City Savings Bank, Inc.
(A Wholly Owned Subsidiary of Union Bank of the Philippines)

Financial Statements
December 31, 2018
and Year Ended December 31, 2018
(with Comparative Figures for 2017)

and

Independent Auditor's Report

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INDEPENDENT AUDITOR'S REPORT

The Board of Directors and the Stockholders
City Savings Bank, Inc.

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of City Savings Bank, Inc. (the Bank), a wholly owned subsidiary of Union Bank of the Philippines, which comprise the statement of financial position as at December 31, 2018, and the statement of income, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended December 31, 2018, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2018, and its financial performance and its cash flows for the year ended December 31, 2018 in accordance with Philippine Financial Reporting Standards (PFRSs).

Basis for Opinion

We conducted our audit in accordance with Philippine Standards on Auditing (PSAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants in the Philippines (the Code of Ethics) together with the ethical requirements that are relevant to our audit of the financial statements in the Philippines, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The financial statements of the Bank as at December 31, 2017 and for the year then ended were audited by another auditor whose report dated February 28, 2018 expressed an unqualified opinion on those financial statements. As part of our audit of the 2018 financial statements, we also audited the adjustments described in Note 2 that were applied to the 2017 financial statements to come up with the statement of financial position as at January 1, 2017 presented herein as corresponding figures. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2017 financial statements other than with respect to the adjustments, and accordingly, we do not express an opinion or any other form of assurance on the 2017 and financial statements taken as a whole.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with PFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with PSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with PSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on the Supplementary Information Required Under Revenue Regulations 15-2010

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required under Revenue Regulations 15-2010 in Note 32 to the financial statements is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such information is the responsibility of the management of City Savings Bank, Inc. The information has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

SYCIP GORRES VELAYO & CO.

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PTR No. 7332517, January 3, 2019, Makati City

April 4, 2019

CITY SAVINGS BANK, INC.
(A Wholly Owned Subsidiary of Union Bank of the Philippines)

STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2018
(With Comparative Figures as of December 31, 2017 and January 1, 2017)

	December 31		January 1
	2018	2017 (As restated - Note 2)	2017 (As restated - Note 2)
ASSETS			
Cash and Other Cash Items (Note 6)	**₱408,712,128**	₱383,208,812	₱390,771,018
Due from Bangko Sentral Ng Pilipinas (Note 7)	**3,034,359,867**	5,907,098,253	3,942,994,492
Due from Other Banks (Note 8)	**2,863,246,006**	1,351,812,028	1,596,975,535
Securities Purchased Under Resale Agreements (Note 9)	**8,882,000,000**	9,442,008,358	4,240,466,629
Loans and Receivables (Note 10)	**50,956,158,325**	58,395,036,822	57,724,677,754
Investments in Associates and Subsidiary (Note 11)	**7,999,381,478**	98,387,004	2,325,795
Premises, Furniture, Fixtures and Equipment (Note 12)	**223,707,279**	232,946,640	352,790,492
Investment Properties (Note 13)	**1,577,055**	2,759,883	3,942,711
Intangible Assets (Note 14)	**149,348,119**	83,715,892	99,154,855
Deferred Tax Assets (Note 26)	**647,523,263**	891,437,944	995,787,752
Prepayments and Other Resources (Note 15)	**269,859,542**	172,464,516	152,366,587
	₱75,435,873,062	₱76,960,876,152	₱69,502,253,620
LIABILITIES AND EQUITY			
LIABILITIES			
Deposit Liabilities (Note 17)			
Time	**₱34,340,970,795**	₱46,326,147,580	₱47,059,315,951
Savings	**2,196,811,493**	1,882,998,087	2,167,757,297
Demand	**92,655,262**	110,507,762	129,695,612
	36,630,437,550	48,319,653,429	49,356,768,860
Bills Payable (Note 18)	**22,651,257,850**	14,060,606,802	8,932,732,039
Accounts Payable and Accrued Expenses (Note 19)	**1,114,256,863**	1,010,822,228	1,041,699,391
Income Tax Payable (Note 26)	**114,210,522**	389,325,925	355,519,858
Other Liabilities (Note 20)	**325,772,098**	113,290,264	129,821,757
	60,835,934,883	63,893,698,648	59,816,541,905
EQUITY			
Capital Stock (Note 22)	**258,256,000**	258,256,000	258,256,000
Additional Paid-in Capital	**937,333,350**	937,333,350	937,333,350
Surplus Reserves	**298,014,596**	116,857	116,857
Surplus Free	**13,115,994,974**	11,921,258,813	8,558,769,969
Remeasurement Losses on Net Retirement Liability (Note 24)	**(9,660,741)**	(49,787,516)	(68,764,461)
	14,599,938,179	13,067,177,504	9,685,711,715
	₱75,435,873,062	₱76,960,876,152	₱69,502,253,620

See accompanying Notes to Financial Statements.

CITY SAVINGS BANK, INC.

(A Wholly Owned Subsidiary of Union Bank of the Philippines)

STATEMENT OF INCOME

FOR THE YEAR ENDED DECEMBER 31, 2018
(With Comparative Figures for the Year Ended 2017)

	Years Ended December 31	
	2018	2017 (As restated - Note 2)
INTEREST INCOME		
Loans and receivables (Note 10)	**₱7,335,251,051**	₱8,960,729,583
Deposits with banks and others (Notes 7, 8 and 9)	**322,530,726**	174,668,887
	7,657,781,777	9,135,398,470
INTEREST EXPENSE		
Deposit liabilities (Note 17)	**1,709,833,107**	1,418,538,159
Bills payable (Note 18)	**721,296,621**	323,577,281
	2,431,129,728	1,742,115,440
NET INTEREST INCOME	**5,226,652,049**	7,393,283,030
OTHER INCOME (Note 23)	**295,623,188**	195,728,716
TOTAL OPERATING INCOME	**5,522,275,237**	7,589,011,746
OPERATING EXPENSES		
Compensation and employee benefits (Note 24)	**810,738,388**	790,052,355
Taxes and licenses (see Note 32)	**698,784,730**	762,282,981
Service charges	**227,612,651**	239,519,002
Depreciation and amortization (Notes 12, 13, and 14)	**178,209,404**	194,316,935
Rent (Note 25)	**104,459,420**	93,827,158
Insurance	**87,915,228**	109,028,675
Provision for (reversal of) credit and impairment losses (Note 16)	**66,920,631**	(382,209)
Contracted services	**57,101,338**	140,807,842
Security, messengerial and janitorial services	**55,879,886**	54,171,220
Communications, telephone and telegraph	**51,291,388**	45,483,486
Fines and penalties	**40,053,734**	82,309,466
Management and professional fees	**48,648,054**	24,381,598
Transportation, travel and freight	**40,446,057**	37,827,899
Repairs and maintenance	**37,789,013**	26,790,278
Power, light and water	**27,821,537**	25,636,259
Advertising and publicity	**27,416,417**	20,459,571
Stationery and supplies used	**23,238,826**	33,048,138
Fuel and lubricants	**15,017,811**	10,741,535
Membership fees and dues	**7,503,549**	5,890,628
Others	**98,772,745**	81,273,503
	2,705,620,807	2,777,466,320
INCOME BEFORE SHARE IN NET INCOME OF ASSOCIATES AND SUBSIDIARY	**2,816,654,430**	4,811,545,426
SHARE IN NET LOSS OF ASSOCIATES AND SUBSIDIARY (Note 11)	**(61,279,472)**	(1,578,946)
INCOME BEFORE TAX	**2,755,374,958**	4,809,966,480
PROVISION FOR INCOME TAX (Note 26)	**888,847,220**	1,447,477,636
NET INCOME	**₱1,866,527,738**	₱3,362,488,844

See accompanying Notes to Financial Statements.

CITY SAVINGS BANK, INC.
(A Wholly Owned Subsidiary of Union Bank of the Philippines)

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2018
(With Comparative Figures for the Year Ended 2017)

	Years Ended December 31	
	2018	2017 (As restated - Note 2)
NET INCOME	**₱1,866,527,738**	₱3,362,488,844
OTHER COMPREHENSIVE INCOME		
Item that will not be reclassified subsequently to profit or loss in subsequent periods		
Gain on remeasurements of post-employment defined benefit obligation (Note 24)	**57,323,964**	27,109,922
Income tax effect	**(17,197,189)**	(8,132,977)
	40,126,775	18,976,945
TOTAL COMPREHENSIVE INCOME	**₱1,906,654,513**	₱3,381,465,789

See accompanying Notes to Financial Statements.

CITY SAVINGS BANK, INC.
(A Wholly Owned Subsidiary of Union Bank of the Philippines)

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2018
(With Comparative Figures for the Year Ended 2017)

	Capital Stock (Note 22)	Additional Paid-in Capital	Surplus Reserves	Surplus	Remeasurement losses on net retirement liability (Note 24)	Total
Balances at December 31, 2017	**₱258,256,000**	**₱937,333,350**	**₱116,857**	**₱12,642,615,140**	**(₱49,787,516)**	**₱13,788,533,831**
Effect of adoption of PFRS 9, *Financial Instruments* (Note 2)	**–**	**–**	**–**	**(373,893,838)**	**–**	**(373,893,838)**
Prior-period adjustments (Note 2)	**–**	**–**	**–**	**(721,356,327)**	**–**	**(721,356,327)**
Balances at January 1, 2018, as restated	**258,256,000**	**937,333,350**	**116,857**	**11,547,364,975**	**(49,787,516)**	**12,693,283,666**
Net income	**–**	**–**	**–**	**1,866,527,738**	**–**	**1,866,527,738**
Other comprehensive income, net of tax	**–**	**–**	**–**	**–**	**40,126,775**	**40,126,775**
Total comprehensive income	**–**	**–**	**–**	**1,866,527,738**	**40,126,775**	**1,906,654,513**
Appropriations during the year (Note 22)	**–**	**–**	**297,897,739**	**(297,897,739)**	**–**	**–**
Balances at December 31, 2018	**₱258,256,000**	**₱937,333,350**	**₱298,014,596**	**₱13,115,994,974**	**(₱9,660,741)**	**₱14,599,938,179**
Balances at January 1, 2017	₱258,256,000	₱937,333,350	₱116,857	₱9,276,979,063	(₱68,764,461)	₱10,403,920,809
Prior- period adjustments (Note 2)	–	–	–	(718,209,094)	–	(718,209,094)
Balances at January 1, 2017, as restated	258,256,000	937,333,350	116,857	8,558,769,969	(68,764,461)	9,685,711,715
Net income, as previously reported	–	–	–	3,365,636,077	–	3,365,636,077
Prior period adjustments	–	–	–	(3,147,233)	–	(3,147,233)
Net income, as restated	–	–	–	3,362,488,844	–	3,362,488,844
Other comprehensive income, net of tax	–	–	–	–	18,976,945	18,976,945
Total comprehensive income, as restated	–	–	–	3,362,488,844	18,976,945	3,381,465,789
Balances at December 31, 2017	₱258,256,000	₱937,333,350	₱116,857	₱11,921,258,813	(₱49,787,516)	₱13,067,177,504

See accompanying Notes to Financial Statements.

