

**McGladrey & Pullen**  
Certified Public Accountants

# **Kansas Corporate Credit Union**

Financial Statements

December 31, 2008 and 2007

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# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report

Supervisory Committee and Board of Directors  
Kansas Corporate Credit Union  
Wichita, Kansas

We have audited the accompanying statements of financial condition of Kansas Corporate Credit Union (a Kansas state-chartered credit union) as of December 31, 2008 and 2007, and the related statements of operations, comprehensive income, members' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Credit Union's management. 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Credit Union has reported members' share accounts and certificates as members' equity in the accompanying statements of financial condition that, in our opinion, should be reported as liabilities in order to conform to accounting principles generally accepted in the United States of America. If these share accounts and certificates were reported in conformity with accounting principles generally accepted in the United States of America, liabilities would increase and members' equity would decrease by \$236,856,144 and \$370,797,806, respectively, as of December 31, 2008 and 2007.

In our opinion, except for the effect of the accounting practice described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Kansas Corporate Credit Union as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As disclosed in Note 2 to the financial statements, during the year ending December 31, 2008, the Credit Union wrote off \$20,033,409 U.S. Central Credit Union capital based on the announcement that the U.S. Central Credit Union losses exceeded the capital in the organization.

As described in Note 9 to the financial statements, on April 21, 2009, the NCUA Board issued an order permitting corporate credit unions to measure compliance with regulatory capital requirements using regulatory capital as reported on their November 30, 2008, NCUA Form 5310. Using this November 30, 2008, measurement date, Kansas Corporate Credit Union is in compliance with the regulatory capital requirements. However, due to losses incurred in December 2008, Kansas Corporate Credit Union's regulatory capital, measured as of December 31, 2008, would not meet all of the NCUA's regulatory capital requirements that are normally in place. Should the NCUA change its position on the measurement of regulatory capital, the Credit Union may be in regulatory noncompliance and subject to intervention by the NCUA.

Minneapolis, Minnesota  
December 16, 2009

*McGladrey & Pullen, LLP*

**Kansas Corporate Credit Union  
Statements of Financial Condition  
December 31, 2008 and 2007**

<b>Assets</b>	<b>2008</b>	<b>2007</b>
Cash and cash equivalents	\$ 895,943	\$ 2,252,932
Uncollected cash items	35,038,118	12,988,175
Investments		
Available-for-sale securities	40,195,569	15,714,205
CUNA Mutual Group notes	-	5,000,000
U.S. Central Credit Union investments	168,619,990	351,277,409
Other investments	4,195,000	-
Loans to members, net	67,321,473	36,069,346
Accrued interest receivable	956,545	3,191,418
Property and equipment, net	716,089	718,178
National Credit Union Share Insurance Fund deposit	122,821	127,693
Other assets	1,214,066	799,253
	<u>\$ 319,275,614</u>	<u>\$ 428,138,609</u>
 <b>Liabilities and Members' Equity</b>		
Liabilities		
Notes payable to U.S. Central Credit Union	\$ 54,209,491	\$ 29,721,761
Uncollected deposits due to member accounts	35,038,118	12,988,175
Accrued expenses and other liabilities	1,666,495	3,357,639
Total liabilities	<u>90,914,104</u>	<u>46,067,575</u>
Commitments, contingent liabilities and subsequent events		
Members' Equity		
Members' accounts	201,655,603	337,615,545
Retained earnings, substantially restricted	(7,821,039)	11,386,606
Membership capital shares	29,200,541	27,182,261
Paid-in capital	6,000,000	6,000,000
Total capital	<u>27,379,502</u>	<u>44,568,867</u>
Accumulated other comprehensive loss	<u>(673,595)</u>	<u>(113,378)</u>
Total members' equity	<u>228,361,510</u>	<u>382,071,034</u>
	<u>\$ 319,275,614</u>	<u>\$ 428,138,609</u>

**Kansas Corporate Credit Union**  
**Statements of Operations**  
**For the Years Ended December 31, 2008 and 2007**

	<u>2008</u>	<u>2007</u>
<b>Interest and Dividend Income</b>		
Interest on interest-bearing accounts, CUNA Mutual Group notes and U.S. Central Credit Union investments	\$ 10,068,778	\$ 18,647,762
Interest on available-for-sale securities	864,944	835,432
Interest on loans	2,216,920	1,929,205
	<u>13,153,642</u>	<u>21,412,399</u>
<b>Interest and Dividend Expense</b>		
Dividends on members' shares	9,371,055	18,186,828
Interest on borrowed funds	2,010,005	1,537,217
	<u>11,381,060</u>	<u>19,724,045</u>
<b>Net Interest and Dividend Income</b>	1,772,582	1,688,354
<b>Noninterest Income (loss)</b>		
Service charges, other fees and other noninterest income	1,906,324	2,008,189
U.S. Central Credit Union capital accounts impairment	(20,033,409)	-
	<u>(18,127,085)</u>	<u>3,696,543</u>
<b>General and Administrative Expenses</b>		
Salaries and benefits	1,178,141	1,011,591
Travel, conference, and education expenses	53,042	62,797
Marketing and promotion expenses	45,193	29,127
Occupancy expenses	99,368	86,111
Fees	1,128,973	1,309,445
Professional services	143,844	112,540
Board and committee expenses	49,258	47,025
Dues	36,973	30,681
Other expenses	118,350	131,174
	<u>2,853,142</u>	<u>2,820,491</u>
<b>Net (Loss) Income</b>	<u>\$ (19,207,645)</u>	<u>\$ 876,052</u>

