

**LANGLEY FEDERAL CREDIT UNION  
AND SUBSIDIARY  
Newport News, Virginia**

**CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011 and 2010**

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## Independent Auditor's Report

Board of Directors and  
Supervisory Committee  
Langley Federal Credit Union and Subsidiary  
Newport News, Virginia

We have audited the accompanying consolidated statements of financial condition of Langley Federal Credit Union and Subsidiary (Credit Union) as of December 31, 2011 and 2010 and the related consolidated statements of income, 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 consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial condition of Langley Federal Credit Union and Subsidiary as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*CliftonLarsonAllen LLP*

Baltimore, Maryland  
April 5, 2012

## **FINANCIAL STATEMENTS**

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**December 31, 2011 and 2010**

<b>ASSETS</b>	<b>2011</b>	<b>2010</b>
Cash and cash equivalents	\$ 203,940,146	\$ 86,006,346
Investments:		
Available-for-sale	788,850,500	818,644,340
Other	2,243,075	2,165,633
Loans held-for-sale	1,242,250	1,135,200
Loans, net	591,106,022	611,111,849
Accrued interest receivable	3,879,493	5,208,923
Property and equipment, net	42,853,644	46,621,237
National Credit Union Share Insurance Fund deposit	13,632,135	13,082,192
Assets held-for-sale	256,702	1,761,189
Other assets	3,528,841	3,867,634
	<b>\$ 1,651,532,808</b>	<b>\$ 1,589,604,543</b>
<b>TOTAL ASSETS</b>		
<b>LIABILITIES AND MEMBERS' EQUITY</b>		
<b>LIABILITIES</b>		
Members' shares	\$ 1,432,085,646	\$ 1,386,864,304
Accrued expenses and other liabilities	10,430,931	9,533,243
	1,442,516,577	1,396,397,547
Total liabilities		
<b>MEMBERS' EQUITY</b>		
Retained earnings, substantially restricted	209,787,058	203,336,064
Accumulated other comprehensive loss	(770,827)	(10,129,068)
	209,016,231	193,206,996
Total members' equity		
<b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>	<b>\$ 1,651,532,808</b>	<b>\$ 1,589,604,543</b>

The accompanying notes are an integral part of the consolidated financial statements.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**Years Ended December 31, 2011 and 2010**

	<b>2011</b>	<b>2010</b>
<b>INTEREST INCOME</b>		
Loans	\$ 41,146,887	\$ 44,584,504
Investments and cash equivalents	9,616,267	15,681,190
Trading investments	55,132	30,036
Total interest income	50,818,286	60,295,730
<b>INTEREST EXPENSE</b>		
Members' shares	13,294,146	17,591,484
Borrowed funds	-	108,555
Total interest expense	13,294,146	17,700,039
Net interest income	37,524,140	42,595,691
<b>PROVISION FOR LOAN LOSSES</b>	4,909,636	8,342,281
Net interest income after provision for loan losses	32,614,504	34,253,410
<b>NON-INTEREST INCOME</b>		
Service charges and other fees	18,957,586	17,190,240
Net gains on sales of loans	624,839	1,130,091
Net gains on sales of available-for-sale investments	3,667,459	6,850,743
Net gains on trading assets	405,356	226,345
Net loss on assets held-for-sale	(583,674)	(25,962)
Total non-interest income	23,071,566	25,371,457
<b>NON-INTEREST EXPENSE</b>		
Salaries and benefits	23,322,406	23,024,963
Operations	17,419,352	15,933,705
Occupancy	5,085,284	5,391,545
NCUSIF assessments	3,408,034	2,407,503
Total non-interest expense	49,235,076	46,757,716
<b>NET INCOME</b>	\$ 6,450,994	\$ 12,867,151

The accompanying notes are an integral part of the consolidated financial statements.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**Years Ended December 31, 2011 and 2010**

	2011	2010
<b>NET INCOME</b>	\$ 6,450,994	\$ 12,867,151
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>		
Unrealized holding gains on investments classified as available-for-sale	13,025,700	1,579,895
Reclassification adjustment for net realized gains on investments included in net income	(3,667,459)	(6,850,743)
Total other comprehensive income (loss)	9,358,241	(5,270,848)
<b>TOTAL COMPREHENSIVE INCOME</b>	\$ 15,809,235	\$ 7,596,303

The accompanying notes are an integral part of the consolidated financial statements.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY  
Years Ended December 31, 2011 and 2010**

	Retained Earnings			Total	Accumulated Other Comprehensive Loss
	Regular Reserve	Appropriated Other	Unappropriated		
<b>BALANCE, DECEMBER 31, 2009</b>	\$ 24,767,479	\$ 10,000,000	\$ 155,701,434	\$ 190,468,913	\$ (4,858,220)
<b>COMPREHENSIVE INCOME</b>					
Net income	-	-	12,867,151	12,867,151	-
Other comprehensive loss:					
Net change in unrealized losses on securities available-for-sale	-	-	-	-	(5,270,848)
Total comprehensive income (loss)	-	-	12,867,151	12,867,151	(5,270,848)
<b>BALANCE, DECEMBER 31, 2010</b>	<u>24,767,479</u>	<u>10,000,000</u>	<u>168,568,585</u>	<u>203,336,064</u>	<u>(10,129,068)</u>
<b>COMPREHENSIVE INCOME</b>					
Net income	-	-	6,450,994	6,450,994	-
Other comprehensive income:					
Net change in unrealized losses on securities available-for-sale	-	-	-	-	9,358,241
Total comprehensive income	-	-	6,450,994	6,450,994	9,358,241
<b>BALANCE, DECEMBER 31, 2011</b>	<u>\$ 24,767,479</u>	<u>\$ 10,000,000</u>	<u>\$ 175,019,579</u>	<u>\$ 209,787,058</u>	<u>\$ (770,827)</u>

The accompanying notes are an integral part of the consolidated financial statements.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years Ended December 31, 2011 and 2010**

