

USSCO JOHNSTOWN FEDERAL CREDIT UNION

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INDEPENDENT AUDITORS' REPORT

To the Supervisory Committee
USSCO Johnstown Federal Credit Union
Johnstown, Pennsylvania

We have audited the accompanying financial statements of USSCO Johnstown Federal Credit Union which comprise the statements of financial condition as of December 31, 2019 and 2018, and the related statements of income, comprehensive income, changes in 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 of material misstatement.

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 USSCO Johnstown Federal Credit Union as of December 31, 2019 and 2018, 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.

Emphasis of a Matter

As described more in Note 16 to the financial statements, in January 2020, the World Health Organization has declared COVID-19 to constitute a "Public Health Emergency of International Concern." Given the uncertainty of the situation, the duration of any business disruption and related financial impact cannot be reasonably estimated at this time. Our opinion is not modified with respect to this matter.



Johnstown, Pennsylvania

July 13, 2020

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Statements of Financial Condition
December 31, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
<i>ASSETS</i>		
Loans to members, net of allowance for loan losses	\$ 68,901,484	\$ 68,931,771
Cash and cash equivalents	2,420,152	4,402,859
Perpetual contributed capital	690,324	690,324
Investment securities:		
Available-for-sale securities	45,798,300	41,635,841
Credit Union Service Organizations - CUSOs	1	1
Accrued interest receivable	384,221	286,061
Property, buildings and equipment, net of accumulated depreciation	1,989,779	1,977,768
Acquired intangible core deposits, net	412,496	461,120
NCUSIF deposit	1,077,047	1,101,598
Assets held in foreclosure	1,260	1,260
Other assets	1,748,395	1,649,569
	<hr/>	<hr/>
<i>TOTAL ASSETS</i>	<u>\$ 123,423,459</u>	<u>\$ 121,138,172</u>
 <i>LIABILITIES AND MEMBERS' EQUITY</i>		
<i>LIABILITIES</i>		
Members' customer deposits	\$ 106,804,665	\$ 106,107,085
Accounts payable and other liabilities	486,150	635,693
	<hr/>	<hr/>
<i>TOTAL LIABILITIES</i>	<u>107,290,815</u>	<u>106,742,778</u>
 <i>MEMBERS' EQUITY</i>		
Appropriated statutory regular reserve	1,477,420	1,477,420
Undivided earnings	11,707,581	10,667,176
Equity acquired in merger	2,518,597	2,518,597
Accumulated other comprehensive loss	429,046	(267,799)
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<i>TOTAL MEMBERS' EQUITY</i>	<u>16,132,644</u>	<u>14,395,394</u>
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<i>TOTAL LIABILITIES AND MEMBERS' EQUITY</i>	<u>\$ 123,423,459</u>	<u>\$ 121,138,172</u>

See accompanying notes to the financial statements.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Statements of Income
For the Years Ended December 31, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
<i>INTEREST INCOME</i>		
Interest and fees on loans	\$ 3,416,053	\$ 2,940,278
Interest on investments	1,135,181	730,817
TOTAL INTEREST INCOME	<u>4,551,234</u>	<u>3,671,095</u>
<i>DIVIDEND AND INTEREST EXPENSE</i>		
Members' share and savings accounts	242,980	202,252
Borrowed funds	4,002	1,654
TOTAL DIVIDEND AND INTEREST EXPENSE	<u>246,982</u>	<u>203,906</u>
NET INTEREST INCOME	4,304,252	3,467,189
CREDIT FOR LOAN LOSSES	108,770	264,391
<i>NET INTEREST INCOME AFTER CREDIT FOR LOAN LOSSES</i>	<u>4,195,482</u>	<u>3,202,798</u>
<i>NON-INTEREST INCOME</i>		
Member account servicing fees	1,237,102	1,140,425
Gain on sale of investments available-for-sale	138,442	2,877
Merger bargain purchase income	0	1,386,679
Other	171,766	362,364
TOTAL NON-INTEREST INCOME	<u>1,547,310</u>	<u>2,892,345</u>
<i>NON-INTEREST EXPENSES</i>		
Salaries and wages	1,406,809	1,354,884
Employee benefits	341,299	334,390
Insurance premiums	41,529	47,008
Professional and outside services	1,313,568	1,229,844
Office operation expense	578,846	499,105
Office occupancy expense	321,513	297,184
Association dues and operating fees	55,377	52,066
Education and promotion	110,883	81,924
Other operating expenses	532,563	467,738
TOTAL NON-INTEREST EXPENSES	<u>4,702,387</u>	<u>4,364,143</u>
NET INCOME	<u>\$ 1,040,405</u>	<u>\$ 1,731,000</u>

See accompanying notes to the financial statements.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

Statements of Comprehensive Income
For the Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
NET INCOME	\$ 1,040,405	\$ 1,731,000
<i>OTHER COMPREHENSIVE INCOME</i>		
Change in unrealized gain/(loss) on securities available for sale	696,845	(126,071)
TOTAL OTHER COMPREHENSIVE INCOME	<u>696,845</u>	<u>(126,071)</u>
<i>TOTAL COMPREHENSIVE INCOME</i>	<u>\$ 1,737,250</u>	<u>\$ 1,604,929</u>

See accompanying notes to the financial statements.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Statements of Changes in Members' Equity
For the Years Ended December 31, 2019 and 2018**

	<u>APPROPRIATED STATUTORY REGULAR RESERVE</u>	<u>UNAPPROPRIATED UNDIVIDED EARNINGS</u>	<u>EQUITY ACQUIRED IN MERGER</u>	<u>ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)</u>	<u>TOTAL EQUITY</u>
BALANCES, DECEMBER 31, 2017	\$ 1,477,420	\$ 8,936,176	\$ 0	\$ (141,728)	\$ 10,271,868
COMPREHENSIVE INCOME					
<i>Equity acquired in merger</i>	0	0	2,518,597	0	2,518,597
<i>Net Income</i>	0	1,731,000	0	0	1,731,000
<i>Other comprehensive income</i>	0	0	0	(126,071)	(126,071)
BALANCES, DECEMBER 31, 2018	1,477,420	10,667,176	2,518,597	(267,799)	14,395,394
COMPREHENSIVE INCOME					
<i>Equity acquired in merger</i>	0	0	0	0	0
<i>Net Income</i>	0	1,040,405	0	0	1,040,405
<i>Other comprehensive income</i>	0	0	0	696,845	696,845
BALANCES, DECEMBER 31, 2019	\$ 1,477,420	\$ 11,707,581	\$ 2,518,597	\$ 429,046	\$ 16,132,644