CITY SAVINGS BANK, INC.
(A Wholly Owned Subsidiary of Union Bank of the Philippines)

STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2018
(With Comparative Figures for the Year Ended 2017)

	Years Ended December 31	
	2018	2017 (As restated - Note 2)
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	**₱2,755,374,958**	₱4,809,966,480
Adjustments for:		
Depreciation and amortization (Notes 12, 13 and 14)	**178,209,404**	194,316,935
Share in net loss of associates and subsidiary (Note 11)	**61,279,472**	1,578,946
Gain on bargain purchase (Note 11)	**–**	(41,290,645)
Provision (reversal) for credit and impairment losses (Note 16)	**66,920,631**	(382,209)
Gain from disposal of premises, furniture, fixtures and equipment (Notes 12 and 23)	**(119,569)**	(3,850,874)
Amortization of bills payables' issuance costs (Note 18)	**(55,160,747)**	(9,760,848)
Changes in operating assets and liabilities		
Decreases (increases) in:		
Loans and receivables	**6,843,462,403**	(650,791,395)
Prepayments and other resources	**(81,106,936)**	(75,961,895)
Increases (decreases) in:		
Deposit liabilities	**(11,689,215,879)**	(1,037,115,431)
Accounts payable and accrued expenses	**95,395,761**	22,047,933
Other liabilities	**(30,194,202)**	(53,775,252)
Net cash provided by (used in) operations	**(1,855,154,704)**	3,154,981,745
Income taxes paid	**(777,314,306)**	(1,317,454,737)
Net cash provided by (used in) operating activities	**(2,632,469,010)**	1,837,527,008
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of premises, furniture, fixtures and equipment (Notes 12 and 31)	**(111,449,183)**	(34,816,717)
Acquisitions of intangible assets (Note 14)	**(114,925,974)**	(15,480,507)
Proceeds from sale of premises, furniture, fixtures and equipment	**1,114,158**	9,470,950
Advance payments made for an investment in an associate (Notes 11 and 15)	**(16,288,090)**	(15,000,000)
Acquisitions of investment in an associate and subsidiary (Notes 11 and 20)	**(7,662,273,946)**	(6,416,568)
Net cash used in investing activities	**(7,903,823,035)**	(62,242,842)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from availments of bills payable (Note 18)	**56,343,889,919**	54,528,344,185
Settlements of bills payable (Note 18)	**(47,698,078,124)**	(49,390,708,574)
Net cash provided by financing activities	**8,645,811,795**	5,137,635,611
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(1,890,480,250)**	6,912,919,777

(Forward)

	Years Ended December 31	
	2018	2017 (As restated - Note 2)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		
Cash and other cash items (Note 6)	**₱383,208,812**	₱390,771,018
Due from Bangko Sentral ng Pilipinas (Note 7)	**5,907,098,253**	3,942,994,492
Due from other banks (Note 8)	**1,351,812,028**	1,596,975,535
Securities purchased under resale agreement (Note 9)	**9,442,008,358**	4,240,466,629
	17,084,127,451	10,171,207,674
CASH AND CASH EQUIVALENTS AT END OF PERIOD		
Cash and other cash items (Note 6)	**408,712,128**	383,208,812
Due from Bangko Sentral ng Filipinas (Note 7)	**3,034,359,867**	5,907,098,253
Due from other banks (Note 8)	**2,868,575,206***	1,351,812,028
Securities purchased under resale agreement (Note 9)	**8,882,000,000**	9,442,008,358
	₱15,193,647,201	₱17,084,127,451
OPERATIONAL CASH FLOWS FROM INTEREST		
Interest paid	**₱2,340,936,387**	₱1,715,699,918
Interest received	**7,545,880,608**	5,442,823,355

**Gross of allowance for impairment*

See accompanying Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

City Savings Bank, Inc. (the Bank) was incorporated under Philippine laws and was registered with the Securities and Exchange Commission (SEC) on December 9, 1965. The Bank's application for the extension of their corporate existence was approved by the SEC on December 9, 2014 for another 50 years from December 9, 2015. The Bank was granted license to operate by the Bangko Sentral ng Pilipinas (BSP) on December 29, 1965.

The Bank is a thrift bank specializing in granting of teachers' loans under the Department of Education's (DepEd) Automatic Payroll Deduction System. As at December 31, 2018, the Bank has 85 branches, including its head office, and 30 other banking offices.

The Bank is a subsidiary of Union Bank of the Philippines (UBP or Parent Bank). UBP, a universal bank incorporated and domiciled in the Philippines, is listed in the Philippine Stock Exchange (PSE) and is 49.36% owned by Aboitiz Equity Ventures, Inc. (AEVI). As at December 31, 2018 and 2017, UBP's ownership interest in the Bank is 99.78%.

The Bank has 40% ownership interest in CSB Land, Inc. (CSBLI), a real estate development company and 49% ownership in First Agro Industrial Rural Bank, Inc. (FAIR Bank), a rural bank.

On June 30, 2018, the Bank acquired 100% ownership in Philippine Resources Savings Banking Corporation (PR Savings Bank), following the approval of the Philippine Competition Commission (PCC) and the Monetary Board (MB) of the BSP.

On July 5, 2018 and July 10, 2018, the BOD and the stockholders, respectively, approved the plan of merger with PR Savings Bank, with the Bank as the surviving entity. Subsequently on December 20, 2018, the MB of the BSP approved the merger subject to certain conditions, including completion of the merger within one year from the date of receipt of the BSP approval and that the merger should be effective on the date the SEC issues the certificate of merger (see Note 11).

On February 28, 2019, the SEC approved the merger of the Bank and PR Savings Bank.

In February 2018, the Bank and Union Properties, Inc. (UPI), a wholly owned subsidiary of UBP, signed a share purchase agreement (SPA) with AEVI for the purchase of 2,461,338 common shares representing 51% ownership of AEVI on PETNET, Inc. (PETNET), whereby the Bank and UPI acquired 40% and 11% share in ownership, respectively. On May 8, 2018, the PCC approved the acquisition of PETNET by the Bank and UPI. The agreement was approved by the BSP on November 23, 2018. On December 17, 2018, the parties closed the transaction by settling the purchase price and confirming that all closing conditions have been fulfilled.

The Bank's principal and registered office of business is at City Savings Financial Plaza, Osmeña Boulevard, corner P. Burgos Streets, Cebu City.

The accompanying financial statements of the Bank were authorized and approved for issue by the Bank's Board of Directors (BOD) on April 4, 2019.

2. Summary of Significant Accounting Policies

Basis of Preparation
The accompanying financial statements have been prepared on a historical cost basis. The financial statements are presented in Philippine peso (₱), which is the Bank's functional currency. All values are rounded to the nearest Peso, except when otherwise indicated.

The Bank has elected not to prepare consolidated financial statements. The Bank availed the exemption from preparing the consolidated financial statements on the basis that its Parent Bank publishes consolidated financial statements that are available for public use and comply with PFRSs. The consolidated financial statements of the Parent Bank can be obtained from the SEC and the Parent Bank's respective registered business address.

The accompanying financial statements are the Bank's separate financial statements in accordance with Philippine Accounting Standards (PAS) 27, *Separate Financial Statements*.

Statement of Compliance
The financial statements of the Bank have been prepared in compliance with Philippine Financial Reporting Standards (PFRSs).

Presentation of Financial Statements
The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented in Note 21.

Changes in Accounting Policies and Disclosures
The accounting policies adopted are consistent with those of the previous financial year, except that the Bank has adopted the following new accounting pronouncements starting January 1, 2018. Adoption of these pronouncements did not have any significant impact on the Bank's financial position or performance unless otherwise indicated.

- Amendments to PFRS 2, *Share-based Payment, Classification and Measurement of Share-based Payment Transactions*
- Amendments to PFRS 4, *Insurance Contracts, Applying PFRS 9, Financial Instruments, with PFRS 4*
- Amendments to PAS 28, *Measuring an Associate or Joint Venture at Fair Value* (Part of *Annual Improvements to PFRSs* 2014-2016 Cycle)
- Amendments to PAS 40, *Investment Property, Transfers of Investment Property*
- Philippine Interpretation IFRIC-22, *Foreign Currency Transactions and Advance Consideration*
- PFRS 9 (2014), *Financial Instruments*

  PFRS 9, *Financial Instruments (2014 version)* replaces PAS 39, *Financial Instruments: Recognition and Measurement* for annual periods beginning on or after January 1, 2018, bringing together all three aspects of the accounting for financial instruments: classification and measurement; impairment; and hedge accounting. This new standard on financial instruments replaced PAS 39 and PFRS 9 (2009, 2010 and 2013 versions), herein referred to as PFRS 9. In addition to the principal classification categories for financial assets and financial liabilities, which were early adopted by the Bank on January 1, 2014, PFRS 9 (2014) includes the following major provisions:
  - limited amendments to the classification and measurement requirements for financial assets

introducing a fair value through other comprehensive income (FVOCI) measurement for eligible debt securities; and,

- an expected loss model (ECL) in determining impairment of all financial assets that are not measured at fair value through profit or loss (FVTPL), which generally depends on whether there has been a significant increase in credit risk since initial recognition of a financial asset.

Classification and Measurement
Financial assets classified under the new FVOCI category are both held in order to collect contractual cash flows and to realize fair value gains by selling the instruments. Changes in the fair value of FVOCI debt securities are recognized in other comprehensive income up until derecognition, when the fair value change will be recognized in profit or loss. As a result of this amendment to the standard, the Bank adopted a new classification category, FVOCI financial assets for debt securities under the business model where the objective is both to collect contractual cash flow and selling financial assets. As at January 1, 2018 and December 31, 2018, there were no financial assets classified under this category.

Expected Credit Loss
The adoption of PFRS 9 has fundamentally changed the Bank's accounting for impairment losses by replacing PAS 39's incurred loss approach with a forward-looking ECL approach. Thus, it is no longer required for a credit event to have occurred before credit losses are recognized. Instead, an entity calculates the ECL for all assets classified under amortized cost. The ECL calculation is composed of three major components - probability of default (PD), loss given default (LGD), and exposure at default (EAD). PD captures the obligor or borrower risk. LGD reflects, in part, how collateral is being managed. EAD is largely the on-balance sheet amount and off-balance sheet amount (for committed lines) in the event of a default. The off-balance sheet amounts to be included shall be computed through the credit conversion factor (CCF).

The significant increase/improvement in credit risk (SICR) model shall be used to classify accounts into PFRS 9 ECL's three stages. A set of defined empirical-based rules and expert judgment that discriminate good and bad credit make up the SICR. The 12-month ECL is computed for Stage 1 accounts, while the lifetime ECL is calculated for Stage 2 and Stage 3 accounts. Accounts with evidence of impairment are classified under Stage 3 and shall follow the Bank's impairment methodology. On the other hand, Stage 1 and Stage 2 accounts shall use future values derived from the term structures of the PD, LGD, and CCF. These future values also take into consideration prospective business environment conditions through the inclusion of macroeconomic forecasts. Altogether, the resulting value is called the baseline ECL. Together, ECL models and their corresponding policies, should enhance the assessment and monitoring of accounts.

At January 1, 2018, the Bank determined the amount of provision required under the ECL model, in accordance with its existing governance framework relevant to the proper implementation of PFRS 9. The Bank continues to refine its processes to enhance its implementation of PFRS 9.

The Bank applied the modified retrospective application in adopting PFRS 9, which allowed the Bank not to restate comparative periods for the effect of the adoption.

The following set out the impact of replacing PAS 39's incurred loss calculation with PFRS 9's Expected Credit Losses (ECL):

	PAS 39 Measurement Amount*	Remeasurement ECL	PFRS 9 Amount
Financial assets			
Due from other banks	₱1,351,812,028	(₱1,862,016)	₱1,349,950,012
Loans and other receivables	59,533,192,052	(532,272,038)	59,000,920,014
	₱60,885,004,080	(₱534,134,054)	₱60,350,870,026
Non-financial assets			
Deferred tax assets	₱891,437,944	₱160,240,216	₱1,051,678,160

**Restated amounts after prior- period adjustments*

The table below presents a reconciliation of the prior period's closing impairment allowance measured in accordance with PAS 39 to the opening impairment allowance determined in accordance with PFRS 9 as of January 1, 2018:

Measurement category	Impairment allowance under PAS 39	Remeasurement	Impairment allowance under PFRS 9
Due from other banks	₱–	₱1,862,016	₱1,862,016
Loans and other receivables	1,138,155,230	532,272,038	1,670,427,268
Other resources	278,662	–	278,662
	₱1,138,433,892	₱534,134,054	₱1,672,567,946

The impact of transition to PFRS 9 on Surplus is as follows:

Surplus	
Closing balance under PAS 39 (December 31, 2017)*	₱11,921,258,813
Recognition of PFRS 9 ECL	(534,134,054)
Deferred tax effect	160,240,216
Opening balance under PFRS 9 (January 1, 2018)	₱11,547,364,975

**Restated amounts after prior period adjustments*

The new hedge accounting model under PFRS 9 aims to simplify hedge accounting, align the accounting for hedge relationships more closely with an entity's risk management activities and permit hedge accounting to be applied more broadly to a greater variety of hedging instruments and risks eligible for hedge accounting. The adoption of these amendments did not have an impact on the 2018 financial statements as the Bank does not apply hedge accounting.