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 6,450,994	\$ 12,867,151
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of mortgage servicing rights, net	182,794	197,345
Capitalization of mortgage servicing rights	(170,497)	(330,938)
Change in valuation allowance for mortgage servicing rights	151,525	7,540
Accretion of discount on investment securities, net	(153,987)	(148,324)
Provision for loan losses	4,909,636	8,342,281
Depreciation and amortization	4,148,405	4,108,249
Net gains on sales of available-for-sale investments	(3,667,459)	(6,850,743)
Gain on disposal of equipment	(47,542)	(7,926)
Gain on sale of loans	(624,839)	(1,130,091)
Net change in:		
Trading investments	-	9,767,969
Loans held for sale	517,789	1,386,841
Accrued interest receivable	1,329,430	1,456,829
Assets held-for-sale	1,504,487	(925,444)
Other assets	174,971	548
Accrued expenses and other liabilities	897,688	(406,803)
Net cash provided by operating activities	15,603,395	28,334,484
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of available-for-sale investments	(1,470,026,648)	(1,855,290,625)
Proceeds from maturities/calls of available-for-sale investments	669,994,424	891,561,555
Proceeds from sale of available-for-sale investments	843,005,751	830,365,445
Net change in other investments	(77,442)	161,429,931
Net change in loans to members	15,630,373	41,738,520
Purchases of participation loans	(534,182)	(3,429,004)
Net change in the NCUSIF deposit	(549,943)	(1,124,598)
Proceeds from disposal of property and equipment	1,035,697	10,305
Purchases of property and equipment	(1,368,967)	(4,099,750)
Net cash provided by investing activities	57,109,063	61,161,779
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayment of borrowed funds	-	(161,468,599)
Net change in members' shares and deposit accounts	45,221,342	70,494,209
Net cash provided by (used in) financing activities	45,221,342	(90,974,390)

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years Ended December 31, 2011 and 2010**  
(Continued)

	<b>2011</b>	<b>2010</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	\$ 117,933,800	\$ (1,478,127)
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	86,006,346	87,484,473
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	\$ 203,940,146	\$ 86,006,346
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Dividends paid on members' shares and interest paid on borrowed funds	\$ 13,294,196	\$ 18,108,364

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

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations**

Langley Federal Credit Union (the Credit Union) is a cooperative association holding a corporate charter under the provisions of the Federal Credit Union Act. Participation in the Credit Union is limited to those individuals who qualify for membership. The field of membership is defined in the Credit Union's Charter and Bylaws.

**Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of the Credit Union and its wholly owned subsidiary, Langley Financial Services, LLC, a credit union service organization (the CUSO). The CUSO is engaged primarily in providing investment and insurance products and services to Credit Union members. All significant intercompany balances and transactions have been eliminated in consolidation.

**Use of Estimates in Preparing Financial Statements**

The preparation of consolidated 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, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of income and expenses during the reporting period. 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 the allowance for loan losses and the determination of fair value of accounts evaluated for impairment and disclosure.

**Concentrations of Credit Risk**

Most of the Credit Union's business activity is with its members who are part of the over 500 Select Employee Groups including Langley Air Force Base and NASA-Langley. The Credit Union may be exposed to credit risk from a regional economic standpoint because a significant concentration of its borrowers work or reside on the Virginia Peninsula. During the year ended December 31, 2010 and continuing into 2011, the financial deterioration resulting from the general economic conditions in this region have resulted in significant loan losses and declines in fair value of investments for the Credit Union and those with whom it does business, including corporate credit unions. The Credit Union continually monitors the Credit Union's operations, including the loan and investment portfolios, for potential impairment.

However, the loan portfolio is well diversified and the Credit Union does not have any significant concentrations of credit risk except auto and commercial and residential real estate. The Credit Union's policy for repossessing collateral is that when all other collection efforts have been exhausted, the Credit Union enforces its first lien holder status and repossesses the collateral. The Credit Union has full and complete access to repossessed collateral. Repossessed collateral normally consists of vehicles and residential and commercial real estate.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Cash and Cash Equivalents**

For the purpose of the Consolidated Statements of Financial Condition and the Consolidated 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 that were purchased with maturities of three months or less. Amounts due from financial institutions may, at times, exceed federally insured limits.

**Investments**

Trading Investments, consisting of U.S. treasury notes, were carried at fair value. Realized and unrealized gains and losses on trading investments were recognized in the Consolidated Statements of income as they occurred. Quoted market prices were used to determine the fair value of trading investments. Securities not classified as trading, including equity securities with readily determinable fair values, are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

The Credit Union evaluates debt and equity securities for other-than-temporary impairment (OTTI), at least quarterly. This guidance specifies that (a) if the Credit Union does not have the intent to sell a debt security prior to recovery and (b) it is more-likely-than-not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When the Credit Union does not intend to sell the security and it is more-likely-than-not the Credit Union will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an OTTI of a debt security in earnings and the remaining portion in other comprehensive income (loss). For held-to-maturity debt securities, the amount of OTTI recorded in other comprehensive income (loss) for the noncredit portion of a previous OTTI should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

Purchase premiums and discounts are recognized in interest income using the straight-line method, which approximates the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Other investments are classified separately and are stated at cost. If such investments are deemed to be impaired, the recorded cost is reduced by the amount of the impairment.

**Loans Held-For-Sale**

Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income. All sales are made without recourse.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Loans to Members, Net**

The Credit Union grants mortgage, commercial and consumer loans to members. The ability of the members to honor their contracts is dependent upon the real estate and general economic conditions of the area.

Loans that the Credit Union has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at their outstanding unpaid principal balances, less an allowance for loan losses and net deferred origination fees and costs. Interest income on loans is recognized over the term of the loan and is calculated using the simple interest method on principal amounts outstanding.

The accrual of interest income on loans is discontinued at the time the loan is 90 days past due, unless the credit is well-secured and in the process of collection. Other personal loans are typically charged off no later than 180 days past due. Past-due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if the collection of principal and interest is considered doubtful.

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

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

**Allowance for Loan Losses**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is likely. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of the underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Credit Union's allowance for loan losses, and may require the Credit Union to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Allowance for Loan Losses** (continued)

The Credit Union's allowance for loan losses is that amount considered adequate to absorb probable losses in the portfolio based on management's evaluations of the size and current risk characteristics of the loan portfolio. Such evaluations consider prior loss experience, the risk rating and the levels of nonperforming loans. A loan is considered impaired when, based on current information and events, it is probable that the Credit Union will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Specific allowances for loan losses are established for impaired loans on an individual basis as required. The specific allowances established for these loans are based on a thorough analysis of the most probable source of repayment, including the present value of the loan's expected future cash flow, the loan's estimated market value or the estimated fair value of the underlying collateral. General allowances are established for loans that can be grouped into pools based on similar characteristics. In this process, general allowance factors are based on an analysis of historical charge-off experience and expected losses given default derived from the Credit Union's internal risk-rating process.