See accompanying notes to the financial statements.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Statements of Cash Flows
For the Years Ended December 31, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
<i>CASH FLOWS FROM OPERATING ACTIVITIES</i>		
Net income for the year	\$ 1,040,405	\$ 1,731,000
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation	226,154	220,572
Amortization of core deposits	48,624	8,104
Credit for loan losses	108,770	264,391
Gain/(loss) on sale of available-for-sale securities	138,442	2,877
<i>(Increase)/decrease in operating assets:</i>		
Accrued interest receivable	(98,160)	45,264
Other assets	(98,826)	(162,989)
<i>Increase/(decrease) in operating liabilities:</i>		
Other liabilities	(149,543)	98,250
<i>CASH PROVIDED BY OPERATING ACTIVITIES</i>	<u>1,215,866</u>	<u>2,207,469</u>
<i>CASH FLOWS FROM INVESTING ACTIVITIES</i>		
Proceeds from sold/matured available-for-sale investments	37,933,101	8,707,206
Purchase of available-for-sale investments	(41,537,157)	(18,336,329)
Purchase of office properties and equipment	(238,165)	(40,943)
Purchase of contributed capital	0	(190,324)
Loans to members, net of principal collections	(78,483)	(8,375,664)
Acquired core deposit intangible	0	(461,120)
Proceeds from merger	0	2,518,597
Increase in NCUSIF deposit	24,551	(203,569)
<i>CASH USED IN INVESTING ACTIVITIES</i>	<u>(3,896,153)</u>	<u>(16,382,146)</u>
<i>CASH FLOW FROM FINANCING ACTIVITIES</i>		
Net change in customer deposits	697,580	15,043,021
Line of credit borrowings	20,900,034	7,627,989
Line of credit repayments	(20,900,034)	(7,627,989)
<i>CASH PROVIDED BY FINANCING ACTIVITIES</i>	<u>697,580</u>	<u>15,043,021</u>
<i>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</i>	<u>\$ (1,982,707)</u>	<u>\$ 868,344</u>

(CONTINUED)

USSCO JOHNSTOWN FEDERAL CREDIT UNION

Statements of Cash Flows
For the Years Ended December 31, 2019 and 2018

(CONCLUDED)

	<u>2019</u>	<u>2018</u>
<i>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</i>	\$ (1,982,707)	\$ 868,344
<i>CASH AND CASH EQUIVALENTS, JANUARY 1</i>	<u>4,402,859</u>	<u>3,534,515</u>
<i>CASH AND CASH EQUIVALENTS, DECEMBER 31</i>	<u>\$ 2,420,152</u>	<u>\$ 4,402,859</u>

SUPPLEMENTAL DISCLOSURES

Cash paid during the year for:

Interest

\$ 246,982	\$ 203,906
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(Increase)/decrease in unrealized gain/loss on available-for-sale securities

<u>\$ 696,845</u>	<u>\$ (126,071)</u>
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See accompanying notes to the financial statements.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The USSCO Johnstown Federal Credit Union provides a variety of financial services to members through its locations in Johnstown, Richland, Somerset and Ebensburg, Pennsylvania. Participation in the Credit Union is limited to those individuals that qualify for membership, which is defined in the Credit Union's Charter and Bylaws. The Credit Union's primary source of revenue is member loans, a significant portion being home equity, vehicle loans, and small business lending. With an affiliation with Keystone Lending Alliance, a Pittsburgh CUSO, the Credit Union has expanded its membership base throughout the Western Pennsylvania area.

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States (U.S. 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 revenues and expenses during the reporting period. Specifically, management has made estimates based on assumptions for fair value of financial instruments and the assessment of other-than-temporary-impairments on investments. Actual results could differ from those estimates.

Perpetual Contributed Capital

As part of membership, the Credit Union is required to maintain a membership capital share account (capital account) at Vizo Financial Corporate Credit Union. The perpetual contributed capital for December 31, 2019 and 2018 was \$690,324 and \$690,324, respectively. A capital account is a restricted share base that is subject to depletion based on the financial health of the corporate credit union. Therefore, capital account balances could become impaired. Perpetual contributed capital is not subject to share insurance covered by the National Credit Union Share Insurance Fund or any other deposit insurer. The perpetual contributed capital is redeemable only at the option of corporate credit union provided regulatory approval is obtained. Perpetual contributed capital cannot be pledged against borrowings, has no scheduled maturity, and offers non-cumulative dividends.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Investments

In accordance with the Financial Accounting Standards Codification, the Credit Union classifies investment securities into the following two categories:

Securities Available-for-Sale: Available-for-Sale securities consist of investment securities determined by this Credit Union to be available for sale in the near term. This Credit Union has deemed their government and government agency bond portfolio to be available-for-sale. These securities are reported at fair value. Unrealized holding gains and losses on available-for-sale securities are reported as a separate component of equity until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. The amortization of premiums and the accretion of discounts are recognized in interest income using methods approximating the interest method over the period of maturity.

Other Investments: Other investments consist of an investment in a Credit Union Service Organization. The ownership in the CUSO is less than 20% and the fair value is not readily determinable thus the investment is recorded at cost.

Each year, the Credit Union evaluates this CUSO for potential impairments. Gains or losses on disposition are based on the net proceeds and the adjusted carrying amount of the securities sold, using the specific identification method.

Declines in the fair value of individual investments below their cost that are other than temporary, result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses.

Loans to Members and Allowance for Loan Losses

The Credit Union grants home equity, commercial and consumer loans to members. The loan portfolio is represented primarily by loans throughout Cambria and Somerset Counties. The ability of the members to honor their contracts is dependent upon the real estate and general economic conditions in this area.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses.

