to pledge its investment securities held in safekeeping by the FHLB. The aggregate fair value of pledged securities was approximately $364,099,881 and $468,540,000 at December 31, 2019 and 2018, respectively. Maximum available borrowings are limited to 35% of total assets as of December 31, 2019 and 2018, and were approximately $351,078,046 and $452,620,000 at December 31, 2019 and 2018, respectively. The average monthly outstanding borrowings on this line was $0 for the year ended December 31, 2019. There were no outstanding borrowings under this arrangement at December 31, 2019 and 2018.

Federal Reserve Bank discount window – The Credit Union maintains a secured borrowing arrangement through the FRB discount window. At December 31, 2019 and 2018, the Credit Union had investments securities held in safekeeping at FRB as collateral with outstanding fair values of approximately $24,792,864 and $38,963,000, respectively. Maximum available borrowings for the FRB secured borrowing is determined as a percentage of collateral. There were no outstanding borrowings as of December 31, 2019 and 2018, under the FRB secured borrowing arrangement.

U.S. Bank – The Credit Union maintains an unsecured Federal Funds Purchasing Agreement with U.S. Bank. The agreement allows the Credit Union to borrow federal funds on a revolving 15-business-day basis at a rate agreed upon at the time of the transaction. There is no limit on the number of days within a calendar year that funds may be borrowed on an overnight basis. The maximum amount of funds available to the Credit Union at any time was $10,000,000 as of December 31, 2019 and 2018. There were no outstanding borrowings as of December 31, 2019 and 2018, under this borrowing arrangement.

Central Liquidity Facility – In 2012, the Credit Union became a member of the Central Liquidity Facility (CLF) through the purchase of its capital stock. The capital stock purchase amount was calculated based on one-half of 1% of the Credit Union’s paid-in and unimpaired capital and surplus. At least one-half of the payment for the subscription amount required that membership shall be transferred to the CLF. The remainder may be held by the Credit Union on call of the Board. As a member of the CLF, the Credit Union can request any amount of funding it needs up to its legal borrowing limit as long as the Credit Union is creditworthy and demonstrates liquidity needs. As of December 31, 2019 and 2018, there were no outstanding borrowings under this arrangement.

Note 10 – Other Assets

Other assets at December 31, consist of the following:

	2019	2018
Credit union owned life insurance	$ 33,650,156	$ 31,761,281
Prepaid expenses	3,734,580	2,852,936
Other assets and receivables	8,993,560	10,874,856
	$ 46,378,296	$ 45,489,073

Credit Union Owned Life Insurance (CUOLI) policies – The cash surrender value of the CUOLI policies amounts to approximately $33,650,156 and $31,759,425 as of December 31, 2019 and 2018, respectively. Income from the increase in cash surrender value (CSV) policies was used to offset contributions to the Credit Union's Supplemental Executive Retirement Plan as described in Note 12.

Other assets and receivables – Other receivables are comprised primarily of serviced mortgage payments receivable, principal payments receivable from an investment brokerage firm, various clearing accounts, and the deferred compensation investment described in Note 12.

Note 11 – Off-Balance Sheet Activities

The Credit Union is 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 amounts recognized in the consolidated 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 the loans recorded in the consolidated financial statements.

The following financial instruments were outstanding at December 31, whose contract amounts represent credit risk:

	2019	2018
Commercial non-RE loans	$ 1,372,706	$ -
Commercial real estate	8,895,174	-
Credit card	296,433,678	291,957,000
First mortgage	8,794,828	-
HELOC and other mortgage	56,089,072	48,001,000
Other consumer	17,610,070	16,587,000
Overdraft line	86,791,421	88,189,000
	$ 475,986,949	$ 444,734,000

Note 11 – Off-Balance Sheet Activities (continued)

As of December 31, 2019 and 2018, there was $1,664,800 and $0 in mortgage loans approved but not funded, 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 member. Collateral held generally consists of certificates of deposit, share accounts, and real estate.

Note 12 – Contingencies and Commitments

Legal contingencies – The Credit Union is party to various legal actions normally associated with the collection of loans and other business activities of financial institutions, the aggregate effect of which, in the opinion of management and legal counsel, would not be material to the consolidated financial condition of the Credit Union and subsidiaries.

Note 13 – Employee Benefits

401(k) retirement plan – The Credit Union provides a 401(k) employee benefit plan that has a defined contribution retirement savings fund pension plan provision available to employees with at least 3 months of service who have attained the age of 18 years at the anniversary date of the plan. The plan provides for a portion of each participant's gross base compensation to be contributed to the plan based on the employee's number of years of service. Plan expenses for the years ended December 31, 2019 and 2018, totaled approximately $1,389,000 and $1,159,000, respectively.

Deferred compensation plan – The Credit Union has a 457(b) nonqualified deferred compensation plan for members of top management. Under the terms of the 457(b) plan, contributions made to the plan are the responsibility of the plan participants. The Credit Union is responsible for administering the plan and provides no funding. The deferred compensation investments are shown as assets on the consolidated financial statements and are available to creditors in the event of liquidation. The deferred compensation investments totaled approximately $733,000 and $626,000 as of December 31, 2019 and 2018, respectively. The Credit Union has accrued liabilities of approximately $733,000 and $626,000 at December 31, 2019 and 2018, respectively.