- PFRS 15, *Revenue from Contract with Customers*

PFRS 15 supersedes PAS 11, *Construction Contracts*, PAS 18, *Revenue,* and related Interpretations and it applies to all revenue arising from contracts with customers, unless those contracts are in the scope of other standards. The new standard establishes a five-step model to account for revenue arising from contracts with customers. The five-step model is as follows:

a. Identify the contract(s) with a customer
b. Identify the performance obligations in the contract
c. Determine the transaction price

d. Allocate the transaction price to the performance obligations in the contract
e. Recognize revenue when (or as) the entity satisfies a performance obligation.

Under PFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The standard requires entities to exercise judgment, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with the customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract.

The Bank adopted PFRS 15 effective January 1, 2018 using a full retrospective approach. The Bank's revenue consists primarily of interest income which is outside the scope of PFRS 15 (scope-in under PFRS 9). The Bank's revenue streams that are within the scope of PFRS 15 relate to other income, which includes penalties, deposit-related and ATM fees and others. The adoption did not have an impact on the Bank's financial statements, as there is no significant change in the Bank's recognition of revenue, as a result of applying the five-step model under PFRS 15. The Bank typically has a single performance obligation with respect to these services, which is to successfully complete the transaction, thus, services are satisfied at a point in time, i.e. once control of the services is transferred to the customers.

Prior-Period Adjustments
In 2018, the Bank has restated the comparative 2017 financial statement to recognize the prior period adjustments that reduced retained earnings as at January 1, 2018 by ₱721.36 million, which comprise the following: (i) change from outright recognition of certain upfront fees on loans and discounts to effective interest rate method; (ii) recognition of accrual for compliance costs; and (iii) adjustment in the deferred tax assets related to allowance for impairment.

	As at December 31,2017/ January 1, 2018	As at January 1, 2017
Statements of financial position		
Increase (decrease) in:		
Loans and receivables	(₱855,883,873)	(₱973,970,802)
Surplus	(721,356,327)	(718,209,094)
Deferred tax assets	247,799,668	307,803,898
Accounts payable and accrued expenses	113,272,122	52,042,190

	For the year ended 2017
Statement of income	
Increase (decrease) in:	
Income	
Interest income	₱3,262,399,015
Other income	(2,904,793,083)
Operating expenses	
Service charges	239,519,002
Fines and penalties	61,229,932
Deferred income tax	60,004,231
Net income after tax	(3,147,233)

Changes in Presentation
For the years ended December 31, 2018 and 2017, in relation to the change in accounting for upfront fees on loans ,the Bank changed the presentation of upfront fees from ‘Loan processing fees’ under ‘Other income’ to ‘Interest income on loans and receivables’ in the statements of comprehensive income.

The Bank believes that the above change in presentation best reflects the substance of the upfront fees being an integral part of the effective interest rate of the loans and receivables.

Significant Accounting Policies

Fair Value Measurement
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. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability, or
- in the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to the Bank. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities in the absence of a principal market, in the most advantageous market for the asset or liability
- Level 2 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognized in the statement of financial position on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Cash and Other Cash Items
For purposes of reporting cash flows, cash include cash and other cash items (COCI), due from BSP and other banks, securities purchased under resale agreements (SPURA) with the BSP that are convertible to known amounts of cash with original maturities of three months or less from dates of placements and that are subject to an insignificant risk of changes in value.

Financial Instruments - Initial Recognition and Subsequent Measurement

Date of recognition
Financial assets and liabilities, with the exception of loans and advances to customers and balances due to customers, are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial-assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. Loans and advances to customers are recognised when funds are transferred to the customers' accounts. The Bank recognises balances due to customers when funds are transferred to the Bank.

Initial recognition of financial instruments
All financial instruments are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability except for financial assets and financial liabilities at fair value through profit or loss (FVTPL). The Bank classifies its financial assets in the following categories: financial assets at amortized cost, financial assets at FVTPL and financial assets classified under FVOCI. Financial liabilities are categorized as financial liabilities at FVTPL and financial liabilities carried at amortized cost. The classification and measurement of financial instruments is driven by the Bank's business model for managing the financial instruments and the contractual cash flow characteristics of the financial instruments.

As at December 31, 2018 and 2017, all of the Bank's financial assets are categorized as financial assets at amortized cost.

'Day 1' difference
Where the transaction price in a non-active market is different from the fair value based on other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Bank recognizes the difference between the transaction price and the fair value (a 'Day 1'difference) in the statement of income unless it qualifies for recognition as some other type of asset. In cases where transaction price used is made of data which is not observable, the difference between the transaction price and model value is only recognized in the statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Bank determines the appropriate method of recognizing the 'Day 1' difference amount.

Financial assets at amortized cost
This accounting policy relates to 'Due from BSP', 'Due from other banks', 'Securities purchased under resale agreements', 'Loans and receivables' and refundable deposits and other investments under 'Prepayments and other resources'.

Financial assets are measured at amortized cost if both of the following conditions are met:
- the asset is held within the Bank's business model whose objective is to hold financial assets in order to collect contractual cash flows; and
- the contractual terms of the instrument give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal amount outstanding.

After initial measurement, financial assets at amortized cost are subsequently measured at amortized cost using the effective interest method, less any impairment in value.

Reclassification of financial assets
The Bank can only reclassify financial assets if the objective of its business model for managing those financial assets changes. The reclassification will be applied prospectively from the 'reclassification date', which is defined as, the first day of the first reporting period following the change in business

model that results in the Bank reclassifying financial assets. Accordingly, any previously recognised gains, losses or interest will not be restated.

In 2018 and 2017, the Bank did not reclassify its financial assets subsequent to their initial recognition.

Financial liabilities at amortized cost
This category represents issued financial instruments or their components, which are not designated at FVTPL and comprises 'Deposit liabilities', 'Bills payable' and 'Accounts payable and accrued expenses' (excluding documentary stamp taxes and other taxes and licenses payable as part of accrued expenses).

Issued financial instruments or their components, which are not designated as at FVTPL, are classified as financial liabilities at amortized cost, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Bank's own equity shares.

After initial measurement, financial liabilities not qualified as and not designated as at FVTPL are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the EIR.

Deposit liabilities are stated at amounts in which they are to be paid. Interest is accrued periodically and recognized in a separate liability account before recognizing it as part of deposit liabilities.

Bills payable are recognized initially at fair value, which is the issue proceeds of the loan (fair value of consideration received), net of direct issue costs. These are subsequently measured at amortized cost; any difference between the proceeds net of transaction costs and the redemption value is recognized in profit or loss over the term of the bills payable using the effective interest method.

Accounts payable and accrued expenses are recognized initially at their fair value and subsequently measured at amortized cost, using effective interest method for maturities beyond one year, less settlement payments.

<u>Derecognition of Financial Instruments</u>
Financial assets
A financial asset (or where applicable, a part of a financial asset or part of a group of financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired; or
- the Bank retains the right to receive cash flows from the asset but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risk and rewards of the asset but has transferred control over the asset.

Financial liabilities
A financial liability is derecognized when the obligation under the liability is discharged, cancelled or has expired.

Impairment of Financial Assets

Policy applicable beginning January 1, 2018

The adoption of PFRS 9 has fundamentally changed the Bank's loan loss impairment method by replacing PAS 39's incurred loss approach with a forward-looking ECL approach. From January 1, 2018, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets carried at amortized cost, together with loan commitments and financial guarantee contracts. Equity instruments are not subject to impairment under PFRS 9.

Expected credit loss methodology

ECL represent credit losses that reflect an unbiased and probability-weighted amount which is determined by evaluating a range of possible outcomes, the time value of money and reasonable and supportable information about past events, current conditions and forecasts of future economic conditions. ECL allowances are measured at amounts equal to either (i) 12-month ECL or (ii) lifetime ECL for those financial instruments which have experienced a significant increase in credit risk (SICR) since initial recognition (General Approach). The 12-month ECL is the portion of lifetime ECL that results from default events on a financial instrument that are possible within the 12 months after the reporting date. Lifetime ECL are credit losses that results from all possible default events over the expected life of a financial instrument.

Staging assessment

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

For non-credit-impaired financial instruments:

- Stage 1 is comprised of all non-impaired financial instruments which have not experienced a SICR since initial recognition. The Bank recognizes a 12-month ECL for Stage 1 financial instruments.
- Stage 2 is comprised of all non-impaired financial instruments which have experienced a SICR since initial recognition. The Bank recognizes a lifetime ECL for Stage 2 financial instruments.

For credit-impaired financial instruments:

- Financial instruments are classified as Stage 3 when there is objective evidence of impairment as a result of one or more loss events that have occurred after initial recognition with a negative impact on the estimated future cash flows of a loan or a portfolio of loans. The ECL model requires that lifetime ECL be recognized for impaired financial instruments.

The Bank uses internal credit assessment and approvals at various levels to determine the credit risk of exposures at initial recognition. Assessment can be quantitative or qualitative and depends on the materiality of the facility or the complexity of the portfolio to be assessed.

Definition of "default" and "cure"

The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit impaired, in all cases when the borrower becomes more than 90 days past due on its contractual payments. As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted. An instrument is considered to be no longer in default (i.e., to have cured) when it no longer meets any of the default criteria for a consecutive period of 180 days (i.e. consecutive payments from the borrowers for 180 days).

Significant increase in credit risk
The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in probabilities of default and qualitative factors such as downgrade in the credit rating of the borrowers and a backstop based on delinquency. The credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Bank's internal credit assessment, the borrower or counterparty is determined to require close monitoring or with well-defined credit weaknesses. For exposures without internal credit grades, if contractual payments are more than a specified days past due threshold (i.e. 30 days), the credit risk is deemed to have increased significantly since initial recognition. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a SICR since initial recognition, the Bank shall revert to recognizing a 12-month ECL.

ECL parameters and methodologies
ECL is a function of the PD, EAD and LGD, with the timing of the loss also considered, and is estimated by incorporating forward-looking economic information and through the use of experienced credit judgment.

The PD represents the likelihood that a credit exposure will not be repaid and will go into default in either a 12-month horizon for Stage 1 or lifetime horizon for Stage 2. The PD for each individual instrument is modelled based on historic data and is estimated based on current market conditions and reasonable and supportable information about future economic conditions. The Bank segmented its credit exposures based on homogenous risk characteristics and developed a corresponding PD methodology for each portfolio. The PD methodology for each relevant portfolio is determined based on the underlying nature or characteristic of the portfolio, behavior of the accounts and materiality of the segment as compared to the total portfolio.

EAD is modelled on historic data and represents an estimate of the outstanding amount of credit exposure at the time a default may occur. For off-balance sheet and undrawn amounts, EAD includes an estimate of any further amounts to be drawn at the time of default. LGD is the amount that may not be recovered in the event of default and is modelled based on historical cash flow recovery and reasonable and supportable information about future economic conditions, where appropriate. LGD takes into consideration the amount and quality of any collateral held.

Restructured loans
In certain circumstances, the Bank modifies the original terms and conditions of a credit exposure to form a new loan agreement or payment schedule. The modifications can be given depending on the borrower's or counterparty's current or expected financial difficulty. The modifications may include, but are not limited to, change in interest rate and terms, principal amount, maturity date, date and amount of periodic payments and accrual of interest and charges. Distressed restructuring with indications of unlikeliness to pay are categorized as impaired accounts and are moved to Stage 3.

Policy applicable prior to January 1, 2018
The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial assets or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about certain loss events, including, among others: (i) significant financial difficulty of the issuer or debtor; (ii) a breach of contract, such as a default or delinquency in interest or principal payments; (iii) it is probable that the borrower will enter bankruptcy or other financial reorganization; (iv) the disappearance of an active market for that financial asset because of financial difficulties; or, (v) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

For financial assets classified and measured at amortized cost, the Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Financial assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on financial assets carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate or current effective interest rate determined under the contract if the loan has a variable interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in statement of income.

If a financial asset carried at amortized cost has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. When practicable, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of collective evaluation of impairment for loans and receivables, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

When a loan receivable is determined to be uncollectible, it is written-off against the related allowance for impairment. Such loan or receivable is written-off after all the prescribed procedures, including approval from the management and BOD, have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written-off are recognized 'Other income' in the statement of income.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in statement of income.