The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Loans acquired by merger have been recorded at fair value. Loans at fair value acquired by merger do not have an allowance account associated with the merged (acquired) loan portfolio. Fair value is considered to include credit risk and projected losses in the calculated fair value or value identified through actively traded markets for identical loan portfolios. Therefore, at merger date, the acquired credit unions allowance for loan loss is reduced to zero. The allowance for loan loss is considered to be embedded in each loan type's fair valuation. This credit component is a new line item for the continuing organization.

NCUSIF Deposit

The deposit in the National Credit Union Share Insurance Fund (NCUSIF) is in accordance with NCUA regulations, which require the maintenance of a deposit by each insured credit union in an amount equal to one percent (1%) 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.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

Notes to Financial Statements At and For the Years Ended December 31, 2019 and 2018

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

NCUSIF Insurance Premiums

A credit union is required to pay an annual insurance premium equal to one-twelfth of one percent of its total insured shares, unless the payment is waived or reduced by the NCUA Board. The NCUA Board reserves the right to assess additional insurance premiums. In 2019 and 2018, the NCUA Board declared no additional insurance premium.

Property, Buildings and Equipment

Property, buildings and equipment are stated at cost, for purchased items, and at fair value at the date of acquisition for items acquired as part of a merger, less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful life of the asset. Maintenance and repair costs are charged to expense as incurred. Expenditures that extend the life or increase the productivity of the asset are capitalized.

Acquired Intangible Core Deposits

The acquired intangible core deposits arose from a credit union merger and is amortized on an accelerated method over its estimated useful life.

Foreclosed Real Estate

Foreclosed real estate includes both formally foreclosed property and in-substance foreclosed property. In-substance foreclosed properties are those properties for which the institution has taken physical possession, regardless of whether formal foreclosure proceedings have taken place.

At the time of foreclosure, foreclosed real estate is recorded at the lower of the carrying amounts of fair value less cost to sell, which becomes the property's new basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, these assets are carried at the lower of their new cost basis or fair value less cost to sell. Costs incurred in maintaining foreclosed real estate and subsequent adjustments to the carrying amount of the property are included in income (loss) on foreclosed real estate.

Appropriated Statutory Regular Reserve

The Credit Union is required by regulation to maintain a statutory reserve. This reserve, which represents a regulatory restriction of undivided earnings, is not available for the payment of dividends.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Equity Acquired in Merger

Equity acquired in a merger represents equity accounted for in accordance with the acquisition method of accounting. Under this accounting method, undivided earnings of the acquired are combined on the acquirer's statement of financial condition as a separate component of equity. This component of equity is considered part of net worth as defined by the regulations established by the NCUA.

Comprehensive Income (Loss)

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

Statement of Cash Flows

The Credit Union considers all cash and amounts due from depository institutions, and interest-bearing deposits in banks, to be cash equivalents for purposes of the statement of cash flows.

Concentration of Credit Risk

The Credit Union's business activity is with its members. The majority of the Credit Union's loan portfolio is comprised of real estate and automobile loans. The Credit Union may be exposed to credit risk from a regional economic standpoint, since a significant concentration of its borrowers work or reside in the Cambria and Somerset Counties of Pennsylvania.

The Credit Union maintains most of their cash in deposit accounts at one financial institution. The balance, at times, may exceed federally insured limits. The Credit Union exceeded the insured limit by \$1,204,319 and \$2,561,485 at December 31, 2019 and 2018, respectively.

Members' Share and Savings Accounts

Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation. Dividends on members' share and savings accounts are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union. Dividend rates on members' share accounts are set by the Board of Directors based on an evaluation of current and future economic conditions.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Income Taxes

The Credit Union is exempt, by statute, from federal and state income taxes.

Accounting Standards Adopted

Effective January 1, 2019, the Credit Union adopted ASU 2014-09, Revenue from Contracts with Customers —Topic 606 and all subsequent ASUs that modified ASC 606. The standard required a credit union to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers at the time the transfer of goods or services takes place. The Credit Union completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, deposit related fees, interchange fees, merchant income, and insurance commission income. Based on this assessment, the Credit Union concluded that ASU 2014-09 did not materially change the method in which the Credit Union currently recognizes revenue for these revenue streams. See Note 15 for disclosure related to revenue recognition.

Reclassification of Comparative Amounts

Certain comparative balance sheet amounts for the prior year have been reclassified to conform to current-year classifications. Acquired intangible core deposits of \$461,120 we reclassified from other assets. The 2018 perpetual capital should have been reported at \$690,324. Therefore, \$190,324 was reclassified to perpetual contributed capital, cash and cash equivalents was reduced by \$180,735 and other assets by \$9,589. These reclassifications were reclassified only within asset accounts and resulted in no change in total assets. Such reclassifications had no effect on net income or equity.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 2 - LOANS TO MEMBERS

The composition of loans to members as of December 31, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Mortgage/Home equity loans	\$ 15,029,144	\$ 16,547,055
Share secured	570,651	665,292
Unsecured	4,504,882	5,087,126
Business	6,300,955	6,412,950
Automobile	42,340,561	40,022,391
Education	655,815	663,845
Other	<u>14,160</u>	<u>6,127</u>
Subtotal	69,416,168	69,404,786
Loan credit discount	(109,167)	(219,766)
Loan yield adjustment	65,133	195,417
Allowance for loan losses	<u>(470,650)</u>	<u>(448,666)</u>
	<u>\$ 68,901,484</u>	<u>\$ 68,931,771</u>

The Credit Union primarily grants loans to customers in Cambria and Somerset County, Pennsylvania area. Although the Credit Union has a diversified loan portfolio, exposure to credit loss can be adversely impacted by downturns in local economic and employment conditions.

Allowance for Credit Losses and Recorded Investment in Financing Receivables

Management has established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio.