**Kansas Corporate Credit Union**  
**Statements of Comprehensive Income**  
**For the Years Ended December 31, 2008 and 2007**

	<u>2008</u>	<u>2007</u>
<b>Net (Loss) Income</b>	\$ (19,207,645)	\$ 876,052
<b>Other Comprehensive Income</b>		
Unrealized holding (losses) gains on investments classified as available-for-sale	<u>(560,217)</u>	<u>47,568</u>
<b>Comprehensive (Loss) Income</b>	<u>\$ (19,767,862)</u>	<u>\$ 923,620</u>

**Kansas Corporate Credit Union**  
**Statements of Members' Equity and Accumulated Other Comprehensive Income**  
**For the Years Ended December 31, 2008 and 2007**

	Regular Reserve	Unappropriated	Total Retained Earnings	Membership Capital Shares	Paid-in Capital	Members' Accounts	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2006	\$ 5,744,039	\$ 4,766,515	\$ 10,510,554	\$ 26,594,581	\$ 6,000,000	\$ 291,788,531	\$ (160,946)	\$ 334,732,720
Net income	-	876,052	876,082	-	-	-	-	876,052
Net change in members' accounts	-	-	-	587,680	-	45,827,014	-	46,414,094
Net change in unrealized gains (losses) on available-for-sale investments	-	-	-	-	-	-	47,568	47,568
Balance, December 31, 2007	5,744,039	5,642,567	11,386,606	27,182,261	6,000,000	337,615,545	(113,378)	382,071,034
Net loss	-	(19,207,645)	(19,207,645)	-	-	-	-	(19,207,645)
Net change in members' accounts	-	-	-	2,018,280	-	(135,959,942)	-	(133,941,662)
Net change in unrealized gains (losses) on available-for-sale investments	-	-	-	-	-	-	(560,217)	(560,217)
Balance, December 31, 2008	<u>\$ 5,744,039</u>	<u>\$(13,565,078)</u>	<u>\$ (7,821,039)</u>	<u>\$ 29,200,541</u>	<u>\$ 6,000,000</u>	<u>\$ 201,655,603</u>	<u>\$ (673,595)</u>	<u>228,361,510</u>

**Kansas Corporate Credit Union**  
**Statements of Cash Flows**  
**For the Years Ended December 31, 2008 and 2007**

	<u>2008</u>	<u>2007</u>
<b>Cash Flows from Operating Activities</b>		
Net (loss) income	\$ (19,207,645)	\$ 876,052
Adjustments to reconcile net income to net cash provided by operating activities:		
(Accretion) amortization of securities, net	(13,944)	4,503
Gain from sale of property and equipment	(3,000)	(30,064)
Depreciation and amortization	73,524	68,264
U.S. Central Credit Union capital accounts impairments	20,033,409	-
Net change in:		
Accrued interest receivable	2,234,873	(769,698)
Other assets	(414,813)	3,400,439
Accrued expenses and other liabilities	(1,691,144)	(3,000,208)
Net cash provided by operating activities	<u>1,011,260</u>	<u>549,288</u>
<b>Cash Flows from Investing Activities</b>		
Purchases of available-for-sale investments	(33,341,829)	(3,428,000)
Proceeds from maturities of available-for-sale investments	8,314,192	3,528,556
Proceeds from sales of available-for-sale investments	-	3,180,756
Net change in U.S. Central Credit Union investments	162,624,010	(51,519,631)
Net decrease in other investments	(4,195,000)	-
Net decrease in CUNA Mutual Group Notes	5,000,000	-
Net change in loans to members	(31,252,127)	8,334,172
Decrease (increase) in the National Credit Union Share Insurance		
Fund deposit	4,872	(14,526)
Proceeds from sale of property and equipment	3,000	58,526
Purchases of property and equipment	(71,435)	(71,133)
Net cash provided by / ( used) in investing activities	<u>107,085,683</u>	<u>(39,931,280)</u>
<b>Cash Flows from Financing Activities</b>		
Net decrease in borrowed funds	24,487,730	(6,255,691)
Net (decrease) increase in members' shares	(133,941,662)	46,414,694
Net cash (used in) / provided by financing activities	<u>(109,453,932)</u>	<u>40,159,003</u>
<b>(Decrease) Increase in Cash and Cash Equivalents</b>	(1,356,989)	777,011
<b>Cash and Cash Equivalents at Beginning of Year</b>	<u>2,252,932</u>	<u>1,475,921</u>
<b>Cash and Cash Equivalents at End of Year</b>	<u>\$ 895,943</u>	<u>\$ 2,252,932</u>
<b>Supplemental Cash Flow Information</b>		
Dividends paid on members' shares and interest paid on borrowed funds	\$ 13,741,781	\$ 18,724,607