When possible, the Bank seeks to restructure loans rather than to take possession of the collateral. This may involve extending the payment arrangement and agreement for new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews restructured loans to ensure that all criteria evidencing the good quality of the loan are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate. The difference between the recorded amount of the original loan and the present value of the restructured cash flows, discounted at the original effective interest rate, is recognized as part of 'Provision for (reversal of) credit and impairment losses' account in statement of income.

Offsetting Financial Instruments

Financial assets and liabilities are offset and the resulting net amount, considered as a single financial asset or financial liability, is reported in the statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously. The right of set-off must be available at the end of the reporting period, that is, it is not contingent on future event. It must also be enforceable in the normal course of business, in the event of default, and in the event of insolvency or bankruptcy; and must be legally enforceable for both entity and all counterparties to the financial instruments.

Investments in Associates and Subsidiary

Associates are those entities over which the Bank is able to exert significant influence but which is neither a subsidiary nor interest in a joint venture. Subsidiaries are entities over which the Bank has control. The Bank controls an entity when it has the power over the entity, it is exposed, or has rights to, variable returns from its involvement with the entity, and it has the ability to affect those returns through its power over the entity.

Investment in associates and subsidiary are initially recognized at cost and subsequently accounted for using the equity method.

Acquired investment in associate and subsidiary is subject to the purchase method. The purchase method involves the recognition of the acquiree's identifiable assets and liabilities, including contingent liabilities, regardless of whether they were recorded in the financial statements prior to acquisition. Any excess of acquisition cost over the fair value of the investors' share in identifiable net assets of the acquiree at the date of acquisition is considered as goodwill. Any goodwill attributable to the investor's share is included in the amount recorded as investment in an associate and subsidiary. If the fair value of the investors' share in identifiable net assets exceeds the acquisition cost of the acquirer, a gain on bargain purchase is recognized and is added in the amount recorded as investment.

All subsequent changes to the ownership interest in the equity of the associate and subsidiary are recognized in the Bank's carrying amount of the investment. Changes resulting from the profit or loss generated by the associates are credited or charged against the equity and is presented as 'Share in net income (loss) of associates and subsidiary' in the statement of income. Changes resulting from other comprehensive income of the associate or items recognized directly in the associate's equity are recognized in other comprehensive income or equity of the Bank, as applicable. Dividends received are treated as a reduction in the carrying amounts of the investments.

Impairment loss is provided when there is objective evidence that the investments in associates will not be recovered (see accounting policy on Impairment of Nonfinancial Assets).

However, when the Bank's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Bank does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognizing its share of those profits only after its share of the profits exceeds the accumulated share of losses that has previously not been recognized.

Premises, Furniture, Fixtures and Equipment

Premises, furniture, fixtures and equipment are carried at acquisition cost less accumulated depreciation and amortization, and any impairment in value.

The initial cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Expenditures for additions, major improvements and renewals are capitalized, while expenditures for repairs and maintenance are charged to expense as incurred.

Depreciation is computed on a straight-line basis over the estimated useful lives of the depreciable assets as follows:

Buildings and building improvements	15 to 25 years
Furniture, fixtures and equipment	2 to 5 years
Leasehold improvements	3 to 10 years or term of the lease, whichever is shorter

The residual values, estimated useful lives and method of depreciation of premises, furniture, fixtures and equipment (except land) are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see accounting policy on Impairment of Non-financial Assets).

Fully-depreciated assets are retained in the accounts until they are no longer in use and no further charge for depreciation is made in respect of those assets.

An item of premises, furniture, fixtures and equipment, including the related accumulated depreciation and impairment losses, if any, is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising from the derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in profit or loss in the year the item is derecognized.

Investment Properties
Investment properties pertain to condominium units held by the Bank to earn rentals, rather than for administrative purposes or sale in the ordinary course of business. These are carried at acquisition cost less accumulated depreciation and amortization, and any impairment in value.

Direct operating expenses related to investment properties, such as repairs and maintenance and real estate taxes, are normally charged against current operations in the period in which these costs are incurred.

Investment properties are depreciated over the estimated useful lives ranging from two to ten years and is recognized under ‘Depreciation and amortization’ in the statements of income .

An asset’s carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see accounting policy on Impairment of Non-financial Assets).

Investment property, including the related accumulated depreciation and any impairment losses, is derecognized upon disposal or when permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss on the retirement or disposal of an investment property is recognized in profit or loss in the year of retirement or disposal.

Intangible Assets
Intangible assets include computer software and licenses which are accounted for under the cost model. The cost of the asset is the amount of cash or cash equivalents paid or the fair value of the other considerations given up to acquire an asset at the time of its acquisition.

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and install the specific software. Capitalized costs are amortized on a straight-line basis over the estimated useful lives ranging from two to five years as the lives of these intangible assets are considered finite. These costs are recognized in profit or loss as part of ‘Depreciation and amortization’ in the statements of income. Costs associated with maintaining computer software are expensed as incurred.

Acquired branch licenses from BSP are capitalized on the basis of the costs incurred to acquire the license. Estimated useful lives of branch licenses are considered infinite; hence, not amortized. The useful life of the intangible asset is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

An asset’s carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see accounting policy on Impairment of Non-financial Assets).

When an intangible asset is disposed of, the gain or loss on disposal is determined as the difference between the net proceeds and the carrying amount of the asset is recognized in profit or loss.

Prepayments and Other Resources
Prepayments and other resources pertain to other assets controlled by the Bank as a result of past events. They are recognized in the financial statements when it is probable that the future economic benefits will flow to the Bank and the asset has a cost or value that can be measured reliably.

Impairment of Non-financial Assets
The Bank's investments in associates and subsidiary, premises, furniture, fixtures and equipment, investment properties, intangible assets and other nonfinancial assets are subject to impairment testing. Intangible assets with an indefinite useful life are tested for impairment at least annually. All other individual assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable.

When an indicator of impairment exists or when an annual impairment testing for an asset is required, the Bank makes an estimate of recoverable amount. Recoverable amount is the higher of an asset's (or cash-generating unit's) fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is assessed as part of the cash generating unit to which it belongs.

Where the carrying amount of an asset (or cash generating unit) exceeds its recoverable amount, the asset (or cash generating unit) is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset (or cash generating unit). An impairment loss is charged to profit or loss in the year in which it arises.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment loss is reversed if the asset's or cash generating unit's recoverable amount exceeds its carrying amount. However, the recoverable amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of income.

Provisions and Contingencies
Provisions
Provisions are recognized when an obligation (legal or constructive) is incurred as a result of a past event and where it is probable that an outflow of assets embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle an obligation, the provision is reversed.

Contingencies
Contingent assets are not recognized but are disclosed in the notes to financial statements when an inflow of economic benefits is probable. Contingent liabilities are not recognized but are disclosed in the notes to financial statements unless the possibility of an outflow of resources embodying economic benefits is remote.

Revenue Recognition (outside the scope of PFRS 15)

Interest income

Interest income is recognized in profit or loss for all instruments measured at amortized cost using the effective interest rate method.

Service fees arising from activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction that are considered integral in the creation or acquisition of financial asset is recognized in profit or loss using the effective interest rate method.

The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Rental income

Rent arising from leased properties is accounted for on a straight-line basis over the lease terms of ongoing leases and is presented as part of 'Other income' in the statements of income.

Revenue Recognition

Revenue from contracts with customers, if any, is recognized when control of the goods or services are transferred to the customer at an amount that reflects the consideration to which the Bank expects to be entitled in exchange for goods or services. The following specific recognition criteria must also be met before revenue is recognized:

Service charges and fees

Service charges and penalties relating to loans and receivables and deposit transactions are recognized point in time, i.e. only upon collection or accrued when there is reasonable degree of certainty as to its collectability.

Gain on sale of premises, furniture, fixtures and equipment

Gain on sale of assets is recognized when the risk and rewards to the assets is transferred to the buyer or when the collectability of the entire sales price is reasonably assured. This is presented as part of 'Other income' in the statements of income.

Expense Recognition

Costs and expenses are recognized in profit or loss upon utilization of the assets or services or at the date these are incurred. All finance costs are reported in profit or loss on an accrual basis.

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Bank as lessee
Leases which do not transfer to the Bank substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments (net of any incentive received from the lessor) are recognized as expense in profit or loss on a straight-line basis over the lease term. Associated costs, such as repairs and maintenance and insurance, are expensed as incurred.

Bank as lessor
Leases which do not transfer to the lessee substantially all the risks and benefits of ownership of the asset are classified as operating leases. Lease income from operating leases is recognized as income in profit or loss on a straight-line basis over the lease term.

<u>Employee Benefits</u>
Post-employment Defined Benefit Plan
A defined benefit plan is a post-employment plan that defines an amount of post-employment benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of post-employment plan remains with the Bank, even if plan assets for funding the defined benefit plan have been acquired. Plan assets may include assets specifically designated to a long-term benefit fund, as well as qualifying insurance policies. The Bank's defined benefit post-employment plan covers all regular full-time employees. The pension plan is tax-qualified, noncontributory and administered by a trustee.

The liability recognized in the statement of financial position for a defined benefit plan (presented under 'Other liabilities') is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets.

The cost of providing benefits under the defined benefit plan is calculated regularly by independent actuaries using the projected unit credit method.

Defined benefit costs comprise the following:
- Service cost
- Net interest on the net defined benefit liability or asset
- Remeasurements of net defined benefit liability or asset

Service costs which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expense in the statement of income. Past-service costs are recognized immediately in profit or loss in the period of a plan amendment or curtailment.

Net interest is calculated by applying the discount rate at the beginning of the period, taking account any changes in the net defined benefit asset or liability during the period as a result of contributions and benefit payments. Net interest on the net defined benefit liability or asset is recognized as expense or income in the statement of income.

Remeasurements, comprising of actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions and the return on plan assets (excluding amount included in net interest) are reflected immediately in the statement of financial position with a charge or credit recognized in other comprehensive income in the period in which they arise. Remeasurements are not reclassified to profit or loss in subsequent periods.

Post-employment Defined Contribution Plans
A defined contribution plan is a post-employment plan under which the Bank pays fixed contributions into an independent entity, such as the Social Security System. The Bank has no legal or constructive obligations to pay further contributions after payment of the fixed contribution. The contributions recognized in respect of defined contribution plans are expensed as they fall due. Liabilities or assets may be recognized if underpayment or prepayment has occurred.

Compensated Absences
Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the end of the reporting period. These are included in 'Accounts Payable and Accrued Expenses' in the statement of financial position at the undiscounted amount that the Bank expects to pay as a result of the unused entitlement.

Income Taxes
Tax expense recognized in profit or loss comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in capital funds, if any.

Current tax
Current tax assets or liabilities comprise those claims from, or obligations to, fiscal authorities relating to the current or prior reporting period, that are uncollected or unpaid at the end of the reporting period. These are calculated using the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognized as a component of tax expense in profit or loss.

Deferred tax
Deferred tax is accounted for using the liability method, on all temporary differences at the end of the reporting period between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Under the liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carryforward of unused tax credits from excess minimum corporate income tax (MCIT) over regular corporate income tax (RCIT) and unused net operating loss carryover (NOLCO) to the extent that it is probable that taxable profit will be available against which the deferred tax assets can be utilized. Deferred tax, however, is not recognized when it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting income nor taxable income.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. Unrecognized deferred tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will be available to allow such deferred tax assets to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized or the liability is settled provided such tax rates have been enacted or substantively enacted at the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

Deferred tax assets and deferred tax liabilities are offset if the Bank has a legally enforceable right to set off current tax assets against current tax liabilities and the deferred taxes relate to the same entity and the same taxation authority.

Equity

Capital stock represents the nominal value of shares that have been issued. Additional paid-in capital includes any premium received on the issuance of capital stock. Any transaction costs associated with the issuance of shares are deducted from additional paid-in capital, net of any related income tax benefits.

Surplus free includes all current and prior period results as reported in the statements of income and which are available and not restricted for use by the Bank, reduced by the amounts of dividend declared, if any.