For purposes of determining the allowance for loan losses, the Credit Union has aggregated certain loans in the portfolio by portfolio segment. These portfolio segments are as follows: Unsecured credit card loans, all other unsecured loans, new vehicle loans, used vehicle loans, fixed rate real estate loans > 15 years, fixed rate real estate loans < 15 years, adjustable rate real estate loans 1 year or less, adjustable rate real estate loans > 1 year, closed-end fixed rate real estate loans, closed-end adjustable rate real estate loans, open-end adjustable rate real estate loans, open-end fixed rate real estate loans, MBL real estate loans, business purpose real estate loans, MBL motor vehicle loans, business purpose motor vehicle loans, MBL line-of-credit loans, business purpose line-of-credit loans, MBL equipment loans, business purpose equipment loans, other MBL loans and other business purpose loans.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018

NOTE 2 - LOANS TO MEMBERS (continued)

Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over a two-year period for all portfolio segments. Certain qualitative factors are then added to the historical allocation percentage to get the adjusted factor to be applied to nonclassified loans. These qualitative factors are reviewed each quarter and adjusted based upon relevant changes within the portfolio. The following qualitative factors are analyzed for each portfolio segment:

- Changes in lending policies and procedures
- Changes in economic and business conditions
- Changes in the nature and volume of portfolio
- Changes in lending management and staff
- Changes in loan review system and Board oversight
- Changes in non-performing loans
- Concentrations of credit/portfolio risk
- Changes in external factors (competition, regulatory, legal, etc.)

Activity in the allowance for loan losses is summarized as follows for the years ended December 31:

	<u>2019</u>	<u>2018</u>
Balance, January 1	\$ 448,666	\$ 368,054
Debit charged to operations	108,770	264,391
Charge-offs	(185,321)	(214,675)
Recoveries	98,535	30,896
Balance, December 31	<u>\$ 470,650</u>	<u>\$ 448,666</u>

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 2 - LOANS TO MEMBERS (continued)

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at year end. The Credit Union considers the allowance for loan losses of \$470,650 adequate to cover loan losses inherent in the loan portfolio at December 31, 2019. The following table presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans as of December 31, 2019 and 2018:

2019:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Allowance for losses:				
Ending Balance	\$130,503	\$ 18,903	\$321,244	\$470,650
Individually evaluated for impairment	\$ 61,000	\$ 0	\$ 42,606	\$103,606
Collectively evaluated for impairment	\$ 69,503	\$ 18,903	\$278,638	\$367,044
2019:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Loans:				
Ending Balance	\$14,003,393	\$6,300,955	\$49,111,820	\$69,416,168
Individually evaluated for impairment	\$ 140,864	\$ 0	\$ 50,629	\$ 191,493
Collectively evaluated for impairment	\$13,862,529	\$6,300,955	\$46,061,191	\$69,224,675
2018:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Allowance for losses:				
Ending Balance	\$ 92,930	\$ 20,842	\$334,894	\$448,666
Individually evaluated for impairment	\$ 20,000	\$ 0	\$ 39,389	\$ 59,389
Collectively evaluated for impairment	\$ 72,930	\$ 20,842	\$295,505	\$389,277
2018:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Loans:				
Ending Balance	\$16,547,055	\$6,412,950	\$46,444,781	\$69,404,786
Individually evaluated for impairment	\$ 92,002	\$ 0	\$ 122,785	\$ 214,787
Collectively evaluated for impairment	\$16,455,053	\$6,412,950	\$46,321,996	\$69,189,999

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 2 - LOANS TO MEMBERS (continued)

The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Credit Union's internal credit risk grading system is based on experiences with similarly graded loans. The Credit Union's internally assigned grades are as follows:

Pass – Loans classified as pass are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral.

Impaired Loans – Loans classified as impaired have an element of potential loss. These loans may be secured with insufficient collateral or other sources to provide full payment to the Credit Union, making collection or liquidation in full highly questionable and improbable, based on existing circumstances.

Non-impaired / Delinquent loans over 29 days – Loans classified here are business loans which have a potential weakness or risk that exists, which could cause a more serious problem if not corrected.

Non-impaired / Delinquent loans over 59 days – Loans classified here are non-business loans which have a well-defined weakness based on objective evidence and can be characterized by the distinct possibility that the Credit Union will sustain some loss if the deficiencies are not corrected.

Proposed Charge-offs – Loans classified as proposed charge-offs are considered uncollectible, or of such little value that continuation as an asset is not warranted.

Additionally, the Credit Union scores member business loans between a one and eight based on the loan quality.

The following table represents credit exposures for the loans classes by internally assigned grades as of December 31, 2019 and 2018:

2019:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Pass	\$13,667,002	\$6,300,955	\$48,898,945	\$68,866,902
Impaired	336,391	0	87,769	424,160
Business loans				
delinquent > 29 days	0	0	0	0
Non-business loans				
delinquent > 59 days	0	0	125,106	125,106
Proposed charge-offs	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	<u>\$14,003,393</u>	<u>\$6,300,955</u>	<u>\$49,111,820</u>	<u>\$69,416,168</u>

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 2 - LOANS TO MEMBERS (continued)

2018:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Pass	\$16,171,395	\$6,412,950	\$46,165,224	\$68,749,569
Impaired	375,660	0	224,276	599,936
Business loans				
delinquent > 29 days	0	0	0	0
Non-business loans				
delinquent > 59 days	0	0	52,580	52,580
Proposed charge-offs	0	0	2,701	2,701
Total	<u>\$16,547,055</u>	<u>\$6,412,950</u>	<u>\$46,444,781</u>	<u>\$69,404,786</u>

The following table presents performing and nonperforming loans as of December 31, 2019 and 2018. Payment activity is reviewed by management on a monthly basis to determine how loans are performing. Loans are considered to be nonperforming when they become 90 days past due.