These factors are developed and applied to the portfolio by loan type. The qualitative factors associated with the allowances are subjective and require a high degree of management judgment. These factors include the credit quality statistics, recent economic uncertainty, losses incurred from recent events and other relevant data.

**Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Credit Union, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Credit Union does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

**Loan Servicing**

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Loan Servicing** (continued)

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Credit Union later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan, and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

**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.

**Other Real Estate Owned and Assets Held-for-Sale**

Assets acquired through, or in lieu of, loan foreclosure are assets held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in operating expenses.

**Property and Equipment**

Land and construction in progress are carried at cost. Land includes amounts for grounds improvements depreciated using the straight-line method over an estimated useful life of 20 years. Building, leasehold improvements, and furniture and equipment are carried at cost, less accumulated depreciation and amortization. Buildings are depreciated using the straight-line method over the estimated useful lives of the assets ranging from 20 to 40 years. The cost of leasehold improvements is amortized using the straight-line method over lesser of the useful life of the assets or the expected terms of the related leases. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured. Furniture and equipment are depreciated using the straight-line method over the estimated useful lives of the assets ranging from 2 to 5 years. Management reviews premises and equipment for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**National Credit Union Share Insurance Fund (NCUSIF) Deposit and Insurance Premium**

The deposit in the NCUSIF is in accordance with National Credit Union Administration (NCUA) regulations, which requires 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 was terminated, if it converted its insurance coverage to another source, or if management of the fund was transferred from the NCUA Board.

Credit Unions are also required to pay an annual insurance premium, unless the payment is waived or reduced by the NCUA Board.

In September 2011, the NCUA Board voted to assess each federally-insured credit union an amount of 0.25% of its insured shares as of June 30, 2011 in order to fund the Temporary Corporate Credit Union Stabilization Fund. For the Credit Union, the expense amounted to \$3,408,034.

During 2010, the total NCUSIF assessments were \$2,407,503. In June 2010, the NCUA Board voted to assess each federally-insured credit union a premium of 0.1340% of its insured shares as of March 31, 2010 to repay a portion of the Temporary Corporate Credit Union Stabilization Fund borrowings from the U. S. Treasury. For the Credit Union, this premium amounted to \$1,100,248. In September 2010, the NCUA Board voted to assess each federally-insured credit union a premium of 0.1242% of its insured shares as of June 30, 2010 in order to return the NCUSIF's equity ratio to within its normal operating range. For the Credit Union, this premium amounted to \$1,307,255.

**Members' Shares**

Members' shares are the savings deposit accounts of the owners of the Credit Union. Share ownership entitles the members to vote in the annual elections of the Board of Directors and on other corporate matters. Irrespective of the amount of shares owned, no member has more than one vote. Members' shares are subordinated to all other liabilities of the Credit Union upon liquidation. Dividends on members' shares are based on available earnings at the end of a dividend period and are not guaranteed by the Credit Union. Dividend rates are set by the Credit Union's Board of Directors.

**Advertising Costs**

Advertising costs are expensed as incurred.

**Income Taxes**

The Credit Union is exempt, by statute, from federal and state income taxes. The Credit Union's wholly owned subsidiary is a limited liability corporation; its tax liability passes to the owner, Langley Federal Credit Union.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**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 Consolidated Statements of Financial Condition.

**Fair Value Measurements**

Fair value measurement standards provide a comprehensive framework for measuring fair value and expands disclosures for assets and liabilities reported at fair value. Specifically, it sets forth a definition of fair value and establishes a hierarchy prioritizing the inputs to valuation techniques, giving the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable value inputs.

**Reclassifications**

Certain account reclassifications have been made to the 2010 consolidated financial statements in order to conform to classifications used in the current year.

**Recent Accounting Pronouncements**

In July 2010, the FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. ASU 2010-20 requires that more information be disclosed about the credit quality of a Credit Union's loans and the allowance for loan losses held against those loans. A Credit Union will need to disaggregate new and existing disclosure based on how it develops its allowance for loan losses and how it manages credit exposures. Existing disclosures to be presented on a disaggregated basis include a roll-forward of the allowance for loan losses, the related recorded investment in such loans, the nonaccrual status of loans, and impaired loans. Additional disclosure is also required about the credit quality indicators of loans by class at the end of the reporting period, the aging of past due loans, information about troubled debt restructurings, and significant purchases and sales of loans during the reporting period by class. Disclosures are required for the Credit Union for fiscal year ending December 31, 2011. Refer to Note 4 for required disclosures.

Additional guidance (ASU No. 2010-06) issued under ASC Topic 820 requires expanded disclosures related to fair value measurements including (1) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (2) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (3) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (4) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. ASU 2010-06 further clarifies that (1) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the Statement of Financial Condition and (2) companies should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011 and 2010

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Recent Accounting Pronouncements** (continued)

included in Levels 2 and 3 of the fair value hierarchy. The disclosure requirements became effective for the Credit Union on January 1, 2011. Adoption of these additional disclosures did not have a material impact on the Credit Union's financial statements.

In June 2011, FASB issued Accounting Standards Update (ASU) 2011-05, Comprehensive Income (FASB ASC Topic 220): Presentation of Comprehensive Income. The ASU requires that all changes in members' equity related to other comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two statement approach, the first statement would present the total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. This amendment is effective for fiscal years ending after December 15, 2012, and will be applied retrospectively for comparative financial statements.

**NOTE 2 – TRADING ACTIVITIES**

At December 31, 2011 and 2010, the Credit Union held no trading investments.

Gross realized gains on trading investments of \$670,514 and \$237,423 and gross realized losses of \$265,158 and \$11,078, respectively, were included in the net gains on trading assets during 2011 and 2010.

**NOTE 3 – INVESTMENTS**

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

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
U.S. Government obligations and federal agencies securities	\$ 789,621,327	\$ 451,620	\$ (1,222,447)	\$ 788,850,500
	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
U.S. Government obligations and federal agencies securities	\$ 828,773,408	\$ 420,852	\$ (10,549,920)	\$ 818,644,340

Gross realized gains and losses on sales of investments available-for-sale were \$3,817,330 and \$149,871, respectively, in 2011 and \$7,125,054 and \$274,311, respectively, in 2010.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 3 – INVESTMENTS (CONTINUED)**

Other investments at December 31 consist of the following:

	<u>2011</u>	<u>2010</u>
Deposit in other institutions	\$ 100,000	\$ 100,000
Member capital account in a corporate credit union	545,580	545,580
Equity securities of other credit union associations	<u>1,597,495</u>	<u>1,520,053</u>
	<u>\$ 2,243,075</u>	<u>\$ 2,165,633</u>

The Credit Union views its investments in the capital account in corporate credit unions as long-term investments. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recoverability of the par value rather than recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by factors such as (1) the significance of the decline in net assets of the institution as compared to the investment amount and length of time a decline has persisted, (2) impact of legislative and regulatory changes on the institution, and (3) the liquidity position of the institution.