**Kansas Corporate Credit Union  
Notes to Financial Statements  
December 31, 2008 and 2007**

**Note 1. Significant Accounting Policies**

**Nature of Operations:** Kansas Corporate Credit Union (the Credit Union) is a state-chartered credit union organized under the provisions of the Kansas Credit Union Act. The field of membership is defined in the Credit Union's Charter and Bylaws.

**Risks and Uncertainties:** The Credit Union is subject to certain risks and uncertainties including, but not limited to, interest rate, prepayment, market, geographic concentration, regulatory and credit risk. Net interest income and dividends result from the difference between the interest income and dividends earned on interest-earning assets and the interest and dividend expense incurred on interest-bearing liabilities and shares. Net interest income and dividends can be significantly affected by changes in the relative amounts of, and the interest rates and dividend rates associated with these assets, liabilities and shares. Additionally, during periods of falling interest rates, the loans underlying The Credit Union's securities portfolio are more likely to prepay, and The Credit Union may not be able to reinvest the proceeds from prepayments in securities and other financial assets with yields similar to those of the prepaying securities. Moreover, The Credit Union's assets, liabilities and shares are primarily interest and credit sensitive financial instruments and, as such, are subject to a degree of market risk, which may affect their fair value. This has resulted in significant declines in fair values during 2008 and 2007, and continues to be a risk for the future.

**Use of Estimates:** The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, except for the classification of members' accounts as members' equity, which conforms to the statutory definition in the Kansas Credit Union Act. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 income and expenses during the reporting period. Specifically, management has made significant assumptions in estimating the fair value of investments and principal and interest cash flows when evaluating investment securities for other-than-temporary impairments. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of fair value of financial instruments and the determination of impairment of member capital and paid-in capital shares in U.S. Central Federal Credit Union.

**Members' Shares:** Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation. Interest on members' share accounts is based on available earnings at the end of an interest period and is not guaranteed by the Credit Union. Interest rates on members' share accounts and certificates are set by the Board of Directors, based on an evaluation of current and future market conditions.

Member capital shares (MCS) have a three-year maturity, once notice has been given by a member credit union. Paid-in capital accounts (PIC) have a 20-year maturity. The PIC account is a long-term investment by member credit unions and is callable at the discretion of the Board of Directors.

Members' share accounts and certificates have been classified as members' equity on the balance sheets. It is the Credit Union's position that share accounts and certificates represent an ownership interest and are properly classified as equity. This classification conforms to the statutory definition in the Kansas Credit Union Act. However, such classification is not in accordance with generally accepted accounting principles (GAAP), which require members' share accounts and certificates to be classified as liabilities.

**Kansas Corporate Credit Union**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

**Cash and Cash Equivalents:** For the purpose of the statements of financial position and the statements of cash flow, cash and cash equivalents includes cash on hand, amounts due from financial institutions, and highly liquid debt instruments classified as cash, which were purchased with maturities of three months or less. Amounts due from financial institutions may, at times, exceed federally insured limits.

**Concentrations of Credit Risk:** The Credit Union's exposure to credit loss in the event of nonperformance by the member credit unions to which the lines of credit have been extended is represented by the contractual amounts of those lines. The Credit Union uses the same credit policies in making these commitments as it does for on-balance-sheet instruments.

Lines of credit extended by the Credit Union generally have no fixed expiration date and are cancelable at any time at the option of the Credit Union. 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.

**U.S. Central Credit Union Accounts:** U.S. Central Credit Union (US Central) is the credit union in which corporate credit unions are members. Under the corporate credit union structure, U.S. Central acts as a liquidity facility and source of investment for corporate credit unions. As investments with U.S. Central are not readily marketable and typically certificate accounts, which cannot be redeemed at an amount in excess of their face value, such accounts are not subject to the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*; however, these investments are assessed for impairment. See also Note 2.

**Available-for-Sale Securities:** Securities classified as available-for-sale are those debt securities that The Credit Union intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of The Credit Union's assets and liabilities, liquidity needs, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported as a separate component of other comprehensive income. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings. Amortization of premiums and discounts are recognized in interest income over the period to maturity.

In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Credit Union to retain its investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value.