2019:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Performing	\$13,885,547	\$6,300,955	\$49,099,842	\$69,286,344
Nonperforming	117,846	0	11,978	129,824
Total	<u>\$14,003,393</u>	<u>\$6,300,955</u>	<u>\$49,111,820</u>	<u>\$69,416,168</u>

2018:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Performing	\$16,455,053	\$6,412,950	\$46,387,005	\$69,255,008
Nonperforming	92,002	0	57,776	149,778
Total	<u>\$16,547,055</u>	<u>\$6,412,950</u>	<u>\$46,444,781</u>	<u>\$69,404,786</u>

Age Analysis of Past Due Loans by Class

Following is a table which includes an aging analysis of the recorded investment of past due loans as of December 31, 2019 and 2018:

2019:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
30-59 days past due	\$ 91,945	\$ 0	\$ 486,237	\$ 578,182
60-89 days past due	20,379	0	137,868	158,247
90 days or more and still accruing	0	0	13,361	13,361
Nonaccrual	117,846	0	11,978	129,824
Total Past Due	230,170	0	649,444	879,614
Total Current	13,773,223	6,300,955	48,462,376	68,536,554
Total Loans	<u>\$14,003,393</u>	<u>\$6,300,955</u>	<u>\$49,111,820</u>	<u>\$69,416,168</u>

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 2 - LOANS TO MEMBERS (continued)

2018:	<u>Residential</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
30-59 days past due	\$ 291,008	\$ 0	\$ 428,259	\$ 719,267
60-89 days past due	36,337	0	82,601	118,938
90 days or more and still accruing	0	0	0	0
Nonaccrual	<u>92,002</u>	<u>0</u>	<u>57,776</u>	<u>149,778</u>
Total Past Due	419,347	0	568,636	987,983
Total Current	<u>16,127,708</u>	<u>6,412,950</u>	<u>45,876,145</u>	<u>68,416,803</u>
Total Loans	<u>\$16,547,055</u>	<u>\$6,412,950</u>	<u>\$46,444,781</u>	<u>\$69,404,786</u>

Impaired Loans

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable, as of December 31, 2019 and 2018:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
2019:					
With no related allowance:					
Residential	\$ 195,525	\$ 195,525	\$ 0	\$ 201,002	\$ 9,205
Commercial	0	0	0	0	0
Consumer	37,136	37,136	0	46,804	2,933
With an allowance:					
Residential	140,866	140,866	61,000	138,420	1,429
Commercial	0	0	0	0	0
Consumer	<u>50,633</u>	<u>50,633</u>	<u>42,606</u>	<u>63,124</u>	<u>4,802</u>
Total	<u>\$ 424,160</u>	<u>\$ 424,160</u>	<u>\$ 103,606</u>	<u>\$ 449,350</u>	<u>\$ 18,369</u>
2018:					
With no related allowance:					
Residential	\$ 283,658	\$ 283,658	\$ 0	\$ 266,968	\$ 14,952
Commercial	0	0	0	0	0
Consumer	101,486	101,486	0	50,340	5,551
With an allowance:					
Residential	92,002	92,002	20,000	93,117	3,962
Commercial	0	0	0	0	0
Consumer	<u>122,790</u>	<u>122,790</u>	<u>39,389</u>	<u>89,853</u>	<u>3,803</u>
Total	<u>\$ 599,936</u>	<u>\$ 599,936</u>	<u>\$ 59,389</u>	<u>\$ 500,278</u>	<u>\$ 28,268</u>

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 2 - LOANS TO MEMBERS (continued)

Nonaccrual Loans

Loans are generally considered nonaccrual upon reaching 90 days delinquency, unless they are well collateralized by real estate, although the Credit Union may be receiving partial payments of interest and partial repayments of principal on such loans. When a loan is placed on nonaccrual status, previously accrued but unpaid interest is deducted from interest income.

Interest income on loans would have increased by an immaterial amount if these loans had performed in accordance with their original terms.

NOTE 3 - INVESTMENTS

The amortized cost and fair values of investment securities at December 31 are summarized as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>DECEMBER 31, 2019</u>				
<i>Securities available-for-sale:</i>				
Certificates of deposit	\$18,103,000	\$ 247,022	\$ 303	\$ 18,349,719
Mortgage-backed securities	<u>27,266,255</u>	<u>289,892</u>	<u>107,566</u>	<u>27,448,581</u>
	<u>\$45,369,255</u>	<u>\$ 536,914</u>	<u>\$ 107,869</u>	<u>\$45,798,300</u>
 <i>Other investments-CUSO</i>	 <u>\$ 1</u>	 <u>\$ 0</u>	 <u>\$ 0</u>	 <u>\$ 1</u>
 <u>DECEMBER 31, 2018</u>				
<i>Securities available-for-sale:</i>				
Certificates of deposit	\$24,355,000	\$ 4,826	\$ 121,014	\$ 24,238,812
U.S. government (including agencies)	1,496,767	0	4,422	1,492,345
Corporate bonds	1,004,475	0	10,965	993,510
Mortgage-backed securities	<u>15,047,397</u>	<u>43,207</u>	<u>179,430</u>	<u>14,911,174</u>
	<u>\$41,903,639</u>	<u>\$ 48,033</u>	<u>\$ 315,831</u>	<u>\$41,635,841</u>
 <i>Other investments-CUSO</i>	 <u>\$ 1</u>	 <u>\$ 0</u>	 <u>\$ 0</u>	 <u>\$ 1</u>

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 3 - INVESTMENTS (continued)

The following tables shows the Credit Union's unrealized losses and fair values, aggregated by investment category and length of time that the individual securities have been in continuous unrealized loss position, at December 31:

	<u>Less than Twelve Months</u>		<u>Twelve Months or Greater</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
<u>DECEMBER 31, 2019</u>						
Certificates of deposit	\$ 0	\$ 0	\$ 247,696	\$ (303)	\$ 247,696	\$ (303)
Mortgage-backed securities	<u>11,070,845</u>	<u>(85,417)</u>	<u>1,759,537</u>	<u>(22,149)</u>	<u>12,830,382</u>	<u>(107,566)</u>
Total	<u>\$ 11,070,845</u>	<u>\$ (85,417)</u>	<u>\$ 2,007,233</u>	<u>\$ (22,452)</u>	<u>\$ 13,078,078</u>	<u>\$ (107,869)</u>
<u>DECEMBER 31, 2018</u>						
Certificates of deposit	\$ 4,663,774	\$ (45,225)	\$ 3,401,211	\$ (75,789)	\$ 8,064,985	\$ (121,014)
U.S. government (including agencies)	1,492,345	(4,422)	0	0	1,492,345	(4,422)
Corporate bonds	0	0	993,510	(10,965)	993,510	(10,965)
Mortgage-backed securities	<u>2,893,815</u>	<u>(15,947)</u>	<u>5,690,585</u>	<u>(163,483)</u>	<u>8,584,400</u>	<u>(179,430)</u>
Total	<u>\$ 9,049,934</u>	<u>\$ (65,594)</u>	<u>\$ 10,085,306</u>	<u>\$ (250,237)</u>	<u>\$ 19,135,240</u>	<u>\$ (315,831)</u>