Investments by maturity as of December 31, 2011, are summarized as follows:

	<u>Available-for-Sale</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Less than 1 year maturity	\$ 69,998,035	\$ 69,985,000
1 - 5 years maturity	649,693,956	649,005,100
6 - 10 years maturity	<u>69,929,336</u>	<u>69,860,400</u>
	<u>\$ 789,621,327</u>	<u>\$ 788,850,500</u>

Other investments have 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, 2011 and 2010, are as follows:

<u>December 31, 2011</u>	<u>Fair Value Associated With Unrealized Losses Existing for:</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>	<u>Less Than 12 Months</u>	<u>More Than 12 Months</u>	
Available-for-Sale					
U.S. Government obligations and federal agencies securities	<u>\$ 438,583,400</u>	<u>\$ -</u>	<u>\$ (1,222,447)</u>	<u>\$ -</u>	<u>\$ (1,222,447)</u>

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
December 31, 2011 and 2010

**NOTE 3 – INVESTMENTS (CONTINUED)**

<u>December 31, 2010</u>	Fair Value Associated With Unrealized Losses Existing for:		Continuous Unrealized Losses Existing for:		<u>Total Unrealized Losses</u>
	Less Than 12 Months	More Than 12 Months	Less Than 12 Months	More Than 12 Months	
U.S. Government obligations and federal agencies securities	<u>\$ 698,547,070</u>	<u>\$ -</u>	<u>\$ (10,549,920)</u>	<u>\$ -</u>	<u>\$ (10,549,920)</u>

Based upon an evaluation of the available evidence, including recent changes in market rates, credit rating information and information obtained from regulatory filings, management believes the decline in fair value for these securities is temporary. In addition, the Credit Union does not intend to sell and it is unlikely that the Credit Union will be required to sell these investment securities prior to recovery of the amortized cost basis. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period in which the other-than-temporary impairment is identified.

**Investment risk**

Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is possible that changes in the values of investment securities could occur in the near term and that such changes could materially affect the amounts reported in the Consolidated Statements of Financial Condition.

**NOTE 4 – LOANS, NET**

Loans, net consisted of the following at December 31:

	<u>2011</u>	<u>2010</u>
Commercial Participation and Small Business Loans:		
Real Estate	\$ 70,744,948	\$ 87,567,280
Other	869,715	1,167,900
Construction/Development	3,720,108	2,493,607
	<u>75,334,771</u>	<u>91,228,787</u>
Residential Real Estate Loans:		
Fixed Rate	47,797,092	54,458,872
Variable Rate	18,591,195	20,089,454
Home Equity Line of Credit	73,896,845	71,800,790
	<u>140,285,132</u>	<u>146,349,116</u>

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 4 – LOANS, NET (CONTINUED)**

	<u>2011</u>	<u>2010</u>
Consumer Loans:		
Title	\$ 268,585,057	\$ 268,544,265
Credit Card	66,960,495	65,539,221
Other Unsecured	42,430,660	42,279,546
Other Secured	<u>4,655,593</u>	<u>5,053,266</u>
	<u>382,631,805</u>	<u>381,416,298</u>
Total loans	598,251,708	618,994,201
Deferred net loan origination costs	3,868,726	3,924,379
Allowance for loan losses	<u>(11,014,412)</u>	<u>(11,806,731)</u>
	<u>\$ 591,106,022</u>	<u>\$ 611,111,849</u>

The Credit Union has purchased loan participations originated by various other credit unions or credit union service originations (CUSO) which are secured by commercial property and real estate. These loan participations were purchased without recourse and the originating Credit Union or CUSO performs all loan servicing functions on these loans. The amount of outstanding commercial participation loans purchased and secured by real estate included in the Commercial Participation and Small Business Loan segment above at December 31, 2011 and 2010 are \$67,168,514 and \$ 81,492,748, respectively.

The Credit Union offers non-traditional mortgage loans to its members. These loans include hybrid/balloon, high loan-to-value and variable interest mortgages. Hybrid loans consist of loans that are fixed for an initial period of five or ten years. After this period, the mortgages are converted to variable rates using an indexed rate, which can result in significant payment adjustment to the borrower. The high loan-to-value (LTV) loans consist of first mortgages with LTVs over 80 percent.

Non-traditional mortgage loans may have significantly different credit risk characteristics than traditional fixed and variable rate mortgages. However, the Credit Union believes it has established prudent underwriting standards as well as adequate risk management functions to monitor the additional risk. Non-traditional mortgage loans, which are included in the real estate and small business loan captions above, totaled \$23,320,316 and \$25,731,718 at December 31, 2011 and 2010, respectively.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 4 – LOANS, NET (CONTINUED)**

Specific changes in the allowance for loan losses and recorded investment in loans by segment for the year ended December 31, 2011 are as follows:

	<b>Commercial Participation and Small Business</b>	<b>Residential Real Estate</b>	<b>Consumer</b>	<b>Total</b>
<b>Allowance for loan losses:</b>				
Beginning balance	\$ 4,238,902	\$ 889,188	\$ 6,678,641	\$ 11,806,731
Provision for loan losses	(400,199)	21,737	5,288,098	4,909,636
Recoveries	-	-	1,599,042	1,599,042
Charge-offs	(15,402)	(420,375)	(6,865,220)	(7,300,997)
Ending balance	<u>\$ 3,823,301</u>	<u>\$ 490,550</u>	<u>\$ 6,700,561</u>	<u>\$ 11,014,412</u>
Ending balance: Individually evaluated for impairment	\$ 3,451,056	\$ -	\$ -	\$ 3,451,056
Ending balance: Collectively evaluated for impairment	<u>372,245</u>	<u>490,550</u>	<u>6,700,561</u>	<u>7,563,356</u>
	<u>\$ 3,823,301</u>	<u>\$ 490,550</u>	<u>\$ 6,700,561</u>	<u>\$ 11,014,412</u>
<b>Commercial Participation and Small Business</b>				
	<b>Residential Real Estate</b>	<b>Consumer</b>	<b>Total</b>	
<b>Loans to members:</b>				
Ending balance: Individually evaluated for impairment	\$ 16,338,070	\$ -	\$ -	\$ 16,338,070
Ending balance: Collectively evaluated for impairment	<u>58,996,701</u>	<u>140,285,132</u>	<u>382,631,805</u>	<u>581,913,638</u>
	<u>\$ 75,334,771</u>	<u>\$ 140,285,132</u>	<u>\$ 382,631,805</u>	<u>\$ 598,251,708</u>