Surplus reserves pertains to the difference of the 1% required General Loan Loss Provision, as required by the BSP Circular No. 1011 - *Guidelines on the Adoption of the Philippine Financial Reporting Standard (PFRS) 9 - Financial Instruments,* on Stage 1 on-balance sheet loans over the computed allowance for credit losses on Stage 1 accounts under PFRS 9.

Remeasurements on retirement liability comprise of cumulative actuarial gains and losses resulting from remeasurements of post-employment defined benefit obligation.

Events after the Reporting Date

Any post-year-end event that provides additional information about the Bank's financial position at the end of the reporting period (adjusting event) is reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material to the financial statements.

Future Changes in Accounting Policies

Pronouncements issued but not yet effective are listed below. Unless otherwise indicated, the Bank does not expect that the future adoption of the said pronouncements will have a significant impact on its financial statements. The Bank intends to adopt the following pronouncements when they become effective.

Effective beginning on or after January 1, 2019

- Amendments to PFRS 9, *Prepayment Features with Negative Compensation*

  Under PFRS 9, a debt instrument can be measured at amortized cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to PFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract. The amendments should be applied retrospectively and are effective from January 1, 2019, with earlier application permitted. These amendments have no impact on the financial statements of the Bank.

- PFRS 16, *Leases*

  PFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under PAS 17, *Leases*. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognize a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

  Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

  Lessor accounting under PFRS 16 is substantially unchanged from today's accounting under PAS 17. Lessors will continue to classify all leases using the same classification principle as in PAS 17 and distinguish between two types of leases: operating and finance leases.

  PFRS 16 also requires lessees and lessors to make more extensive disclosures than under PAS 17.

  A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs.

  Upon adoption of this standard, the Bank expect to recognize a right of use asset and lease liability for covered lease contracts. Management is currently assessing the impact of this new standard in the financial statements.

- Amendments to PAS 19, *Plan Amendment, Curtailment or Settlement*

  The amendments to PAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to:

  - Determine current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event

  - Determine net interest for the remainder of the period after the plan amendment, curtailment or settlement using: the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event; and the discount rate used to remeasure that net defined benefit liability (asset).

  The amendments also clarify that an entity first determines any past service cost, or a gain or loss on settlement, without considering the effect of the asset ceiling. This amount is recognized in profit or loss. An entity then determines the effect of the asset ceiling after the plan amendment, curtailment or settlement. Any change in that effect, excluding amounts included in the net interest, is recognized in other comprehensive income.

The amendments apply to plan amendments, curtailments, or settlements occurring on or after the beginning of the first annual reporting period that begins on or after January 1, 2019, with early application permitted. These amendments will apply only to any future plan amendments, curtailments, or settlements of the Bank.

- Amendments to PAS 28, *Long term Interest in Associates and Joint Venture*

  The amendments clarify that an entity applies PFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in PFRS 9 applies to such long-term interests.

  The amendments also clarified that, in applying PFRS 9, an entity does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognized as adjustments to the net investment in the associate or joint venture that arise from applying PAS 28, *Investments in Associates and Joint Ventures*.

  The amendments should be applied retrospectively and are effective from January 1, 2019, with early application permitted. Since the Bank does not have such long-term interests in its associate and joint venture, the amendments will not have an impact on its financial statements.

- Philippine Interpretation IFRIC 23, *Uncertainty over Income Tax Treatments*

  The interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of PAS 12, *Income Taxes,* and does not apply to taxes or levies outside the scope of PAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

  The interpretation specifically addresses the following:
    - Whether an entity considers uncertain tax treatments separately
    - The assumptions an entity makes about the examination of tax treatments by taxation authorities
    - How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
    - How an entity considers changes in facts and circumstances

  An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed.

  This interpretation is not relevant to the Bank because there is no uncertainty involved in the tax treatments made by management in connection with the calculation of current and deferred taxes as of December 31, 2018 and 2017.

- Amendments to PFRS 3, *Business Combinations, Previously held interests in a joint operation (Part of Annual Improvements to PFRSs 2015 - 2017 Cycle)*

  The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation.

A party that participates in, but does not have joint control of, a joint operation might obtain joint control of the joint operation in which the activity of the joint operation constitutes a business as defined in PFRS 3. The amendments clarify that the previously held interests in that joint operation are not remeasured.

An entity applies those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2019 and to transactions in which it obtains joint control on or after the beginning of the first annual reporting period beginning on or after January 1, 2019, with early application permitted. These amendments are currently not applicable to the Bank but may apply to future transactions.

- Amendments to PAS 12, *Income Taxes, Income tax consequences of payments on financial instruments classified as equity (Part of Annual Improvements to PFRSs 2015 - 2017 Cycle)*

  The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognizes the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events.

  An entity applies those amendments for annual reporting periods beginning on or after January 1, 2019, with early application is permitted. These amendments are not relevant to the Bank because dividends declared by the Bank do not give rise to tax obligations under the current tax laws.

- Amendments to PAS 23, *Borrowing Costs, Borrowing costs eligible for capitalisation (Part of Annual Improvements to PFRSs 2015 - 2017 Cycle)*

  The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

  An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. An entity applies those amendments for annual reporting periods beginning on or after January 1, 2019, with early application permitted.

  Since the Bank's current practice is in line with these amendments, the Bank does not expect any effect on its financial statements upon adoption.

Effective beginning on or after January 1, 2020

- Amendments to PFRS 3, *Definition of a Business*

  The amendments to PFRS 3 clarify the minimum requirements to be a business, remove the assessment of a market participant's ability to replace missing elements, and narrow the definition of outputs. The amendments also add guidance to assess whether an acquired process is substantive and add illustrative examples. An optional fair value concentration test is introduced which permits a simplified assessment of whether an acquired set of activities and assets is not a business.

  An entity applies those amendments prospectively for annual reporting periods beginning on or after January 1, 2020, with earlier application permitted.

  These amendments will apply on future business combinations of the Bank.

- Amendments to PAS 1, *Presentation of Financial Statements*, and PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, *Definition of Material*

  The amendments refine the definition of material in PAS 1 and align the definitions used across PFRSs and other pronouncements. They are intended to improve the understanding of the existing requirements rather than to significantly impact an entity's materiality judgments.

  An entity applies those amendments prospectively for annual reporting periods beginning on or after January 1, 2020, with earlier application permitted.

Deferred effectivity

- Amendments to PFRS 10, *Consolidated Financial Statements* and PAS 28*, Investments in Associates and Joint Ventures - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

  The amendments address the conflict between PFRS 10 and PAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that a full gain or loss is recognized when a transfer to an associate or joint venture involves a business as defined in PFRS 3. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognized only to the extent of unrelated investors' interests in the associate or joint venture.

  On January 13, 2016, the Financial Reporting Standards Council deferred the original effective date of January 1, 2016 of the said amendments until the International Accounting Standards Board (IASB) completes its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

3. Significant Accounting Judgments and Estimates

The preparation of the Bank's financial statements in accordance with PFRS requires the Bank to make judgments and estimates that affect the amounts reported in the financial statements and related notes. Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may ultimately differ from these estimates.

Judgments
In the process of applying the Bank's accounting policies, management has made the following judgment, apart from those involving estimation, which have the most significant effect on the amounts recognized in the financial statements:

a. *Distinction between Operating and Finance Leases*
The Bank has entered into various lease agreements. Critical judgment was exercised by management to distinguish each lease agreement as either an operating or a finance lease by looking at the transfer or retention of significant risk and rewards of ownership of the properties covered by the agreements. Failure to make the right judgment will result in either overstatement or understatement of assets and liabilities. Currently, the Bank's lease agreements are determined to be operating leases.

Estimates
Following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period.

a. *Estimation of impairment losses on loans and receivables*
The measurement of impairment losses both under PFRS 9 and PAS 39 across all categories of financial assets requires judgment, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

Applicable beginning January 1, 2018
The Bank adopted a loan loss methodology (LLM) based on the concepts of PFRS 9. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Significant factors affecting the estimates on the ECL model include:

- The Bank's internal grading model, which assigns PDs to individual grades
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a Lifetime Expected Credit Loss basis and the qualitative assessment
- The Bank's definition of default, which is consistent with regulatory requirements
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, and the effect on PDs, EADs and LGDs

The carrying value of loans and receivables and the analysis of allowance for impairment on such financial assets are shown in Notes 10 and 16, respectively.

Applicable prior to January 1, 2018
Adequate amount of allowance for impairment is provided for specific and groups of accounts, where objective evidence of impairment exists. The Bank evaluates the amount of allowance for impairment based on available facts and circumstances affecting the collectability of the accounts, including, but not limited to, the length of the Bank's relationship with the borrowers, the borrowers' current credit status, average age of accounts, value of the collaterals, collection experience and historical loss experience. The methodology and assumptions used in estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

b. *Estimation of expected life of loans*
The Bank recognizes the upfront fees from loan originations as interest income using the EIR method over the expected life of the loans. The Bank estimates the expected life of the loans, based on the period over which the loans are expected to be settled in full. The estimation is reviewed periodically and is updated based on the current expectations on the behavior and repayment of the borrowers.

c. *Valuation of post-employment defined benefit obligation*
The determination of the Bank's obligation and cost of post-employment defined benefit is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among others, discount rates, future salary rate increases and mortality rates. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, defined benefit obligations are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

In determining the appropriate single weighted average discount rate, management considers the interest rates of government securities, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation.

The mortality rate is based on publicly available mortality tables for the Philippines and is modified accordingly with estimates of mortality improvements. Future salary increases and pension increases are based on expected future inflation rates, seniority, promotion and other market factors.

The amounts of post-employment defined benefit obligation and expense and an analysis of the movements in the estimated present value of post-employment defined benefit obligation are presented in Note 24.

4. **Financial Risk Management Objectives and Policies**

The Bank is committed to protect its reputation, core investments, team members, customers and communities and to create long-term value for all its stakeholders and to adopt an agile, scalable, defensible, and competitively opportunistic Enterprise Risk Management (ERM) framework. The Bank recognizes that the management of risk is fundamental to the business of banking. In this regard, it aims to consciously and actively manage the risks inherent in the business by striking a balance between risks and returns and achieving growth through an appropriate risk management policy.

The Bank enters into financial instruments contracts, which consist of loans and receivables and financial liabilities such as deposits and bills payable to finance the Bank's operations. In carrying out its business, the Bank is exposed to a number of risks, including: credit risk, liquidity risk, market risk and operational risk. The Bank also closely monitors other nonfinancial risks, such as strategic risk, compliance risk, regulatory and legal risks, IT risks, and reputation and brand risk.

Risk Management Structure

The Bank's risk governance structure is embedded in its organizational structure. There are four components of the structure: (1) the branch operations and the Operations Committee, (2) the independent risk management team together with the corporate staff functions (Compliance, Information Technology, Accounting and Finance, and Human Resources), (3) Internal Audit, and (4) the Board Committees.

The BOD is ultimately responsible for the overall risk management approach, and reviews and approves the policies for managing each of these risks. The BOD oversees and monitors the implementation of its policies through the various committees that it has created.

Risk Measurement and Reporting

The Bank has established an adequate information system for measuring, monitoring, controlling and reporting credit risks or existing or potential problem loans and other risk assets and for evaluating credit policies vis-à-vis prevailing circumstances and emerging portfolio trends.

Monitoring and controlling risks are primarily performed based on the risk appetite of the Bank. The Bank's risk appetite defines in general terms its risk-taking capacity given acceptable business opportunities that the Bank is willing to pursue, and determines how risks are viewed and addressed by the Bank as a whole. This is expressed and guided by the various limits that are mandated and delegated by the Bank's BOD and shareholders.

The Bank has developed and utilized an internal risk rating system in order to help the Board and Senior Management differentiate risks across the individual credits and groups and to facilitate informed decision making. The internal credit risk rating system influences the portfolio management and board reporting, credit approval and underwriting process, allowance for credit losses from a portfolio basis, relationship management and credit administration.

The Bank shall measure the performance and risk level of its credit portfolio and report these findings to the BOD through the Risk Management Committee.

In terms of measuring the Bank's ability to withstand the impact of stress conditions, stress testing methodology is used. Through stress testing, the impact of exceptional events on the Bank's asset quality, profitability and capital adequacy is measured.