There were 26 positions considered temporarily impaired as of December 31, 2019. The Credit Union reviews its position quarterly and has asserted that the declines outlined in the above tables represent temporary declines and the Credit Union does not intend to sell and does not believe it will be required to sell these securities before recovery of their cost basis, which may be maturity. The Credit Union has concluded that any impairment of its investment securities portfolio is not other than temporary but is the result of interest rate changes that are not expected to result in the noncollection of principal and interest during the period.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 3 - INVESTMENTS (continued)

The following is a summary of maturities of available-for-sale securities as of December 31, 2019:

	<u>Amortized Cost</u>	<u>Fair Value</u>
Amounts maturing in:		
One year or less	\$ 5,317,000	\$ 5,317,000
After one year through five years	14,612,634	14,863,216
After five years through ten years	5,676,447	5,740,478
After ten years	<u>19,763,174</u>	<u>19,877,606</u>
	<u>\$ 45,369,255</u>	<u>\$ 45,798,300</u>

The amortized cost and fair value of mortgage-backed securities are presented in the available-for-sale category by contractual maturity in the preceding table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations without call or prepayment penalties.

Available-for-sale securities sold or called in 2019 and 2018 totaled \$33,082,093 and \$8,707,206, respectively. Additionally, USSCO did not hold any derivative financial instruments such as futures, forwards, swap or option contracts at December 31, 2019 or 2018.

The Credit Union owned 1.7% of X-Card Systems, LLC. USSCO's ownership in this CUSO remained under 20% of the CUSO's total capital and therefore can be carried on the Statements of Financial Condition at cost. The Credit Union evaluated the CUSO for possible impairment. The Credit Union deemed the CUSO to have other-than-temporary impairments and reduced the value to \$1.

NOTE 4 - PROPERTY, BUILDINGS AND EQUIPMENT

Property, buildings and equipment as of December 31 are summarized as follows:

	<u>Useful Life</u>	<u>2019</u>	<u>2018</u>
Land		\$ 325,989	\$ 325,989
Buildings & improvements	25-45	3,116,118	3,533,261
Furniture & equipment	5-7	1,125,177	3,598,790
Leasehold improvements	4	<u>9,307</u>	<u>166,115</u>
		4,576,591	7,624,155
Less: Accumulated depreciation		<u>2,586,812</u>	<u>5,646,387</u>
		<u>\$ 1,989,779</u>	<u>\$ 1,977,768</u>

Depreciation expense for the years ended December 31, 2019 and 2018 amounted to \$226,154 and \$220,572, respectively.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 4 - PROPERTY, BUILDINGS AND EQUIPMENT (continued)

During 2019, the Credit Union evaluated its property and equipment and determined \$3,255,786 to be no longer in use and disposed of those fully depreciated assets.

NOTE 5 - ACQUIRED INTANGIBLE CORE DEPOSITS

Acquired intangible assets were as follows at year end:

	<u>2019</u>		<u>2018</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Amortized intangible assets:				
Core deposits intangibles	\$485,432	\$72,936	\$485,432	\$24,312

Amortization expense was \$48,624 and \$24,312 for 2019 and 2018 respectively. Estimated amortization expense for each of the next five years and thereafter is:

2020	\$ 48,624
2021	48,624
2022	48,624
2023	48,624
2024	48,624
Thereafter	<u>169,376</u>
	<u>\$412,496</u>

NOTE 6 - MEMBERS' SHARE AND SAVINGS ACCOUNTS

A summary of share and savings accounts are as follows:

	<u>2019</u>	<u>2018</u>
Shares	\$ 57,125,134	\$ 56,374,614
Money market	8,500,796	8,701,093
Share draft accounts	24,826,793	23,668,082
IRA shares	3,140,781	3,586,276
Christmas & Vacation Clubs	<u>1,476,753</u>	<u>1,452,571</u>
Subtotal	<u>95,070,257</u>	<u>93,782,636</u>
Share certificate accounts and IRA's:		
0.0% to 3.0%	<u>11,734,408</u>	<u>12,324,449</u>
Subtotal	<u>11,734,408</u>	<u>12,324,449</u>
	<u>\$ 106,804,665</u>	<u>\$ 106,107,085</u>

The aggregate amounts of members' share and savings accounts that meet or exceed the NCUA insurance limit of \$250,000 were approximately \$1,913,873 and \$1,430,397 at December 31, 2019 and 2018, respectively.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 6 - MEMBERS' SHARE AND SAVINGS ACCOUNTS

Scheduled maturities of share certificates and IRA's at December 31 are as follows:

	<u>2019</u>	<u>2018</u>
Less than 1 year	\$ 5,654,736	\$ 5,934,214
Less than 3 years, more than 1 year	4,321,369	5,132,481
More than 3 years	<u>1,758,303</u>	<u>1,257,754</u>
	<u>\$ 11,734,408</u>	<u>\$ 12,324,449</u>

Interest expense on share accounts for the years ended December 31, 2019 and 2018 is summarized as follows:

	<u>2019</u>	<u>2018</u>
Shares	\$ 120,520	\$ 110,653
Share certificates	53,691	34,309
IRA share certificates	<u>68,769</u>	<u>57,290</u>
	<u>\$ 242,980</u>	<u>\$ 202,252</u>

NOTE 7 - BORROWED FUNDS

The Credit Union has an open-ended "revolving credit" agreement with Vizo Financial with an approved credit limit at December 31, 2019 and 2018 of \$3,500,000 and \$3,500,000 respectively. The balance outstanding at December 31, 2019 and 2018 is \$0. The loan is payable on demand and is secured by all loans and accounts receivable from members. Interest is charged at a variable rate, which changes daily and is based upon one percent (1%) over the amount earned by Vizo Financial on investments. During 2019, USSCO borrowed and repaid \$20,900,034. During 2018, USSCO borrowed and repaid \$7,627,989.