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 4 – LOANS, NET (CONTINUED)**

A summary of the changes in the allowance for loan losses for the year ended December 31, 2010 is as follows:

Beginning balance	\$ 10,201,157
Provision for loan losses	8,342,281
Recoveries	1,192,253
Loans charged off	<u>(7,928,960)</u>
<b>Ending balance</b>	<b><u>\$ 11,806,731</u></b>

Commercial Participation and Small Business Loan Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Credit Union's members' business loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk ratings of member business loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) non-performing loans, and (v) the general economic conditions in the market area.

The Credit Union utilizes a risk rating matrix to assign risk ratings to each of its member business loans. Loans are rated on a scale of 1 to 8. A description of the 8 risk ratings is as follows:

*Rating 1 to 3* – These ratings include loans categorized as “pass” and are loans of average to excellent credit quality borrowers. These borrowers generally have significant capital strength, adequate debt service coverage, moderate leverage and stable earnings and growth to commensurate to their relative risk ratings.

*Rating 4* – This rating includes loans on management's “watch list” and is intended to be utilized for pass rated borrowers where credit quality has begun to show signs of financial weakness that now requires management's heightened attention.

*Rating 5* – This rating includes loans categorized as “special mention” and is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation.

*Rating 6* – This rating includes loans categorized as “substandard” for which the accrual of interest has not been stopped. These loans have defined weaknesses which make payment default or principal exposure likely, but not yet certain. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business.

*Rating 7* – This rating includes loans categorized as “substandard-impaired” for which the accrual of interest has generally been stopped. This rating includes loans; (i) where interest is more than 90 days past due; (ii) not fully secured; and (iii) loans where a specific valuation allowance may be necessary.

*Rating 8* – This rating includes loans categorized as “loss” for which the accrual of interest has been stopped. These loans have significant payment issues and are intended for those borrowers where foreclosure or charge-off is deemed imminent and a specific valuation has been provided for based on the estimated deficiency balance.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 4 – LOANS, NET (CONTINUED)**

The commercial participation and small business loan credit risk profile by internally assigned risk ratings by class at December 31, 2011 is as follows:

	<u>Real Estate</u>	<u>Other</u>	<u>Construction/ Development</u>	<u>Total</u>
Pass	\$ 47,060,281	\$ 869,715	\$ 3,720,108	\$ 51,650,104
Special mention	7,346,597	-	-	7,346,597
Substandard	9,066,575	-	-	9,066,575
Substandard-Impaired	<u>7,271,495</u>	<u>-</u>	<u>-</u>	<u>7,271,495</u>
	<u>\$ 70,744,948</u>	<u>\$ 869,715</u>	<u>\$ 3,720,108</u>	<u>\$ 75,334,771</u>

Residential Real Estate and Consumer Loan Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Credit Union's loan portfolio, Management tracks the loans' performance and when the loan becomes 90 days past due these are classified as non-performing loans.

The residential real estate credit risk profile based on members' payment activity by class at December 31, 2011 is as follows:

	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Home Equity Line of Credit</u>	<u>Total</u>
Performing	\$ 47,323,877	\$ 18,428,489	\$ 73,685,069	\$ 139,437,435
Non-performing	<u>473,215</u>	<u>162,706</u>	<u>211,776</u>	<u>847,697</u>
	<u>\$ 47,797,092</u>	<u>\$ 18,591,195</u>	<u>\$ 73,896,845</u>	<u>\$ 140,285,132</u>

The consumer credit risk profile based on members' payment activity by class at December 31, 2011 is as follows:

	<u>Title</u>	<u>Credit Card</u>	<u>Other Unsecured</u>	<u>Other Secured</u>	<u>Total</u>
Performing	\$ 266,912,687	\$ 66,960,495	\$ 41,993,990	\$ 4,655,166	\$ 380,522,338
Non-performing	<u>1,672,370</u>	<u>-</u>	<u>436,670</u>	<u>427</u>	<u>2,109,467</u>
	<u>\$ 268,585,057</u>	<u>\$ 66,960,495</u>	<u>\$ 42,430,660</u>	<u>\$ 4,655,593</u>	<u>\$ 382,631,805</u>

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011 and 2010**

**NOTE 4 – LOANS, NET (CONTINUED)**

All impaired loans have a specific reserve recorded at December 31, 2011 as follows:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>
<i>With specific reserve recorded:</i>				
<u><i>Commercial Participation and Small Business:</i></u>				
Real estate	\$ 16,499,707	\$ 16,338,070	\$ 3,451,056	\$ 16,653,619

A summary of impaired loans as of and for the year ended December 31, 2010 is as follows:

Impaired loans without an allowance	\$ 2,982,574
Impaired loans with an allowance	<u>11,608,114</u>
<b>Total impaired loans</b>	<u><u>\$ 14,590,688</u></u>
<b>Allowance for impaired loans</b>	<u><u>\$ 3,856,791</u></u>

Interest collected on impaired loans for the years ended December 31, 2011 and 2010 was not significant as interest is not accrued on nonaccrual loans past due 90 days or more.