Risk Mitigation

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits when appropriate. Periodic stress tests are likewise conducted to identify potential changes in market and political conditions such as competition, DepEd interest rate changes and Net Take Home Pay changes in the annual approval of the General Appropriations Act that could adversely impact the performance of its credit portfolios. Exposure of certain consumption, real estate and commercial loans to credit risk is also managed in part by obtaining collateral.

The BOD sets limits on deposits or investments that could be placed with a single institution. A report is prepared daily on deposits with other banks to ensure compliance with a maximum limits set.

Financial Risks
The Bank does not actively engage in the trading of financial assets for speculative purposes nor does it write options. The relevant financial risks to which the Bank is exposed to are described below.

Market Risk
The Bank recognizes market risk as the adverse impact on earnings or capital, either immediate or over time, arising from changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates, commodity prices and equity prices. The primary categories of market risk for the Bank are:

i. *Foreign Currency Risk*, arising from changes in exchange rates or risk arising from adverse movements/mismatches in currencies.

   The Bank has minimal exposure to foreign currency risks as most transactions are denominated in Philippine peso, its functional currency.

ii. *Interest Rate Risk*, arising from changes in prevailing interest rates and implied volatilities on interest rate options

   The Bank follows a prudent policy on managing its assets and liabilities so as to ensure that exposure to fluctuations in interest rates are kept within acceptable limits. Long-term borrowings are usually at fixed rates. As at December 31, 2018 and 2017, the Bank has no significant exposure to interest rate risk as most of its financial instruments have fixed rates.

Credit Risk
Credit risk is the risk that a counterparty may fail to discharge an obligation to the Bank. The Bank is exposed to this risk for various financial instruments arising from granting loans to borrowers, placing deposits with other banks, and investing in bonds.

The Bank is exposed to credit risk arising from loan defaults of its clients, with a maximum exposure without taking into account collateral and other credit enhancements equal to the carrying amount of their loans. As a mitigating factor, stringent policy has been implemented in loan granting such that the Bank grants credit only with recognized, creditworthy clients. The Bank transacts only with clients which have demonstrated financial soundness.

The Bank extends loans, such as salary loans to teachers under the DepEd Regional Payroll Services Unit (RPSU) and Autonomous schools, commercial loans as well as pension loans. The Bank's lending policies include, among others, requirement that all loan applicants shall be subject to a screening process using the Bank's borrower databases to serve as the basis for the decision to grant or deny the loan. The Credit Committee undertakes the evaluation of existing policies, practices and procedures on credit or credit-related matters and if necessary, formulate or create new policies that would be used as guidelines for the management of credit risks at the same time ensuring that these are within the risk appetite of the Bank.

The Bank, being an accredited lending institution with DepEd, has entered into an agreement with DepEd for automatic payroll deductions on salary loans granted to teachers. In 2018, upon release of the new Terms and Conditions of the APDS Accreditation, the Bank may approve a loan only upon certification by the DepEd verifier, stating that the monthly payments can be accommodated within the threshold of the monthly net take home pay as required in the General Appropriations Act at the time of approval of loan.

The Bank's investments in bonds and other short-term investments are for compliance with the minimum requirements set by the BSP.

Collateral and other credit enhancements
The Bank holds collateral against certain loans and receivables from borrowers in order to mitigate risk. The collateral may be in the form of mortgages over real estate properties, chattels, deposits and others. The Bank regularly monitors and updates the fair value of the collaterals depending on the type of credit exposure. Estimates of the fair value of collaterals are considered in the review and assessment of the adequacy of allowance for impairment losses. Fair values are determined by the Bank's internal appraisers.

The Bank does not hold any collateral for its salary loans to teachers which comprise 92.90% of the total loans.

Maximum exposure to credit risk after collateral held and other credit enhancements
The table below shows the Bank's maximum exposure to credit risk on loans and receivables as of December 31, 2018 and December 31, 2017 (gross of allowance for impairment losses):

	December 31, 2018			December 31, 2017		
	Maximum Exposure			Maximum Exposure		
	Carrying Value	**Financial Effect of Collateral in Mitigating Credit Risk**	**Maximum Exposure to Credit Risk**	Carrying Value*	Financial Effect of Collateral in Mitigating Credit Risk	Maximum Exposure to Credit Risk
Loans:						
Consumption	**₱48,330,005,932**	**₱13,235,000**	**₱48,316,770,932**	₱55,936,136,932	₱19,582,500	₱55,916,554,432
Commercial	**55,015,710**	–	**55,015,710**	39,800,599	3,666,000	36,134,599
Real Estate	**692,158**	**6,113,644**	–	5,480,230	12,775,844	–
Agricultural	**246,338,185**	–	**246,338,185**	630,388,647	–	630,388,647
Accounts receivable	**2,151,080,169**	–	**2,151,080,169**	1,996,606,346	–	1,996,606,346
Unquoted debt securities	**376,972,586**	–	**376,972,586**	405,205,749	–	405,205,749
Accrued interest receivable	**631,474,717**	–	**631,474,717**	519,573,549	–	519,573,549
	₱51,791,579,457	**₱19,348,644**	**₱51,777,652,299**	₱59,533,192,052	₱36,024,344	₱59,504,463,322

**Restated amounts*

Financial effect of collaterals in mitigating credit risk is equivalent to the fair value of the collateral or the carrying value of the loan, whichever is lower.

Risk Concentration
Concentration of credit arises when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographic location.

The Bank has decided to maintain its focus and its drive to cater the financial needs of the teachers, notwithstanding the concentration risk it entails, as it continues to believe that said strategy remains viable in terms of financial returns, at the same time morally rewarding as the same actualizes the original core values and mission of the Bank along the lines of financial inclusion and literacy.

While the Bank has taken on this concentration risk, efforts to mitigate the risk have started specifically the diversification of the portfolio by expanding the Bank's reach to more autonomous schools and State Universities and Colleges (SUCs). The Bank also started to lend to Pensioners, OFWs and Seafarers.

The Bank, through its Board Risk Committee, likewise manages concentration risks by setting exposure limits to borrowing groups, industries, and where appropriate, on products and facilities.

a. *Concentration by Counterparty*
Information on concentration of financial assets (i.e. Due from BSP, Due from other banks, SPURA, Loans and receivables, and security deposits and other investments under 'Prepayments and other resources') as to counterparties as at December 31, 2018 and 2017 follows:

	2018	2017
Public school teachers	**₱50,929,552,347**	₱59,016,597,476
Financial intermediaries	**15,294,725,587**	17,106,124,389
Corporate	**140,979,815**	72,263,604
Other individuals	**252,703,569**	69,878,274
	66,617,961,318	76,264,863,743
Allowance for impairment loss	**(840,960,944)**	(1,138,365,842)
	₱65,777,000,374	₱75,126,497,901

b. *Concentration by Industry*

The tables below show the distribution of maximum credit exposure by industry sector of financial assets before taking into account the fair value of the loan collateral or other credit enhancements (excluding cash and other cash items):

	December 31, 2018			
	Loans and Advances to Banks[1]	**Loans and Receivables**	**Others[2]**	**Total**
Consumption	**₱–**	**₱48,330,005,937**	**₱–**	**₱48,330,005,937**
Financial intermediaries	**14,784,935,074**	**509,790,514**	**–**	**15,294,725,588**
Agricultural	**–**	**246,338,442**	**–**	**246,338,442**
Commercial	**–**	**55,015,447**	**–**	**55,015,447**
Real estate	**–**	**692,158**	**41,107,971**	**41,800,129**
Others	**–**	**2,649,736,958**	**338,817**	**2,650,075,775**
	14,784,935,074	**51,791,579,456**	**41,446,788**	**66,617,961,318**
Allowance for impairment loss	**(5,329,200)**	**(835,421,133)**	**(210,611)**	**(840,960,944)**
	₱14,779,605,874	**₱50,956,158,323**	**₱41,236,177**	**₱65,777,000,374**

[1]*Loans and advances to banks include Due from BSP, Due from other banks and SPURA.*
[2]*Others include refundable deposits and other investments.*

	December 31, 2017			
	Loans and Advances to Banks[1]	Loans and Receivables	Others[2]	Total
Consumption	₱–	₱55,936,136,932	₱–	₱55,936,136,932
Agricultural	–	630,388,647	–	630,388,647
Financial intermediaries	16,700,918,639	405,205,749	–	17,106,124,388
Commercial	–	39,800,599	–	39,800,599
Real estate	–	5,480,230	30,407,019	35,887,249
Others	–	2,516,179,895	346,033	2,516,525,928
	16,700,918,639	59,533,192,052	30,753,052	76,264,863,743
Allowance for impairment loss	–	(1,138,155,230)	(210,612)	(1,138,365,842)
	₱16,700,918,639	₱58,395,036,822	₱30,542,440	₱75,126,497,901

[1]*Loans and advances to banks include Due from BSP, Due from other banks and SPURA.*
[2]*Others include refundable deposits and other investments.*

Credit quality per class of financial assets
Each borrower is assigned a credit score with E as minimal risk, D as low risk, C as moderate risk, B as average risk and A as high risk.

The credit grades used by the Bank in evaluating the credit quality of its financial assets are as follow:

(a) High grade (accounts with risk grades of low to minimal)
These are receivables which have a high probability of collection. The counterparty has the apparent ability to satisfy its obligation and the security on the receivables is readily enforceable.

(b) Standard grade (accounts with risk grades of average to moderate)
These are receivables where collections are probable due to the reputation and the financial ability of the counterparty to pay but with experience of default.

(c) Substandard (accounts with risk grade of high)
Accounts classified as "Substandard" are individual credits or portions thereof which appear to involve a substantial and unreasonable degree of risk to the Bank because of unfavorable record or unsatisfactory characteristics. There exists in such accounts the possibility of future loss to the Bank unless given closer supervision. Those classified as "Substandard" must have a well-defined weakness or weaknesses that jeopardize their liquidation. Such well-defined weaknesses may include adverse trends or development of financial, managerial, economic or political nature, or a significant weakness in collateral.

(d) Past due or individually impaired comprise accounts under the following risk grading:
   (i) Specially mentioned - Accounts classified as "Specially mentioned" are individual credits that have potential weakness particularly on documentation or credit administration that deserve management's close attention. These potential weaknesses, if left uncorrected, may affect the repayment prospects of the loan and thus heighten the credit risk to the Bank. A credit may also be classified as "Specially mentioned" if there is evidence of weakness in the borrower's financial condition or creditworthiness, or which is subject to an unrealistic repayment program, or inadequate source of funds.

   (ii) Doubtful - Accounts classified as "Doubtful" are individual credits or portions thereof which have the weaknesses inherent in those classified as "Substandard", with the added characteristics that existing facts, conditions, and values make collection or liquidation highly improbable and in which substantial loss is probable. Positive and vigorous action is required to avert or minimize losses.

   (iii) Loss - Accounts classified as "Loss" are individual credits or portions thereof which are considered uncollectible or worthless and of such little value that their continuance as bankable assets is not warranted although the loans may have some recovery or salvage value. The amount of loss is difficult to measure and it is not practical or desirable to defer writing off these basically worthless assets even though partial recovery may be obtained in the future.

Accounts which are not subjected to risk rating are considered unrated.

Applicable beginning January 1, 2018

DepEd/Teachers' Loans
Below is the breakdown of the Bank's DepEd loans exposure (outstanding balance and accrued interest receivable) by credit scoring as of December 31, 2018:

	Amount			
Credit Score	Stage 1	Stage 2	Stage 3	Total
D to E	₱45,059,018,290	₱–	₱–	₱45,059,018,290
B to C	80,318,685	49,243,706	–	129,562,391
A	–	196,141,839	–	196,141,839
Default	–	–	1,620,327,095	1,620,327,095
	₱45,139,336,975	₱245,385,545	₱1,620,327,095	₱47,005,049,615

Non-DepEd Loans
Other receivables from customers of the Bank include small portfolios such as household and GSIS loans. Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing the lending limits when appropriate. The ECL stage bases are determined based on the aging and delinquency of the accounts.

The description of each groupings according to stage is explained further as follows:

(a) Stage 1 (Standard grade)
Those that are considered current and up to 30 days past due, and based on delinquencies and payment history, does not demonstrate significant increase in credit risk.

(b) Stage 2 (Substandard grade)
Those that are considered more 30 days past due but does not demonstrate objective evidence of impairment as of reporting date, and, based on delinquencies and payment history, demonstrates significant increase in credit risk.