The Credit Union also has secondary liquidity available through the Federal Reserve. The Credit Union did not utilize this available credit source in 2019 or 2018.

NOTE 8 - EQUITY - REGULAR RESERVE

The Credit Union is subject to various regulatory net worth 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.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 8 - EQUITY – REGULAR RESERVE (continued)

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 amounts and ratios (set forth in the table below) of net worth (as defined in the regulations) to total assets (as defined). Credit unions are also required to calculate a Risk-Based Net Worth (RBNW) Requirement, which establishes whether or not the Credit Union will be considered “complex” under the regulatory framework. The Credit Union’s RBNW ratio as of December 31, 2019 and 2018 was 6.45% and 5.88%, respectively. The minimum ratio to be considered complex under the regulatory framework is 6%. Management believes, as of December 31, 2019 and 2018, that the Credit Union meets all capital adequacy requirements to which it is subject.

As of December 31, 2019, 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 RBNW Requirement. 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 at December 31, 2019 and 2018 are presented in the table (dollars in thousands):

	<u>Actual</u>		<u>To be Adequately Capitalized under the Prompt Corrective Action Provisions</u>		<u>To be Well Capitalized under the Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
December 31, 2019	\$15,704	12.8%	≥\$7,405	≥6.0%	≥\$8,640	≥7.0%
December 31, 2018	\$14,663	12.1%	≥\$7,268	≥6.0%	≥\$8,480	≥7.0%

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 9 - RETIREMENT PLAN

The Credit Union has a qualified 401(k) retirement plan. Employees may contribute up to fifteen percent (15%) of their income into the plan and the Credit Union will match twenty-five percent (25%) of the employee's contributions, not exceeding ten percent (10%). The amount expensed was \$15,842 and \$16,420 in 2019 and 2018, respectively.

NOTE 10 - COMMITMENTS AND CONTINGENCIES

The principal commitments of the Credit Union are as follows:

Off-Balance Sheet Activities

At December 31, 2019 and 2018, the Credit Union had outstanding commitments for unused lines of credit, and loans that are not reflected in the accompanying financial statement as follows:

	<u>2019</u>		<u>2018</u>	
	Variable Rate	Fixed Rate	Variable Rate	Fixed Rate
Lines of Credit	\$ 0	\$ 617,686	\$ 0	\$ 579,337
Home Equity Lines	1,545,339	0	1,792,216	0
Business Lines	0	0	0	0
Overdraft Protection Commitments	5,448,840	0	6,600,623	0
Credit Cards	0	4,571,853	0	4,495,717
Letters of Credit	0	0	0	45,000
	<u>\$ 6,994,179</u>	<u>\$ 5,189,539</u>	<u>\$ 8,392,839</u>	<u>\$ 5,120,054</u>

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 is based on management's credit evaluation of the counterparty. Collateral held generally consists of certificates of deposit, share accounts, vehicles and real estate.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 10 - COMMITMENTS AND CONTINGENCIES (continued)

Operating Lease

The Credit Union leases its Ebensburg office facility under an operating lease. The original lease term was five years beginning August 1, 2011 and included the option to renew the lease for up to two additional terms of five years each. On August 1, 2017, the Credit Union exercised the option to renew the lease for an additional five years.

The Credit Union was also obligated for an operating lease at the acquiree's location after the 2018 merger. In November 2019 an agreement was reached with the lessor to buy out the remainder of the lease. The 2019 rent payments for this lease totaled \$45,667.

Minimum annual rentals are as follows:

December 31, 2020	\$ 27,000
December 31, 2021	<u>15,750</u>
	<u>\$ 42,750</u>

Rental expense on leased premises totaled \$72,667 and \$35,283 for 2019 and 2018, respectively.

NOTE 11 - RELATED PARTY TRANSACTIONS

In the normal course of business, the Credit Union extends credits to officers, directors and employees, including their immediate families. The aggregate loans at December 31, 2019 and 2018 were \$1,233,485 and \$1,383,380, respectively. The 2019 loan activity follows:

<u>2018</u>	<u>Additions</u>	<u>Principle Payments</u>	<u>2019</u>
\$1,383,380	\$119,593	\$269,488	\$1,233,485

Deposits from related parties at December 31, 2019 and 2018 amounted to \$1,314,514 and \$1,359,705, respectively.

USSCO JOHNSTOWN FEDERAL CREDIT UNION
Notes to Financial Statements

At and For the Years Ended December 31, 2019 and 2018

NOTE 12- FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There is a hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value.

The three broad levels are as follows:

- Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
- Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.
- Level III: Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value where the inputs into the determination of fair value require significant management judgment or estimation.

The following table presents the assets and liabilities reported on the statement of financial condition at their fair value as of December 31, 2019 and 2018 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
<u>2019</u>				
Fair Value Measured on a Recurring Basis:				
Available-for-sale securities	\$ 45,798,300	\$ 0	\$ 0	\$ 45,798,300
Fair Value Measured on a Nonrecurring Basis:				
Impaired Loans	\$ 0	\$ 0	\$ 424,160	\$ 424,160
Assets Held in Foreclosure	\$ 0	\$ 0	\$ 1,260	\$ 1,260

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 12 - FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

2018

Fair Value Measured on a
Recurring Basis:

Available-for-sale

securities	\$ 41,635,841	\$ 0	\$ 0	\$ 41,635,841
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Fair Value Measured on a
Nonrecurring Basis:

Impaired Loans	\$ 0	\$ 0	\$ 599,936	\$ 599,936
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Assets Held in

Foreclosure	\$ 0	\$ 0	\$ 1,260	\$ 1,260
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The fair values of available-for-sale securities are based on quoted market prices.

The fair values of impaired loans and real estate owned are equal to the current carrying values.