A summary of nonaccrual loans by class at December 31, 2011 is as follows:

<u><i>Commercial Participation and Small Business:</i></u>	
Real Estate	\$ 3,374,647
<u><i>Residential Real Estate:</i></u>	
Fixed Rate	473,215
Variable Rate	162,706
Home Equity Line of Credit	211,776
<u><i>Consumer:</i></u>	
Title	1,672,370
Other Unsecured	436,670
Other Secured	<u>427</u>
	<u><u>\$ 6,331,811</u></u>
<b>Foregone interest on nonaccrual loans</b>	<u><u>\$ 407,632</u></u>

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 4 – LOANS, NET (CONTINUED)**

A summary of nonaccrual loans at December 31, 2010 is as follows:

<b>Nonaccrual loans</b>	<u><u>\$ 4,501,740</u></u>
<b>Total loans past-due 90 days or more and still accruing</b>	<u><u>\$ 1,036,936</u></u>
<b>Forgone interest on nonaccrual loans</b>	<u><u>\$ 222,966</u></u>

A summary of past due loans by class as of December 31, 2011 are as follows:

	<u>30-59 Days</u>	<u>60-90 Days</u>	<u>Greater than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans to Members</u>	<u>Loans &gt; 90 Days and Accruing</u>
<u>Commercial Participation and Small Business:</u>							
Real Estate	\$ 2,891,232	\$ 3,012,725	\$ 7,108,132	\$13,012,089	\$ 57,732,859	\$ 70,744,948	\$ 3,733,485
Other	-	-	-	-	869,715	869,715	-
Construction/ Development	-	-	-	-	3,720,108	3,720,108	-
<u>Residential real estate:</u>							
Fixed Rate	759,367	55,816	473,215	1,288,398	46,508,694	47,797,092	-
Variable Rate	170,424	-	162,706	333,130	18,258,065	18,591,195	-
Home Equity Line of Credit	1,238,873	335,650	212,975	1,787,498	72,109,347	73,896,845	1,199
<u>Consumer:</u>							
Title	7,591,704	980,974	1,672,370	10,245,048	258,340,009	268,585,057	-
Credit Card	2,973,220	561,332	1,057,335	4,591,887	62,368,608	66,960,495	1,057,335
Other Unsecured	591,683	218,845	436,670	1,247,198	41,183,462	42,430,660	-
Other Secured	18,116	-	427	18,543	4,637,050	4,655,593	-
	<u><u>\$16,234,619</u></u>	<u><u>\$ 5,165,342</u></u>	<u><u>\$ 11,123,830</u></u>	<u><u>\$32,523,791</u></u>	<u><u>\$565,727,917</u></u>	<u><u>\$598,251,708</u></u>	<u><u>\$ 4,792,019</u></u>

A summary of loan modifications by class during the year ended December 31, 2011 are as follows:

	<u>Number of Contracts</u>	<u>Pre-Modification Outstanding Balance</u>	<u>Post-Modification Outstanding Balance</u>
<u>Troubled Debt Restructurings:</u>			
<u>Commercial Participation and Small Business:</u>			
Real Estate	<u><u>6</u></u>	<u><u>\$ 7,205,688</u></u>	<u><u>\$ 6,746,211</u></u>

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 4 – LOANS, NET (CONTINUED)**

The Credit Union had no new troubled debt restructured loans that were granted during the year that subsequently went into default for the year ended December 31, 2011.

**NOTE 5 – LOAN SERVICING**

The Credit Union services mortgage loans for others that are not included in the accompanying Consolidated Statements of Financial Condition. The unpaid principal balances of these loans at December 31, 2011 and 2010, are summarized as follows:

	<u>2011</u>	<u>2010</u>
Mortgage loan portfolios serviced for FNMA	\$ 135,068,265	\$ 130,636,046

Custodial escrow balances maintained in connection with the loan servicing, and included in members' shares, were approximately \$576,000 and \$565,000 at December 31, 2011 and 2010, respectively.

A summary of the changes in the balance of mortgage servicing rights included in other assets in the Consolidated Statements of Financial Condition in 2011 and 2010 were as follows:

	<u>2011</u>	<u>2010</u>
Balance, beginning of year	\$ 852,810	\$ 711,676
Servicing assets recognized during the year	170,497	330,938
Amortization of servicing assets	(182,794)	(197,344)
Change in valuation allowance	(151,525)	7,540
<b>Balance, end of year</b>	<u>\$ 688,988</u>	<u>\$ 852,810</u>
<b>Fair value of mortgage servicing rights</b>	<u>\$ 695,690</u>	<u>\$ 1,040,873</u>

The aggregate changes in the valuation allowance for mortgage servicing rights in 2011 and 2010 were as follows:

	<u>2011</u>	<u>2010</u>
Balance, beginning of year	\$ -	\$ 7,540
Net increase (decrease)	151,525	(7,540)
<b>Balance, end of year</b>	<u>\$ 151,525</u>	<u>\$ -</u>

The key economic assumptions used in determining the fair value of mortgage servicing rights at December 31 are as follows:

	<u>2011</u>	<u>2010</u>
Prepayment speed	27.68%	15.59%
Weighted-average life (years)	2.70%	4.46%
Yield-to-maturity discount rate	7.25%	7.75%

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2011 and 2010**

**NOTE 6 – PROPERTY AND EQUIPMENT**

Property and equipment at December 31 is summarized as follows:

	<u>2011</u>	<u>2010</u>
Land	\$ 14,409,965	\$ 15,314,119
Buildings	40,606,978	39,630,403
Leasehold improvements	3,348,729	3,346,022
Construction in progress	813,099	3,201,742
Furniture and equipment	<u>24,520,830</u>	<u>22,427,992</u>
	83,699,601	83,920,278
Accumulated depreciation and amortization	<u>(40,845,957)</u>	<u>(37,299,041)</u>
	<u>\$ 42,853,644</u>	<u>\$ 46,621,237</u>

The Credit Union entered into operating leases for office space and sites for automatic teller machines. The operating leases contain renewal options and provisions requiring the Credit Union to pay property taxes and operating expenses over base period amounts.

During 2011 and 2010, the Credit Union entered into commitments totaling \$13,766 and \$2,552,478, respectively, for building and land purchases, improvements, and furniture and equipment. The remaining commitments on these construction and equipment contracts at December 31, 2011 and 2010, are approximately \$14,844 and \$334,000, respectively.

Minimum lease payments under operating leases with initial or remaining terms of one year or more at December 31 are as follows:

2012	\$ 261,065
2013	260,353
2014	210,726
2015	141,858
2016	101,584
Subsequent years	<u>107,775</u>
	<u>\$ 1,083,361</u>

The Credit Union receives services and use of facilities from its sponsoring agency at two of its branch office locations free of cost. Utilization of these services and facilities is not recognized as revenue. The Credit Union views this relationship with the sponsor organization as a reciprocal transfer; that is, in return for the use of services and facilities, the sponsoring employer receives the fringe benefit of on-site financial services for its employees who elect to join the Credit Union.

Rental expense for the years ended December 31, 2011 and 2010, for all facilities leased under operating leases totaled \$386,140 and \$372,075, respectively.