Note 13 – Employee Benefits (continued)

Supplemental Executive Retirement Plan (SERP) – Effective November 13, 2014, the Credit Union has a SERP for certain key members of management. The plan provides a cash benefit in the amount specified in the participation agreement by remaining employed with the Credit Union until the normal retirement date for such payment. The cash surrender value of the CUOLI policies amounts to approximately $33,650,156 and $31,759,000 with a weighted-average yield of 2.82% and 2.81% as of December 31, 2019 and 2018, respectively, and is included in other assets. During the years ended December 31, 2019 and 2018, the Credit Union recognized approximately $948,000 and $896,000, respectively, in investment income related to the increase in cash surrender value, which was used to offset contributions to the Credit Union's SERP.

The Credit Union's liability under the SERP was approximately $2,275,000 and $1,739,000 as of December 31, 2019 and 2018, respectively. The costs associated with the plan totaled approximately $536,000 and $514,000 for the years ended December 31, 2019 and 2018, respectively.

The Credit Union also has a Survivor Income Plan in connection with the CUOLI policies that provides limited death benefits in excess of CSV on behalf of the SERP participants.

Note 14 – Related-Party Transactions

In the normal course of business, the Credit Union extends credit to members of the Board of Directors, Supervisory Committee members, and executive officers. The aggregate loans to related parties at December 31, 2019 and 2018, totaled approximately $2,214,382 and $502,000, respectively. Loans to related parties are made under the same terms available to other members. Shares from related parties at December 31, 2019 and 2018, totaled approximately $4,877,665 and $4,445,000, respectively.

Note 15 – Fair Value Measurements

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities available-for-sale – Fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments or on discounted cash flow models based on the expected payment characteristics of the underlying mortgage instruments.

Impaired loans receivable – The Credit Union evaluates the residential real estate and consumer segments for impairment on a pooled basis. Impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or, as an expedient, at the loan's observable market price or the fair value of the collateral, less costs to sell, if the loan is collateral dependent.

Note 15 – Fair Value Measurements (continued)

Property held-for-sale – Fair values of property held-for-sale are based on the fair value of the underlying asset less costs to sell. The Credit Union obtains third-party valuations including appraisals and broker's price opinions to value the asset at fair value upon transfer to property held-for-sale.

Fair values of assets measured on a recurring basis at December 31, are summarized as follows:

		Fair Value Measurements at Reporting Date Using		
2019	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale	$ 389,116,452	$ -	$ 389,116,452	$ -
2018				
Securities available-for-sale	$ 508,059,225	$ -	$ 508,059,225	$ -

There were no transfers of assets between levels of valuation measurements during the years ended December 31, 2019 and 2018.

Fair values of assets measured on a nonrecurring basis at December 31, are summarized as follows:

		Fair Value Measurements at Reporting Date Using		
2019	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans receivable, net	$ 5,204,810	$ -	$ -	$ 5,204,810
Property held-for-sale	5,303,535	-	-	5,303,535
	$ 10,508,345	$ -	$ -	$ 10,508,345
2018				
Impaired loans receivable, net	$ 4,918,346	$ -	$ -	$ 4,918,346
Property held-for-sale	6,503,535	-	-	6,503,535
	$ 11,421,881	$ -	$ -	$ 11,421,881

Note 15 – Fair Value Measurements (continued)

Additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Credit Union has utilized Level 3 inputs to determine fair value at December 31, is summarized as follows:

2019		Fair Value	Valuation Technique	Unobservable Input	Range
Impaired loans receivable, net	$	5,204,810	Fair market value	Costs to sell	25%
Property held-for-sale	$	5,303,535	Market approach	Adjustment for cost of sales	5%
2018					
Impaired loans receivable, net	$	4,918,346	Discounted cash flows	Discount rate	8.26% - 9.67%
Property held-for-sale	$	6,503,535	Market approach	Adjustment for cost of sales	5%

Note 16 – Regulatory Capital

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital 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 consolidated financial statements. Under capital adequacy regulations and the regulatory framework for prompt corrective action, the Credit Union must meet specific capital regulations that involve quantitative measures of the Credit Union's assets, liabilities, and certain off-balance sheet items as calculated under U.S. GAAP. 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 amounts and ratios (set forth in the following table) of net worth (as defined in the regulations) to assets. The Credit Union is also required to calculate a risk-based net worth (RBNW) ratio that establishes whether the Credit Union will be considered "complex" under the regulatory framework. As of December 31, 2019 and 2018, the Credit Union's RBNW ratio was 5.86% and 6.15%, respectively. The minimum ratio to be considered complex under the regulatory framework is 6%.

As of December 31, 2019, the most recent call reporting period, the 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 RBNW requirement. There have been no conditions or events since the calculation date that management believes have changed the Credit Union's category.

Note 16 – Regulatory Capital (continued)

The Credit Union's actual capital amounts and ratios at December 31, are as follows:

	Actual		To Be Adequately Capitalized Under Prompt Corrective Action Provisions		To Be Well Capitalized Under Prompt Corrective Action Provisions	
2019	Amount	Ratio	Amount	Ratio	Amount	Ratio
Net worth	$ 303,589,430	15.67%	$ 116,263,104	6.00%	$ 135,640,288	7.00%
2018						
Net worth	$ 268,990,207	16.78%	$ 96,182,434	6.00%	$ 112,212,840	7.00%

Because the RBNW requirement is less than the net worth ratio, the Credit Union retains its original category.