**CUNA Mutual Group Notes:** CUNA Mutual Group notes are investment products offered by CUNA Mutual Life Insurance Company. The investment is a "Guaranteed Funding Contract," issued out of a "Separate Account" within CUNA Mutual Life Insurance Company and contains U.S. treasuries, mortgage-backed securities, investment grade corporate debt, commercial mortgage loans, high-yield corporate debt and foreign corporate debt. As CUNA Mutual Group notes are not readily marketable, they are carried at cost and are evaluated periodically for impairment.

**Other Investments:** Other investments and certificates in other financial institutions.

**Kansas Corporate Credit Union**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

**Loans to Members:** Loans to members are stated at the unpaid principal amount. Interest income is recognized over the life of the loan using the simple interest method. Loan fees and certain direct loan origination costs are not material for the financial statements. At December 31, 2008 and 2007, all loans were performing in accordance with the contractual terms. Management believes that no loan loss reserve is necessary due to the loans being generally short term in nature, secured by the members deposit and because the Credit Union has not historically incurred loan losses. Management's periodic evaluation of the adequacy of or need for an allowance is based on the Credit Union's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, and current economic conditions. In addition, member credit union assets generally collateralize all loans.

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

**National Credit Union Share Insurance Fund (NCUSIF) Deposit:** The deposit in the NCUSIF is in accordance with National Credit Union Administration (NCUA) regulations, which require the maintenance of a deposit by each federally insured Credit Union in an amount equal to 1 percent of its insured members shares. The deposit would be refunded to the Credit Union if its insurance coverage is terminated, if it converts its insurance coverage to another source, or if management of the fund is transferred from the NCUA Board.

**NCUSIF Insurance Premium:** The Credit Union is required to pay an annual insurance premium equal to one-twelfth of 1 percent of total insured shares, unless the payment is waived or reduced by the NCUA Board. The NCUA Board waived the 2008 and 2007 insurance premiums.

**Uncollected Cash Items:** Uncollected cash items are deposits made by the Credit Union's members that have not cleared the Federal Reserve Bank. Such amounts generally become available within one to three days and are noninterest-bearing.

**Uncollected Deposits Due to Member Accounts:** Deposits in collection are amounts due to the Credit Union's member credit unions when the related uncollected cash items become available. These amounts generally become available to the member credit unions within one to three days and are noninterest-bearing.

**Capital Requirements:** The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by the NCUA that, if undertaken, could have a direct material effect on The Credit Union and the financial statements. As of December 31, 2008, The Credit Union's capital adequacy requirements are described in Note 10.

The Credit Union continues to be subject to examination and regulation by the NCUA and the Kansas Department of Credit Unions.

**Income Taxes:** The Credit Union is exempt, by statute, from federal and state income taxes. However, the Credit Union is subject to unrelated business income tax as further discussed in Note 8.

**Comprehensive Income:** Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the members' equity section of the statements of financial condition. For 2008 and 2007, other comprehensive income includes no reclassification adjustments.

**Kansas Corporate Credit Union**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

**Recent Accounting Pronouncements:** In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. The cumulative effect of applying the provisions of FIN 48, if any, will be reported as an adjustment to the opening balance of retained earnings for the fiscal year of adoption. FIN 48 is to be effective for fiscal years beginning after December 15, 2007. However, at its October 15, 2008, meeting, the FASB reconsidered the scope of its proposed one-year deferral of the effective date of FIN 48 for all private enterprises, including credit unions. Under the expanded proposal, FIN 48 will be effective for private entities for annual periods beginning after December 15, 2008, if they have not yet issued a full set of U.S. GAAP annual financial statements incorporating the recognition, measurement and disclosure requirements of FIN 48. Early adoption is still permitted. The Credit Union is currently assessing the impact of FIN 48 on its financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*. This new standard significantly changes the accounting for business combination transactions as the pooling-of-interests accounting method will no longer be an acceptable accounting method. This change is effective for fiscal years beginning on or after December 15, 2008, with early adoption prohibited. The Credit Union is currently evaluating the future impact of FASB 141R on the Credit Union's financial condition.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of GAAP*. The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. The statement is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with GAAP*. SFAS No. 162 is not expected to have a material impact on the Credit Union's financial position, results of operations or cash flows.

In September 2006, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefits Associated with Endorsement Split-Dollar Life Insurance Arrangements" (EITF 06-4), and in March 2007, the FASB ratified EITF Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements." EITF 06-4 requires deferred compensation or postretirement benefit aspects of an endorsement-type split-dollar life insurance arrangement to be recognized as a liability by the employer and states the obligation is not effectively settled by the purchase of a life insurance policy. The liability for future benefits should be recognized based on the substantive agreement with the employee, which may be either to provide a future death benefit or to pay for the future cost of the life insurance. EITF 06-10 provides recognition guidance for postretirement benefit liabilities related to collateral assignment split-dollar life insurance arrangements, as well as recognition and measurement of the associated asset on the basis of the terms of the collateral assignment split-dollar life insurance arrangement. EITF 06-4 and EITF 06-10 are effective for fiscal years beginning after December 15, 2007. The Credit Union is currently evaluating the impact of the adoption of EITF 06-4 and EITF 06-10 on the Credit Union's financial condition, results of operations and cash flows.