**LANGLEY FEDERAL CREDIT UNION AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2011 and 2010**

**NOTE 7 – MEMBERS’ SHARES**

Members’ shares are summarized as follows:

	<b>Rates at</b>		
	<b>12/31/11</b>	<b>2011</b>	<b>2010</b>
		<u>                    </u>	<u>                    </u>
Prime shares	0.24%	\$ 272,022,329	\$ 248,654,632
Checking accounts	0.01%	188,091,699	163,975,300
Money market accounts	0.34%	513,642,755	460,389,486
Individual retirement accounts	0.35%	<u>31,291,357</u>	<u>30,964,853</u>
		<u>1,005,048,140</u>	<u>903,984,271</u>
Share and IRA certificates	0.00% to 1.00%	131,533,551	8,355,209
	1.01% to 2.00%	153,080,630	280,698,240
	2.01% to 3.00%	55,661,689	67,956,853
	3.01% to 4.00%	32,253,663	43,558,038
	4.01% to 5.00%	45,863,627	53,070,790
	5.01% to 6.00%	<u>8,644,346</u>	<u>29,240,903</u>
		<u>427,037,506</u>	<u>482,880,033</u>
<b>Total</b>		<u>\$ 1,432,085,646</u>	<u>\$ 1,386,864,304</u>

Share and IRA certificates by maturity are summarized as follows:

	<b>2011</b>	<b>2010</b>
	<u>                    </u>	<u>                    </u>
0 - 1 year maturity	\$ 258,612,513	\$ 308,375,044
1 - 2 years maturity	54,579,676	66,653,972
2 - 3 years maturity	49,878,232	31,841,981
3 - 4 years maturity	29,929,501	45,566,600
4 - 5 years maturity	<u>34,037,584</u>	<u>30,442,436</u>
	<u>\$ 427,037,506</u>	<u>\$ 482,880,033</u>

Regular shares, share draft accounts, money market accounts and individual retirement account shares have no contractual maturity. Certificate accounts generally have maturities of five years or less.

The NCUSIF insures members' shares and certain individual retirement and Keogh accounts up to \$250,000.

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**NOTE 7 – MEMBERS’ SHARES (CONTINUED)**

The aggregate amount of certificates in denominations of \$100,000 or more at December 31, 2011 and 2010, is approximately \$131,777,000 and \$150,663,000, respectively.

**NOTE 8 – BORROWED FUNDS**

The Credit Union utilizes demand loan agreements with two corporate credit unions. The terms of the first agreement call for the pledging of all assets as security for any and all obligations taken by the Credit Union under this agreement. The agreement provides for a credit limit of \$25,000,000 with interest charged at a rate determined by the lender on a periodic basis. The second demand loan agreement is a settlement overdraft line of credit securitized by certificates of deposit on account at that corporate credit union. The agreement provides for a credit limit of \$5,000,000, but limited to the total value of certificates pledged as security. No specific reserve requirement is required; however, funds in the certificate account or in securities may not be withdrawn to the extent that amounts remain owing under the agreement. The demand loan rate is disclosed at the time of a loan advance and subject to change from time to time by the lender. At December 31, 2011 and 2010, there were no borrowings under either agreement. Both agreements are reviewed for continuation by the lenders and the Credit Union periodically.

The Credit Union also has available a guidance line of credit with a bank for short-term borrowings of Federal Funds. The terms of the facility agreement provide for borrowings up to \$10,000,000 with interest payable at the bank’s Federal Fund rate plus 0.25 percent. The bank reviews this uncommitted line of credit annually and reserves the right to cancel at any time at its sole discretion. At December 31, 2011 and 2010, there were no borrowings under this agreement.

**NOTE 9 – OFF-BALANCE SHEET ACTIVITIES**

The Credit Union is party to conditional commitments to lend funds in the normal course of business to meet the financing needs of its members. These commitments represent financial instruments to extend credit that include lines of credit, credit cards and home equity lines that involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the consolidated financial statements.

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

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. Because 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 to secure borrowing on the lines of credit is based on management's credit evaluation of the member.

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**NOTE 9 – OFF-BALANCE SHEET ACTIVITIES (CONTINUED)**

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

Outstanding business loan commitments at December 31, 2011 and 2010, total approximately \$3,135,000 and \$3,304,000, respectively.

Unfunded loan commitments at December 31 under lines of credit are summarized as follows:

	<u>2011</u>	<u>2010</u>
Credit card	\$ 150,840,000	\$ 144,165,000
Home equity	47,661,000	46,852,000
Other consumer	<u>27,236,000</u>	<u>27,420,000</u>
	<u>\$ 225,737,000</u>	<u>\$ 218,437,000</u>

**NOTE 10 – COMMITMENTS AND CONTINGENT LIABILITIES**

The Credit Union is a party to various legal actions normally associated with collections of loans and other 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.

The Credit Union is a party to various legal actions normally associated with collections of loans and other 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.

The Credit Union has entered into an agreement with SunTrust Mortgage Corporation for the sale of mortgage loans. The Credit Union is contingently liable to repurchase loans sold under the agreement where a loan is originated in violation of the agreement and where prepayment or default occurs within specified periods. The Credit Union was not required to repurchase any loans during 2011 or 2010. At December 31, 2011, the Credit Union was contingently liable on loans totaling \$593,294. It is management's belief that any repurchase obligation would not be significant to the Credit Union.

**NOTE 11 – EMPLOYEE BENEFITS**

The Credit Union has a 401(k) savings 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. Plan costs are accrued and funded on a current basis. The Credit Union contributed \$673,734 and \$662,930, respectively, to the plan for the years ended December 31, 2011 and 2010.

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**NOTE 11 – EMPLOYEE BENEFITS (CONTINUED)**

The Credit Union entered into a deferred compensation agreement with a member of the executive management team that provides retirement benefits payable to the employee if they remain employed by the Credit Union until retirement. The benefits are subject to forfeiture if employment is terminated for cause, as defined by the agreement. If the employee becomes fully disabled, as defined in the agreement, accrued benefits remain in full force and effect with the requirements of the agreements and clauses being reduced depending on the severity of the disability. For the years ended December 31, 2011 and 2010, the expense incurred under this agreement totaled \$96,419 and \$0, respectively. As of December 31, 2011 and 2010, the accrued liability amounted to approximately \$1,595,197 and \$1,547,240, respectively.