(c) Stage 3 (Loss)
Those that are considered default or demonstrates objective evidence of impairment as of reporting date.

Below is the breakdown of the Bank's Non-DepEd loans exposure (outstanding balance and accrued interest receivable) by credit quality as of December 31, 2018:

	Amount			
Risk rating	Stage 1	Stage 2	Stage 3	Total
Standard	₱3,321,284,414	₱–	₱–	₱3,321,284,414
Substandard	–	18,979,020	–	18,979,020
Loss	–	–	273,526,500	273,526,500
	₱3,321,284,414	₱18,979,020	₱273,526,500	₱3,613,789,934

As of December 31, 2018, other financial assets, which include 'Due from BSP', 'Due from other banks', 'SPURA', 'Accounts receivable' and 'Unquoted debt securities' under 'Loans and receivables', and 'Security deposits' under 'Prepayments and other resources' are classified as high grade ("Stage 1").

Applicable prior to January 1, 2018
The table below shows the credit quality by class of financial assets (gross of allowance for credit losses):

	2017						
	Neither Past Due nor Specifically Impaired						
	High Grade	Standard Grade	Substandard Grade	Unrated	Past Due but not impaired	Past Due and impaired	Total
Due from BSP	₱5,907,098,253	₱–	₱–	₱–	₱–	₱–	₱5,907,098,253
Due from other banks	1,351,812,028	–	–	–	–	–	1,351,812,028
Cash and other cash items	383,208,812	–	–	–	–	–	383,208,812
Loans and receivables:				–			
Agricultural	–	420,231,926	–	–	7,155,790	203,000,930	630,388,646
Consumption	–	52,495,691,149	–	–	1,097,624,076	2,342,821,708	55,936,136,933
Commercial	–	39,704,167	–	–	–	96,433	39,800,600
Real estate	–	3,919,446	–	–	200,579	1,360,204	5,480,229
Unquoted debt securities	–	405,205,749	–	–	–	–	405,205,749
Accounts receivables	1,988,039,031		3,558,757			5,008,558	1,996,606,346
Accrued interest receivables	–	519,573,549	–	–	–	–	519,573,549
Government securities sold under resale agreement	9,442,008,358	–	–	–	–	–	9,442,008,358
Other assets	–	–	–	30,542,440	–	210,612	30,753,052
	₱19,072,166,482	₱53,884,325,986	₱3,558,757	₱30,542,440	₱1,104,980,445	₱2,552,498,445	₱76,648,072,555

The table below shows the risk grade classification of past due or individually impaired loans as at December 31, 2017:

	December 31, 2017			
	Specially Mentioned	Doubtful	Loss	Total
Loans and discounts	₱1,261,044,418	₱387,162,287	₱899,072,570	₱2,547,279,275
Accounts receivable	–	–	5,008,558	5,008,558
Other assets	–	–	210,612	210,612
	₱1,261,044,418	₱387,162,287	₱904,291,740	₱2,552,498,445

The table below shows the aging analysis of past due but not impaired financial assets of the Bank, which are all loans and receivables, per class that the Bank held as at December 31, 2017.

	December 31, 2017			
	Less than 30 days	31 - 60 days	Over 60 days	Total
Agricultural	₱–	₱3,720,264	₱3,435,526	₱7,155,790
Consumption		605,328,329	492,295,747	1,097,624,076
Real estate	–	200,579	–	200,579
	₱–	₱609,249,172	₱495,731,273	₱1,104,980,445

As at December 31, 2018 and 2017, there were no restructured loans included in the past due or individually impaired receivables of the Bank.

Past due but not impaired loans and receivables
Loans and receivables are considered past due but not impaired if contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of collateral available and/or status of collection of amounts owed to the Bank.

Liquidity Risk
Liquidity risk is the risk to earnings or capital arising from the Bank's inability to make timely payment on its financial obligations to customers and repay deposits on maturity. The Bank's objective is to strike a balance between liquidity and profitability in managing this type of risk. The

Bank closely monitors the current and prospective maturity structure of its resources and liabilities and the market condition to guide pricing and asset/liability allocation strategies to manage its liquidity risks. In addition, the Bank manages liquidity risk by holding sufficient liquid assets of appropriate quality to ensure short-term funding requirements are met and by maintaining a balanced loan portfolio. It seeks to maintain sufficient liquidity to take advantage of interest rate opportunities when they arise.

Liquidity is monitored by the Bank on a daily basis. The table below shows the maturity profile of the Bank's financial assets and liabilities, based on the contractual undiscounted cash flows as at December 31, 2018 and 2017:

		December 31, 2018				
	On Demand	**Up to 1 Month**	**Over 1 to 3 Months**	**Over 3 to 12 Months**	**Beyond 1 Year**	**Total**
Financial Assets						
Cash and other cash items	**₱408,712,128**	**₱–**	**₱–**	**₱–**	**₱–**	**₱408,712,128**
Due from BSP	**3,034,359,867**	**–**	**–**	**–**	**–**	**3,034,359,867**
Due from other banks	**2,868,575,206**	**–**	**–**	**–**	**–**	**2,868,575,206**
Securities Purchased under						
Resale Agreement*	**8,887,859,653**	**–**	**–**	**–**	**–**	**8,887,859,653**
Loans and Receivables						
Loans*	**607,531,955**	**83,589**	**259,096,700**	**3,267,535,588**	**55,076,655,753**	**59,210,903,585**
Unquoted debt securities*	**331,104**	**946,675**	**192,152,440**	**168,525,145**	**15,810,555**	**377,765,919**
Accounts Receivable	**–**	**2,004,909,765**	**–**	**–**	**146,170,404**	**2,151,080,169**
Accrued Interest Receivable	**–**	**631,474,717**	**–**	**–**	**–**	**631,474,717**
Other assets	**–**	**–**	**–**	**–**	**41,446,788**	**41,446,788**
	₱15,807,369,913	**₱2,637,414,746**	**₱451,249,140**	**₱3,436,060,733**	**₱55,280,083,500**	**₱77,612,178,032**
Financial Liabilities						
Deposit liabilities						
Time*	**₱45,878,439**	**₱18,690,450,880**	**₱3,330,995,114**	**₱3,865,967,435**	**₱9,381,432,093**	**₱35,314,723,961**
Savings	**2,196,811,493**	**–**	**–**	**–**	**–**	**2,196,811,493**
Demand	**92,655,262**	**–**	**–**	**–**	**–**	**92,655,262**
Bills payable*	**–**	**8,539,004,208**	**951,135,735**	**13,780,487,923**	**79,177,192**	**23,349,805,058**
Accounts payable and accrued expenses**	**230,381,176**	**614,526,389**	**–**	**–**	**–**	**844,907,565**
Other liabilities**	**–**	**5,600,340**	**–**	**300,000,000**	**–**	**305,600,340**
	₱2,565,726,370	**₱27,849,581,817**	**₱4,282,130,849**	**₱17,946,455,358**	**₱9,460,609,285**	**₱62,104,503,679**

**Includes future interest*
***Excludes statutory liability*

		December 31, 2017				
	On Demand	Up to 1 Month	Over 1 to 3 Months	Over 3 to 12 Months	Beyond 1 Year	Total
Financial Assets						
Cash and other cash items	₱383,208,812	₱–	₱–	₱–	₱–	₱383,208,812
Due from BSP	5,907,098,253	–	–	–	–	5,907,098,253
Due from other banks	1,351,812,028	–	–	–	–	1,351,812,028
Securities Purchased under						
Resale Agreement*	9,445,942,528	–	–	–	–	9,445,942,528
Loans and Receivables						-
Loans*	5,159,802,518	244,892,365	691,796,005	5,468,391,661	49,875,506,636	61,440,389,185
Unquoted debt securities*	–	138,425	193,562,642	166,919,832	49,818,194	410,439,093
Accounts Receivable	–	1,895,734,451	–	–	100,871,895	1,996,606,346
Accrued Interest Receivable	–	519,573,549	–	–	–	519,573,549
Other assets	–	–	–	–	30,753,052	30,753,052
	₱22,247,864,139	₱2,660,338,790	₱885,358,647	₱5,635,311,493	₱50,056,949,777	₱81,485,822,846
Financial Liabilities						
Deposit liabilities						
Time*	41,315,439	29,565,156,861	6,815,612,344	2,168,792,904	9,059,119,684	47,649,997,232
Savings	1,882,998,087	–	–	–	–	1,882,998,087
Demand	110,507,762	–	–	–	–	110,507,762
Bills payable*	–	3,909,597,500	–	8,401,614,164	2,100,635,274	14,411,846,938
Accounts payable and accrued expenses**	140,187,835	676,147,512	–	–	–	816,335,347
Other liabilities**	–	10,361,111	–	–	–	10,361,111
	₱2,175,009,123	₱34,161,262,984	₱6,815,612,344	₱10,570,407,068	₱11,159,754,958	₱64,882,046,477

**Includes future interest*
***Excludes statutory liability*

5. Fair Value Measurement and Categories of Financial Assets and Liabilities

The methods and assumptions used by the Bank in estimating the fair value of the financial instruments are:

Cash and other cash items, due from BSP and other banks, and SPURA
The carrying amounts approximate fair values due to the short-term nature of these accounts.

Loans and receivables
Fair values of loans and receivables are estimated using the discounted cash flow methodology, using the Bank's current incremental lending rates for similar types of loans and receivables.

Security deposits
The fair value of refundable deposits was computed using the discounted cash flow methodology, using the prevailing market rate of interest for a similar instrument.

Investment Properties
The fair value of the condominium units classified under Investment Properties (see Note 13) is determined by an independent external appraiser using the sales comparison approach. This is a comparative approach that considers the sales of similar or substitute properties and related market data and economic conditions prevailing at the time of valuations were made and establishes a value estimate by processes involving comparison. Listings and offerings may also be considered.

Liabilities
The fair values of liabilities approximate their carrying amounts due to either the demand nature or the relatively short term maturities of these liabilities except for time deposit liabilities and bills payable whose Level 3 fair values are estimated using the discounted cash flow methodology using the Bank's incremental borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued.

The following table sets forth the carrying values and estimated fair values as at December 31:

	2018				
	Carrying value	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets					
Loans and receivables	**₱50,956,158,325**	**₱–**	**₱–**	**₱45,986,837,225**	**₱45,986,837,225**
Security deposits (included as part of 'Prepayments and Other Resources')	**41,107,971**	**–**	**–**	**37,929,649**	**37,929,649**
	₱50,997,266,296	**₱–**	**₱–**	**₱46,024,766,874**	**₱46,024,766,874**
Financial liabilities					
Deposit liabilities					
Time	**₱34,340,970,795**	**₱–**	**₱–**	**₱33,404,173,669**	**₱33,404,173,669**
Bills payable	**22,651,257,850**	**–**	**–**	**22,648,472,416**	**22,648,472,416**
	₱56,992,228,645	**₱–**	**₱–**	**₱56,052,646,085**	**₱56,052,646,085**

	2017				
	Carrying value	Level 1	Level 2	Level 3	Total
Financial assets					
At Amortized cost					
Loans and receivables	₱58,395,036,822	₱–	₱–	₱68,692,929,053	₱68,692,929,053
Security deposits (included as part of 'Prepayments and Other Resources')	30,407,019	–	–	30,542,440	30,542,440
	₱58,425,443,841	₱–	₱–	₱68,723,471,493	₱68,723,471,493
Financial liabilities					
Deposit liabilities					
Time	₱46,326,147,580	₱–	₱–	₱46,273,731,263	₱46,273,731,263
Bills payable	14,060,606,082	–	–	14,108,262,948	14,108,262,948
	₱60,386,753,662	₱–	₱–	₱60,381,994,211	₱60,381,994,211

The tables below summarizes the fair value hierarchy of the Bank's nonfinancial assets which are not measured at fair value in the statement of financial position but for which fair value is disclosed:

	2018				
	Carrying value	**Level 1**	**Level 2**	**Level 3**	**Total**
Nonfinancial assets					
Investment properties					
Condominium units	**₱1,577,055**	**₱–**	**₱–**	**₱48,315,538**	**₱48,315,538**

	2017				
	Carrying value	Level 1	Level 2	Level 3	Total
Nonfinancial assets					
Investment properties					
Condominium units	₱2,759,883	₱–	₱–	₱49,638,784	₱49,638,784

In 2018 and 2017, there were no transfers made among each of these levels in the fair value hierarchy.