In April 2009, FASB issued Staff Position No. SFAS 115-2 and SFAS 124-2, Recognition and Presentation of other-than-temporary impairments, which modifies existing requirements for determining when an other-than-temporary impairment exists, and how such other-than-temporary impairments are measured and reported. This FSP changes the presentation and amount of the other-than-temporary impairment recognized in the statement of earnings by separating impairment into (a) the amount of impairment related to the credit loss and (b) the amount of the total impairment related to all other factors.

**Kansas Corporate Credit Union  
Notes to Financial Statements  
December 31, 2008 and 2007**

**Note 2. U.S. Central Credit Union Accounts**

U.S. Central Credit Union investments consist of the following:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Member capital account in U.S. Central Credit Union	\$ -	\$ 13,809,819
Permanent capital account in U.S. Central Credit Union	-	4,230,000
Other accounts in U.S. Central Credit Union	168,619,990	333,237,590
	<u>\$ 168,619,990</u>	<u>\$ 351,277,409</u>

U.S. Central acts as a central credit union for the mutual benefit of 26 corporate credit unions. Its principal activity is to provide wholesale financial and payment services to members and their credit union constituencies and to act as an intermediary between corporate credit unions and the financial community.

In January 2009, U.S. Central announced that it would report a net loss of approximately \$1.1 billion for the year ended December 31, 2008, attributable to \$1.2 billion in other-than-temporary impairment (OTTI) of the investment portfolio. As a result, in March 2009, the NCUA Board placed U.S. Central into conservatorship and appointed itself as Conservator. In April 2009, the Agent for the Conservator announced that U.S. Central's revised OTTI charge for 2008 was \$3.8 billion.

Subsequently, the FASB issued FSP SFAS 115-2, which changed the methodology for recognizing OTTI. This accounting change enabled U.S. Central to add back \$3.7 billion to retained earnings, representing the noncredit portion of the loss.

Through the first nine months of 2009, U.S. Central has recorded significant additional OTTI charges on its investment portfolio and, as a result, at September 30, 2009, all of its paid-in capital shares and 88.9 percent of its membership capital shares have been depleted.

The Credit Union's paid-in capital and member capital share investment in U.S. Central were reviewed for impairment in accordance with The American Institute of Certified Public Accountants Technical Practice Aid issued in March 2009. The financial position of U.S. Central and its ability to redeem these investments within specified timeframes was evaluated and an impairment charge of \$20,033,409 was recorded in 2008, consisting of all of its investments in paid-in capital shares and membership capital shares.

Contractual maturities of U.S. Central share and certificate accounts are between zero and five years. Certificates are generally nonnegotiable and nontransferable, and would incur a market-based adjustment for withdrawal prior to maturity.

As of December 31, 2008 and 2007, certain U.S. Central share certificates have been pledged as collateral on borrowed funds from U.S. Central.

In addition, all accounts at U.S. Central, other than membership and paid-in capital shares are guaranteed by the NCUSIF through March 31, 2012. The NCUA has also extended that guarantee to accommodate a two-year rolling expiration date with the option of quarterly extensions through December 2012. If the option to extend each quarter is fully utilized, the final guarantee would expire December 31, 2014.

**Kansas Corporate Credit Union**  
**Notes to Financial Statements**  
**December 31, 2008 and 2007**

**Note 3. Investments**

Investments classified as available-for-sale consist of the following:

<u>December 31, 2008</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Government Agency securities	\$ 40,869,164	\$ 21,679	\$ (695,274)	\$ 40,195,569

  

<u>December 31, 2007</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Government Agency securities	\$ 15,827,583	\$ 19,736	\$ (133,114)	\$ 15,714,205

Investments by maturity as of December 31, 2008, are summarized as follows:

	<u>Available-for-Sale</u>		<u>U.S. Central Credit Union Investments</u>	<u>Other</u>
	<u>Amortized Cost</u>	<u>Fair Value</u>		
No contractual maturity	\$ -	\$ -	\$ 18,891,929	\$ -
Less than 1 year maturity	-	-	16,400,383	4,095,000
1 – 5 years maturity	-	-	100,327,678	100,000
5 – 10 years maturity	-	-	33,000,000	-
Government agency securities	40,869,164	40,195,569	-	-
	<u>\$ 40,869,164</u>	<u>\$ 40,195,569</u>	<u>\$ 168,619,990</u>	<u>\$ 4,195,000</u>

Expected maturities of asset-backed securities may differ from contractual maturities because borrowers may have the right to call or prepay the obligations and are, therefore, classified separately with no specific maturity date. Member and permanent capital accounts have been classified with no contractual maturity.

Gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2008 and 2007, are as follows:

<u>December 31, 2008</u>	<u>Fair Value</u>	<u>Continuous Unrealized Losses Existing For:</u>		<u>Total Unrealized Losses</u>
		<u>Less Than 12 Months</u>	<u>More Than 12 Months</u>	
<b>Available-for-Sale</b>				
Government agency securities	\$ 31,556,733	\$ (431,124)	\$ (264,150)	\$ (695,274)

  

<u>December 31, 2007</u>	<u>Fair Value</u>	<u>Continuous Unrealized Losses Existing For:</u>		<u>Total Unrealized Losses</u>
		<u>Less Than 12 Months</u>	<u>More Than 12 Months</u>	
<b>Available-for-Sale</b>				
Government agency securities	\$ 9,281,835	\$ (14,292)	\$ (118,822)	\$ (133,114)

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At December 31, 2008, the investment portfolio included 19 securities, two of which have current unrealized losses that have existed for longer than one year. At December 31, 2007, the investment portfolio included eight securities, seven of which had current unrealized losses that existed for longer than one year. All of these securities are considered to be acceptable credit risks.

In order to determine if the declines in fair value below amortized cost represented other-than-temporary impairment for these securities, management considered The Credit Union's intent and ability to hold the securities to recovery of fair value up to amortized cost, the severity of the decline in fair value below amortized cost, the length of time that fair value has been below amortized cost, current ratings by credit ratings agencies and overall economic and market conditions. That analysis concluded there were no other-than-temporary losses at December 31, 2008.

Other investments consist of certificates of deposits in various financial institutions. These certificates have maturities of two years or less.

Certificates are generally nonnegotiable and nontransferable, and may incur substantial penalties for withdrawal prior to maturity.

The fair value of other investments approximates book value.

**Note 4. Loans to Members**

Loans to members consist of the following:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Fixed rate term loans	\$ 45,204,609	\$ 29,399,604
Line of credit	5,605,780	4,690,435
Demand loans	2,111,084	1,979,307
Central Liquidity Facility loans	14,400,000	-
	<b>\$ 67,321,473</b>	<b>\$ 36,069,346</b>

There are no past due or impaired loans at December 31, 2008 or 2007.

**Note 5. Property and Equipment**

Property and equipment are summarized as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Land	\$ 92,432	\$ 92,432
Buildings and improvements	786,601	753,682
Furniture and equipment	468,561	460,481
	1,347,594	1,306,595
Accumulated depreciation and amortization	(631,505)	(588,417)
	<b>\$ 716,089</b>	<b>\$ 718,178</b>

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**Note 6. Members' Shares and Capital Accounts**

Members' shares are summarized as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Daily shares	\$ 12,864,204	\$ 21,149,816
Managed liquidity shares	108,261,313	114,876,990
Certificates	80,530,086	201,588,739
	<u>\$ 201,655,603</u>	<u>\$ 337,615,545</u>

Members' shares and capital accounts by maturity as of December 31, 2008, are summarized as follows:

No contractual maturity	\$ 121,125,517
0 – 1 year maturity	40,814,366
1 – 2 years maturity	8,513,719
2 – 3 years maturity	35,755,542
3 – 4 years maturity	1,700,000
4 – 5 years maturity	22,800,000
Over 5 years maturity	6,147,000
	<u>\$ 236,856,144</u>

Daily and managed liquidity shares have no contractual maturity. Capital shares and certificate accounts have maturities of 11 years or less.

The aggregate amount of certificates in denominations of \$100,000 or more at December 31, 2008 and 2007, is approximately \$189,955,171 and \$203,628,000, respectively.

In addition, all credit union deposits in the Credit Union are further guaranteed by the NCUSIF through March 31, 2012. The NCUA has also extended that guarantee to accommodate a two-year rolling expiration date with the option of quarterly extensions through December 2012. If the option to extend each quarter is fully utilized, the final guarantee would expire December 31, 2014.

Members' capital accounts are summarized as follows:

	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
Membership capital shares	\$ 29,200,541	\$ 27,182,261
Paid-in capital	6,000,000	6,000,000

Under the definitions of membership capital and PIC in Part 704.2 of Rules and Regulations of the NCUA (Part 704.2), capital is available to cover losses that exceed retained earnings. In May 2009, the NCUA published Letter to Credit Unions 09-CU-10, reinforcing the regulatory requirement in Part 704.2 that PIC and MCS are available to cover losses that exceed retained earnings and stating that when there is an accumulated deficit (retained earnings deficit) at a corporate credit union, PIC and permanent capital must be depleted to the extent necessary to eliminate the accumulated deficit. As of October 31, 2009, the NCUA required the Credit Union to deplete paid-in capital in accordance with the guidance provided.

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In the event claims were placed on the Credit Union's assets to satisfy its liabilities, member shares would be satisfied after creditors, but before Member Capital Accounts and paid-in capital.