The deferred compensation agreement does not require mandatory funding. However, the Credit Union elected to fund the agreement with the purchase of a \$2.5 million dollar universal life insurance policy on the executive where the Credit Union is beneficiary and policy owner. The policy's cash surrender values were \$717,868 and \$666,331 at December 31, 2011 and 2010, respectively, and are included within other assets on the Consolidated Statements of Financial Condition. There are no outstanding loans against the policy at December 31, 2011.

**NOTE 12 – MEMBERS' EQUITY**

The Credit Union is subject to various regulatory capital requirements administered by the NCUA. Failure to meet minimum capital requirements can initiate certain mandatory—and possibly additional discretionary—actions by regulators that, if undertaken, could have a direct material effect on the Credit Union's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Credit Union must meet specific capital guidelines that involve quantitative measures of the Credit Union's assets, liabilities, and certain off-balance sheet items as calculated under GAAP. The Credit Union's capital amounts and 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 to total assets. Further, credit unions over \$10,000,000 in assets are also required to calculate a Risk-Based Net Worth (RBNW) requirement that establishes whether or not the Credit Union will be considered "complex" under the regulatory framework. The Credit Union's RBNW requirements as of December 31, 2011 and 2010 were 6.15 percent and 7.14 percent, respectively. The minimum requirement to be considered "complex" under the regulatory framework is 6 percent. Management believes, as of December 31, 2011 and 2010, that the Credit Union meets all capital adequacy requirements to which it is subject.

As of December 31, 2011 and 2010, the NCUA categorized the Credit Union as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized," the Credit Union must maintain a minimum net worth ratio of 7 percent of assets. There are no conditions or events since that notification that management believes have changed the institution's category.

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**NOTE 12 – MEMBERS’ EQUITY (CONTINUED)**

Key aspects of the Credit Union's minimum capital amounts and ratios are summarized as follows:

<u>Asset Category</u>	<u>December 31, 2011</u>		<u>December 31, 2010</u>	
	<u>Amount</u>	<u>Ratio/ Requirement</u>	<u>Amount</u>	<u>Ratio/ Requirement</u>
Amount needed to be classified as "adequately capitalized"	\$ 99,091,968	6.00%	\$ 95,376,273	6.00%
Amount needed to be classified as "well-capitalized"	\$ 115,607,297	7.00%	\$ 111,272,318	7.00%
Actual net worth	\$ 209,787,058	12.70%	\$ 203,336,604	12.79%

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

**NOTE 13 – RELATED-PARTY TRANSACTIONS**

In the normal course of business, the Credit Union extends credit to directors, Supervisory Committee members and executive officers. The aggregate loans to related parties at December 31, 2011 and 2010, are \$2,206,679 and \$2,286,143, respectively. The rates charged on related-party loans are the same rates available to members of the Credit Union. Deposits from related parties at December 31, 2011 and 2010, amounted to \$3,653,422 and \$3,823,584, respectively.

**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS**

**Fair Value**

The Credit Union uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument 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. 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.

Fair value measurements are to focus on an exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which

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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

**Fair Value** (continued)

willing participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

***Fair Value Hierarchy***

The Credit Union groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 Valuation is based on quoted prices in active markets for identical assets or liabilities that the Credit Union has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgments or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value estimation.

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 Investments:** 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.

**Other Investments:** The carrying value approximates fair value based on the redemption provisions of the underlying investments.

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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

***Fair Value Hierarchy*** (continued)

**Loans Held-for-Sale:** The carrying amount of loans held-for-sale approximates fair value.

**Loans, Net:** For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (for example, one-to-four family residential), credit card loans, and other consumer loans are estimated using a discounted cash flow calculation that applies interest rates currently being offered similar loans to a schedule of aggregated expected monthly maturities of these loans.

Fair values for business real estate and business loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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

**Mortgage Servicing Rights:** Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

**Members' Shares:** The fair values disclosed for share draft and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term share certificates approximate their fair values at the reporting date. Fair values for fixed-rate shares and share certificates are estimated using a discounted cash flow calculation that applies interest rates currently being offered on shares and certificates to a schedule of aggregated expected monthly maturities on shares and certificates.

**Off-Balance Sheet Credit-Related Financial 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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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

***Fair Value Hierarchy*** (continued)

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

	December 31, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 203,940	\$ 203,940	\$ 86,006	\$ 86,006
Investments available-for-sale	788,851	788,851	818,644	818,644
Other investments	2,243	2,243	2,166	2,166
Loans held-for-sale	1,242	1,242	1,135	1,132
Loans, net	591,106	598,238	611,112	615,669
Accrued interest receivable	3,879	3,879	5,209	5,209
Mortgage servicing rights	689	696	853	1,041
<b>Financial liabilities:</b>				
Members' shares	\$ 1,432,086	\$ 1,445,914	\$ 1,386,864	\$ 1,403,849

**Fair Value on a Recurring Basis:** The following table presents the assets measured at fair value on a recurring basis on the Consolidated Statements of Financial Condition and by level within the valuation hierarchy (in thousands):

	Total	Quoted Prices		
		In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2011</b>				
Investments available-for-sale	\$ 788,851	\$ -	\$ 788,851	\$ -
<b>December 31, 2010</b>				
Investments available-for-sale	\$ 818,644	\$ 97,136	\$ 721,508	\$ -

**Fair Value on a Nonrecurring Basis:** Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the Consolidated Statements of Financial Condition by caption and by level within the valuation hierarchy (as described above) for which a nonrecurring change in fair value has been recorded (in thousands):

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**NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)**

*Fair Value Hierarchy* (continued)

	<b>Total</b>	<b>Quoted Prices In Active Markets for Identical assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
<b>December 31, 2011</b>				
Impaired loans	\$ 12,887	\$ -	\$ -	\$ 12,887
<b>December 31, 2010</b>				
Impaired loans	\$ 7,751	\$ -	\$ -	\$ 7,751

**NOTE 15 – SUBSEQUENT EVENTS**

Management evaluated subsequent events through April 5, 2012, the date the consolidated financial statements were available to be issued. Events or transactions occurring after December 31, 2011, but prior to April 5, 2012 that provided additional evidence about conditions that existed at December 31, 2011, have been recognized in the consolidated financial statements for the year ended December 31, 2011. Events or transactions that provided evidence about conditions that did not exist at December 31, 2011 but arose before the consolidated financial statements were available to be issued, have not been recognized in the consolidated financial statements for the year ended December 31, 2011.