The estimated fair value of the Credit Union's financial instruments as of December 31 is as follows (in thousands):

	<u>2019</u>		<u>2018</u>	
	<u>Carrying</u>	<u>Fair</u>	<u>Carrying</u>	<u>Fair</u>
	<u>Value</u>	<u>Value</u>	<u>Value</u>	<u>Value</u>
Financial assets:				
Loans to members, net	\$ 68,901	\$ 68,718	\$ 68,932	\$ 68,781
Cash and restricted cash	3,110	3,110	5,093	5,093
Investment securities	45,798	45,798	41,636	41,636
Accrued interest receivable	384	384	286	286
NCUSIF deposit	1,077	1,077	1,102	1,102
Assets held in foreclosure	1	1	1	1
Other assets	2,161	2,161	2,111	2,111
Financial liabilities:				
Members' share and savings	\$ 106,805	\$ 105,085	\$ 106,107	\$ 100,949
Other liabilities	486	486	636	636

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018

NOTE 12 - FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas. As many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets such as premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Credit Union.

The Credit Union employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash, Accrued Interest Receivable, Other Assets and Other Liabilities

The fair value is equal to the current carrying value.

Investment Securities

The fair value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

Loans

The fair value is estimated by discounting the future cash flows using current market inputs at which loans with similar term and qualities would be made to borrowers of similar credit quality and constructing discount rates that consider reinvestment opportunities, operating expenses, non-interest income, credit quality, and prepayment risk.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

Notes to Financial Statements At and For the Years Ended December 31, 2019 and 2018

NOTE 12 - FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Deposits

The fair values of certificates of deposit are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities. Demand and savings accounts are valued at the amount payable on demand as of year-end.

NOTE 13 - MERGED EQUITY

On July 1, 2018, the Credit Union completed the merger of JSTC Employees Federal Credit Union, the acquiree in this business combination. JSTC Employees Federal Credit Union was a federally chartered credit union located in Johnstown, PA, founded in 1958.

The merger provided JSTC Employees Federal Credit Union members with expanded services, locations, and technology. The merger was a business combination of two mutual entities accounted for in accordance with the provisions of acquisition method accounting. The application of acquisition method accounting requires that the acquiree credit union's assets and liabilities be recorded at fair value. The difference between the fair value of assets and liabilities obtained during the merger are reflected in either a bargain purchase gain or goodwill. This business combination resulted in a \$1,386,679 bargain purchase. The Credit Union recorded the amount of bargain purchase in other non-interest income for the year ended December 31, 2018.

NOTE 14 - DEFINED BENEFIT PLAN TERMINATION

JSTC Employees Federal Credit Union previously adopted a 412(i) Defined Benefit Plan. As a result of the merger with USSCO Federal Credit Union, USSCO became the successor in interest and sponsor of the Plan.

The Plan was soft frozen in 2012 so no new hires have participated since that date. The Plan requires a contribution each year for current employees working 1,000 hours or more. The Plan's funding method is to use insurance contracts with guaranteed minimum interest rates unlike traditional defined benefit plan funding which is calculated based on actuarial assumptions. The amount expensed was \$11,844 for 2018.

The Credit Union has elected to terminate the Plan effective January 1, 2019. Benefit accruals, service and compensation from the Plan shall cease effective December 31, 2018 as a result of the termination.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 15 - REVENUE RECOGNITION

January 1, 2019 the Credit Union adopted ASU no. 2014-09 Revenue from Contracts with Customers –Topic 606 and all subsequent ASUs that modify Topic 606. Management has determined that topic 606 does not apply to revenue associated with financial instruments, including revenues from loans and securities. In addition, certain non-interest income streams such as fees associated with mortgage servicing rights, investment security gains, loan servicing fees, certain credit card fees, and gains on sale of loans are also not in scope of the guidance. As a result no changes were made during the year related to these sources of income.

Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, merchant income, and insurance commission income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Credit Union's revenue is generated from contracts with members.

Noninterest revenue streams in-scope of Topic 606 are discussed below:

Member account service fees - consist of insufficient funds (NSF) fees, monthly service fees, check orders, and other deposit account related fees. The Credit Union's performance obligation for monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. NSF fees, check orders and other deposit account related fees are largely transactional based, and therefore, the Credit Union's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit shares is primarily received immediately or in the following month through a direct charge to customers' accounts.

The Credit Union also reports its debit and credit card income, ATM fees, merchant services income, overdraft fees, and other service charges as part of member account service fees. Debit and credit card income is primarily comprised of interchange fees earned whenever the Credit Union's debit and credit cards are processed through card payment networks. ATM fees are primarily generated when a Credit Union cardholder uses a non-Credit Union ATM or a non-Credit Union cardholder uses a Credit Union ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Credit Union's performance obligation for fees and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

USSCO JOHNSTOWN FEDERAL CREDIT UNION

**Notes to Financial Statements
At and For the Years Ended December 31, 2019 and 2018**

NOTE 15 - REVENUE RECOGNITION (continued)

Other noninterest income - Other noninterest income consists of other recurring revenue streams such as safe deposit box rental fees and other miscellaneous revenue streams including insurance commission income. Safe deposit box rental fees are charged to the customer on an annual basis and recognized when billed. The Credit Union has determined that since rentals and renewals occur consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Insurance commissions income includes commission the Credit Union earns on insurance products sold to Credit Union members by third parties.

NOTE 16 - SUBSEQUENT EVENTS

In January 2020, the World Health Organization has declared the outbreak of a novel coronavirus (COVID-19) as a “Public Health Emergency of International Concern,” which continues to spread throughout the world and has adversely impacted global commercial activity and contributed to significant declines and volatility in financial markets. The coronavirus outbreak and government responses are creating disruption in global supply chains and adversely impacting many industries. The outbreak could have a continued material adverse impact on economic and market conditions and trigger a period of global economic slowdown. The rapid development and fluidity of this situation precludes any prediction as to the ultimate material adverse impact of the coronavirus outbreak.

Nevertheless, possible effects may include an increased risk of the Credit Union’s loan portfolio with possible customers defaulting on loans and the possibility of the values of collateral on loans declining, the Credit Union may become less liquid, and the Credit Union could experience a decline in value of its marketable security investments.

Management has reviewed events through July 13, 2020, the date the financial statements were issued and no other subsequent events occurred requiring accrual or disclosure.