**Note 7. Notes Payable**

The Credit Union has a \$175,000,000 line of credit agreement with U.S. Central Credit Union. The terms of this agreement call for the pledging of all assets as security for any and all obligations taken by the Credit Union under this agreement. At December 31, 2008 and 2007, the amounts borrowed under this line were \$39,809,491 and \$29,721,761, respectively. The agreement is reviewed for continuation by the lender and the Credit Union annually.

The Credit Union has also borrowed \$14,400,000 from U.S. Central Credit Union for CLF loans. These loans are passed on to member credit unions. CLF loans have maturity dates of three months or less at December 31, 2008. The Credit Union had no CLF borrowings as of December 31, 2007. See also Note 1.

**Note 8. Commitments and Contingent Liabilities**

The Credit Union is a party to various legal actions normally associated with business activities of financial institutions, the aggregate effect of which, in management's opinion, would not have a material adverse effect on the financial condition or results of operations of The Credit Union.

**Financial Instruments With Off-Balance-Sheet Risk:** The Credit Union is a party to financial statements with off-balance-sheet risk in the normal course of business to meet the financing needs of its members. These financial instruments primarily include lines of credit to member credit unions. As of December 31, 2008 and 2007, The Credit Union has \$132,044,512 and \$153,121,639 respectively, in outstanding committed lines of credit to its member credit unions.

The Credit Union's exposure to credit loss in the event of nonperformance by the party to which the line of credit has been extended is represented by the contractual amount of those lines. The Credit Union uses the same credit policies in making commitments as it does for on-balance sheet instruments such as loans receivable.

Lines of credit extended by The Credit Union generally have no fixed expiration date and are cancelable at any time at the option of The Credit Union. 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 credit union's credit worthiness on a case-by-case basis. Filing a UCC blanket lien collateralized the amount of collateral deemed necessary by The Credit Union.

**Financial Instruments With Concentrations of Credit Risk:** The nature of The Credit Union's business requires that it regularly maintain amounts on deposit at other financial institutions that exceed federally insured limits. The Credit Union has not experienced any losses on these deposits.

**Unrelated Business Income Tax:** The Credit Union is a state-chartered credit union described in Internal Revenue Code (IRC) Section 501(c)(14). As such, the Credit Union is exempt from federal taxation of income derived from the performance of activities that are in furtherance of its exempt purposes. However, IRC Section 511 imposes a tax on the unrelated business income (as defined in Section 512) derived by state-chartered credit unions. Many states have similar laws. The specific application of Section 512 to the various activities conducted by state-chartered credit unions has been at issue for many years. During 2007, the Internal Revenue Service (IRS) issued a series of Technical Advice Memoranda (TAM) to a number of state-chartered credit unions located throughout the country. In these TAMs the IRS ruled certain products and services to be subject to taxation as unrelated business income. In light of the TAMs, the Credit Union has assessed its activities and any potential federal or state income tax liability. In the opinion of management, any liability arising from federal or state taxation of activities deemed to be unrelated to its exempt purposes is not expected to have a material effect on the Credit Union's financial position or results of operation.

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**Note 9. Employee Benefits**

The Credit Union has a 401(k) pension plan that allows employees to defer a portion of their salary into the 401(k) plan. The Credit Union matches a portion of employees' wage reductions. Pension costs are accrued and funded on a current basis. The Credit Union contributed \$46,216 and \$39,667, respectively, to the plan for the years ended December 31, 2008 and 2007.

**Note 10. Regulatory Capital, Reserves and Undivided Earnings**

Part 704 of NCUA Rules and Regulations requires The Credit Union to maintain a minimum total capital ratio of 4.0 percent and a minimum retained earnings ratio of 2.0 percent. The capital ratio is defined by the NCUA as capital, consisting of retained earnings, MCS and PIC, divided by 12-month moving daily average net assets (DANA) and the retained earnings ratio is defined as reserves and undivided earnings divided by 12-month DANA. In April 2009, the NCUA issued an order, under its authority in Part 704.1(b), permitting an alternative capital level for purposes of regulatory compliance outlined in Part 704. The order will remain in effect until modified or rescinded by the NCUA Board or until the effective date of the final rulemaking for Part 704 that is currently in the prerule stage. As a result of the order, The Credit Union is allowed to use capital levels reported in its November 2008 call report, for purposes of determining regulatory compliance with its capital ratio requirement and earnings retention requirement. At November 30, 2008, the capital ratio was 11.49 percent and the retained earnings ratio was 2.96 percent. Using the actual balances at December 31, 2008, the capital ratio was 7.91 percent and the retained earnings ratio was -2.45 percent. The NCUA has the unilateral authority to change its position on reporting the November 2008 capital and retained earnings ratios and should that position change, the Credit Union may be in regulatory noncompliance and subject to a variety of regulatory sanctions by the NCUA.

Reserves are established at the discretion of the Board of Directors to protect the interest of its members and meet regulatory requirements. The Board of Directors authorizes the transfer from undivided earnings to the reserve.

**Note 11. Fair Value of Financial Instruments**

Effective January 1, 2008, the Credit Union adopted SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies only to fair value measurements already required or permitted by other accounting standards and does not impose requirements for additional fair value measures. SFAS No. 157 was issued to increase consistency and comparability in reporting fair values. In February 2008, the FASB issued Staff Position No. FAS No. 157-2, which delays the effective date of SFAS No. 157 for certain nonfinancial assets and nonfinancial liabilities (such as other real estate owned and other foreclosed assets) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The purpose of the delay is to allow additional time to consider the effect of various implementation issues that have arisen, or that may arise, from the application of SFAS No. 157. The Credit Union has elected to apply the deferral provisions in FSP 157-2 and therefore has only partially applied the provisions of SFAS No. 157. The Credit Union's adoption of SFAS No. 157 did not have a material impact on the Credit Union's financial condition or results of operations but did require the Credit Union to include additional disclosures in the footnotes to the financial statements as further described below.

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As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Credit Union uses various methods including market, income and cost approaches. Based on these approaches, the Credit Union often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Credit Union utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Credit Union is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

*Level 1*—Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange (Level 1 also includes U.S. Treasury and federal agency securities and federal agency mortgage-backed securities, which are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.)

*Level 2*—Valuations for assets and liabilities traded in less active dealer or broker markets (Valuations are obtained from third-party pricing services for identical or similar assets or liabilities.)

*Level 3*—Valuations for assets and liabilities are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions (Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.)

The Credit Union uses fair value accounting to report available for sale investment securities in the statements of financial condition. Additional fair value disclosures are required by SFAS No. 107, as amended by SFAS No. 157, and are included in the notes to the financial statements. The following is a description of the valuation methodologies used for instruments measured and/or disclosed at fair value:

**Investment Securities:** The fair value of investment securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use unobservable inputs due to the limited market activity of the instrument.

In determining the appropriate application of the levels of the valuation hierarchy, the Credit Union performs a detailed analysis of the assets and liabilities that are subject to SFAS 157. At each reporting period, all assets and liabilities for which the fair value is based on significant unobservable inputs are classified as Level 3.

**Fair Value on a Recurring Basis:** The table below presents the balances of assets measured and presented in the statements of condition at fair value on a recurring basis:

	<b>December 31, 2008</b>			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Available-for-sale securities	<u>\$ 40,195,569</u>	<u>\$ -</u>	<u>\$ 40,195,569</u>	<u>\$ -</u>

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The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Credit Union's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Credit Union.

The following methods and assumptions were used by the Credit Union in estimating fair values of financial instruments as disclosed herein:

**Cash and Cash Equivalents:** The carrying amounts of cash and cash equivalents approximate their fair value.

**Available-for-Sale and U.S. Central Investments:** Fair values for investments 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.

**Other Investments:** The carrying amounts of other investments approximate their fair value.

**Loans to Members:** The estimated fair value for all fixed rate loans is determined by discounting the estimated cash flows using the current rate at which similar loans would be made to borrowers with similar credit ratings and maturities. The estimated fair value for variable loans is the carrying amount.

**Accrued Interest:** Accrued interest receivable represents interest on loans and investments. The carrying amount of accrued interest receivable approximates fair value.

**Members' Shares:** The fair values disclosed for daily share, managed liquidity shares and membership capital shares are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for member paid-in capital and share certificates are estimated using a discounted cash flow calculation that applies interest rates currently being offered on these accounts to a schedule of aggregated expected monthly maturities on the Credit Union's current member paid-in capital and share certificates.

**Borrowed Funds:** The fair values of the Credit Union's borrowed funds are estimated using discounted cash flow analyses based on the Credit Union's incremental borrowing rates for similar types of borrowing arrangements.

**Off-Balance-Sheet Credit-Related Instruments:** Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value for such financial instruments is nominal.

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The estimated fair value of the Credit Union's financial instruments is summarized as follows:

	December 31, 2008		December 31, 2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets:				
Cash and cash equivalents	\$ 895,943	\$ 896,000	\$ 2,252,932	\$ 2,253,000
Uncollected cash items	35,038,118	35,038,000	12,988,175	12,988,000
Investments available-for-sale	40,195,569	40,196,000	15,714,205	15,714,000
U. S. Central Credit Union investments	168,619,990	167,861,000	351,277,409	347,766,000
CUNA Mutual Group notes	-	-	5,000,000	5,018,000
Other investments	4,195,000	4,195,000	-	-
Loans to members, net	67,321,473	68,329,000	36,069,346	36,336,000
Accrued interest receivable	956,545	957,000	3,191,418	3,191,000
Financial Liabilities:				
Members' shares and uncollected deposits	236,856,144	237,341,000	370,797,806	365,062,000
Borrowed funds	54,209,491	54,982,000	29,721,761	29,944,000