6. Cash and Other Cash Items

Cash and other cash items consist of the following items:

	2018	2017
Cash in vault	**₱311,817,185**	₱329,559,433
Checks and other cash items	**37,801,143**	10,544,279
Cash in automated teller machines (ATM)	**59,093,800**	43,105,100
	₱408,712,128	₱383,208,812

Cash consists primarily of funds in the form of Philippine currency notes and coins in the Bank's vault and those in the possession of tellers, including ATM.

Other cash items include checks drawn on other banks or other branches after the Bank's clearing cut-off time until the close of the regular banking hours.

7. Due from Bangko Sentral Ng Pilipinas

This account is composed of the following:

	2018	2017
Mandatory reserves	**₱3,034,359,867**	₱4,107,127,031
Non-mandatory reserves	**–**	1,799,971,222
	₱3,034,359,867	₱5,907,098,253

Due from BSP represents the aggregate balance of noninterest-bearing peso deposit account which the Bank maintains primarily to meet reserve requirements and to serve as a clearing account for interbank claims and the aggregate amount of placements made under the overnight and term deposit facility with BSP.

Under Section 254 of the Manual of Regulations for Banks (MORB), a bank shall keep its required reserves in the form of deposits placed in the bank's demand deposit account with the BSP. Section 254.1 of the MORB further provides that such deposit account with the BSP is not considered as a regular current account as drawings against such deposits shall be limited to: (a) settlement of obligation with the BSP, and (b) withdrawals to meet cash requirements.

Due from BSP held that are non-mandatory reserves earn annual interest that ranges from 2.50% to 4.75% in 2018 and from 2.50% to 3.00% in 2017, respectively. The total interest income earned from these amounted to ₱26.67 million and ₱14.15 million in 2018 and 2017, respectively, and is presented as part of 'Interest income on deposits with banks and others' in the statements of income.

8. Due from Other Banks

This account consists of the following:

	2018	2017
Savings and demand deposits	**₱1,241,291,310**	₱1,343,469,911
Time deposits	**1,627,283,896**	8,342,117
Less: Allowance for impairment (Note 16)	**(5,329,200)**	–
	₱2,863,246,006	₱1,351,812,028

Savings and demand deposits generally earn interest based on daily bank deposit rates. Time deposits, having maturities of up to three months, earn interest rates of 1.26% to 7.10% in 2018 and 1.26% to 4.72% in 2017. Interest income on deposits with other banks amounted to ₱26.90 million and ₱11.70 million in 2018 and 2017, respectively, and is shown as part of 'Interest income on deposits with banks and others' in the statements of income.

In 2018, the Bank recognized provision for allowance amounting to ₱3.47 million (see Note 16).

9. Securities Purchased Under Resale Agreements

Securities purchased under resale agreements (SPURA) pertain to overnight placements with the BSP, where the underlying securities cannot be sold or repledged. SPURA yielded 2.50% to 4.75% annual interest in 2018 and 2017.

In 2018 and 2017, interest income from SPURA amounted to ₱268.96 million and ₱148.82 million, respectively, and is shown as part of 'Interest income on deposits with banks and others' in the statements of income.

10. **Loans and Receivables**

This account consists of:

	December 31		January 1
	2018	2017 (As restated - Note 2)	2017 (As restated - Note 2)
Loans	**₱49,987,364,832**	₱58,248,633,839	₱58,461,581,376
Unearned service fee and unearned interest and discount (UID)	**(1,355,312,847)**	(1,636,827,431)	(1,813,338,946)
	48,632,051,985	56,611,806,408	56,648,242,430
Accounts receivable	**2,151,080,169**	1,996,606,346	1,869,871,557
Unquoted debt securities, net of UID amounting to ₱770,609	**376,972,586**	405,205,749	459,421,695
Accrued interest receivable	**631,474,717**	519,573,549	93,905,529
	51,791,579,457	59,533,192,052	59,071,441,211
Allowance for impairment (Note 16)	**(835,421,132)**	(1,138,155,230)	(1,346,763,457)
	₱50,956,158,325	₱58,395,036,822	₱57,724,677,754

Loans and receivables bear fixed interest rate charges ranging from 7.50% to 15.00% as of December 31, 2018 and 2017, respectively.

Certain loans as at December 31, 2018 and December 31, 2017 amounting to ₱2.35 billion and ₱3.52 billion, respectively, are pledged as collaterals to secure the Bank's bills payable (see Note 18).

Accounts receivable include ₱1.94 billion and ₱1.83 billion accrued remittances from DepEd as at December 31, 2018 and 2017, respectively, representing the payment collected by DepEd on behalf of the Bank which is normally remitted to the Bank within one month. Account receivables also includes amount due from Land Bank of the Philippines (LBP) pertaining to redemption of matured unquoted debt securities amounting to ₱164.10 million and ₱143.38 million as of December 31, 2018 and 2017.

Unquoted debt securities consist of LBP agrarian reform bonds and investments in Small Business Corporation (SB) in a form of Micro, Small and Medium Enterprise (MSME) notes, as part of the reserve requirements and in compliance with Presidential Decree (PD) No. 717, Agri Agra Law, with Section 15 of Republic Act (RA) No. 9501, Magna Carta for MSMEs, and BSP Circular No. 625.

Details are as follows:

	2018	2017
LBP - Agrarian reform bonds	**₱29,731,511**	₱58,929,929
SB - MSME notes	**348,011,684**	348,011,684
	377,743,195	406,941,613
UID	**(770,609)**	(1,735,864)
	₱376,972,586	₱405,205,749

The agrarian reform bonds are redeemable in a monthly installment from the dates these were issued and bear interest based on an average 91-day treasury bill rates. MSME notes bear interest at rates ranging from 1.50% to 2.39% and from 1.49% to 2.03% per annum in 2018 and 2017, respectively, and have maturities of 182 to 364 days.

Interest income earned on loans and receivables are as follows:

	2018	2017 (As restated - Note 2)
Interest income on:		
Loans	**₱7,275,683,235**	₱8,954,744,624
Accounts receivable	**51,757,770**	–
Unquoted debt securities	**7,810,046**	5,984,959
	₱7,335,251,051	₱8,960,729,583

In 2018, interest income on accounts receivable pertains to interest income earned on deposits on an escrow account related to the acquisition of PR Savings Bank. The amount was released on the closing date of the transaction.

Movements in allowance for credit losses on loans and receivables follow:

	2018	2017
Balance at beginning of period	**₱1,138,155,230**	₱1,346,763,457
Effect of adoption of PFRS 9 (Note 2)	**532,272,038**	–
Balance at January 1, 2018, as restated	**1,670,427,268**	₱1,346,763,457
Provision (reversal) for credit and impairment losses	**63,453,447**	(382,209)
Write off	**(898,459,583)**	(208,226,018)
Balance at end of period	**₱835,421,132**	₱1,138,155,230

BSP Reporting

The breakdown of loans by collateral as to secured, with corresponding collateral types, and unsecured loans (gross of unearned interest and discounts) follows:

	2018	2017
Secured:		
Real estate mortgage	**₱9,488,942**	₱11,586,778
Deposit hold-out	**18,100**	94,085
	9,507,042	11,680,863
Unsecured	**49,977,857,790**	58,236,952,976
	₱49,987,364,832	₱58,248,633,839

The breakdown of loans as to status follows:

	2018	2017
Performing loans - Current	**₱47,861,926,676**	₱55,691,620,511
Non-performing loans (NPLs):		
Past-due	**2,125,221,140**	2,556,796,312
Items in litigation	**217,016**	217,016
	2,125,438,156	2,557,013,328
	₱49,987,364,832	₱58,248,633,839

Non-performing loans (NPLs) of the Bank as of December 31, 2018 and 2017 as reported to the BSP are presented below, net of specific allowance for impairment in compliance with BSP Circular 855, respectively.

	2018	2017
Gross NPLs	**₱2,125,438,156**	₱2,557,013,328
Less: Specific reserves for credit losses on NPLs	**780,641,016**	620,547,757
	₱1,344,797,140	₱1,936,465,571

Under BSP Circular No. 941, loans and receivables shall be considered non-performing, even without any missed contractual payments, when it is considered impaired under existing accounting standards, classified as doubtful or loss, in litigation, and/or there is evidence that full repayment of principal and interest is unlikely without foreclosure of collateral, if any. All other loans, even if not considered impaired, shall be considered non-performing if any principal and/or interest are unpaid for more than 90 days from contractual due date, or accrued interests for more than 90 days have been capitalized, refinanced, or delayed by agreement.

Microfinance and other small loans with similar credit characteristics shall be considered non-performing after contractual due date or after it has become past due. Restructured loans shall be considered non-performing. However, if prior to restructuring, the loans were categorized as performing, such classification shall be retained.

Non-performing loans, investment, receivables, or any financial asset (and/or any replacement loan) shall remain classified as such until (a) there is a sufficient evidence to support that full collection of principal and interests is probable and payments of interest and/or principal are received for at least six (6) months; or (b) written-off.

Information on the concentration of credit as to industry on loans follows (gross of unearned service fee and unearned discounts and allowance for impairment):

	2018		2017	
	Amount	**Percentage**	Amount	Percentage
Financial and insurance activities	**₱601,866,700**	**1.13%**	₱559,342,190	0.92%
Agricultural, forestry and fishing	**268,584,190**	**0.51%**	679,659,174	1.11%
Activities of households as employers and undifferentiated goods and services	**55,016,822**	**0.10%**	39,803,052	0.07%
Real estate activities	**692,158**	**0.00%**	5,481,946	0.01%
Other service activities	**699,833**	**0.00%**	3,428,804	0.01%
Other community, social and personal activities	**52,220,032,601**	**98.26%**	59,882,304,317	97.89%
	₱53,146,892,304	**100.00%**	₱61,170,019,483	100.00%

The BSP considers that concentration of credit exists when total loan exposure to a particular industry or economic sector exceeds 30.00% of total loan portfolio (see Note 4).

11. **Investments in Associates and Subsidiary**

The movements in the investments in associates and subsidiary accounted for under the equity method are as follow:

	% Interest Held	**2018**	2017
Acquisition costs			
PR Savings Bank (Subsidiary)	100.00%	**₱7,016,000,990**	₱–
PETNET (Associate)	40.00%	**941,176,956**	–
FAIR Bank (Associate)	49.00%	**61,445,510**	56,349,510
CSBLI (Associate)	40.00%	**2,000,000**	2,000,000
		8,020,623,456	58,349,510
Equity share in net earnings			
Balance at beginning of period		**40,037,494**	325,795
Gain on bargain purchase		**–**	41,290,645
Share in net income (loss) for the year			
PR Savings Bank		**(37,967,801)**	–
FAIR Bank		**(23,294,642)**	(1,720,659)
CSBLI		**(17,029)**	141,713
		(21,241,978)	40,037,494
Balances at end of year			
PR Savings Bank		**6,978,033,189**	–
PETNET		**941,176,956**	–
FAIR Bank		**77,720,854**	95,919,496
CSBLI		**2,450,479**	2,467,508
		₱7,999,381,478	₱98,387,004

The principal place of business of the Bank's associates and subsidiary are as follows:

a) PR Savings Bank - Cauayan City, Isabela
b) PETNET - Makati, Metro Manila
c) FAIR Bank - Garian, Bogo City, Cebu
d) CSBLI - Osmena Boulevard, Cebu City

Acquisition of PR Savings Bank
On December 29, 2017, the Bank and the registered holders and beneficial owners of Philippine Resources Savings Banking Corp. (PR Savings Bank) from the Ropali Group signed a SPA, whereby the former shall acquire 127.72 million common stock of PR Savings Bank with par value of P10 per share or a total par value of ₱1,277.23 million. The shares represents 66.28% of the total outstanding capital stock of PR Savings Bank.

As part of the conditions precedent to the obligation of the Bank to purchase the common stock, the Bank and International Finance Corporation (IFC) entered into a Share Purchase Agreement ("Agreement") on February 23, 2018, whereby the former shall acquire the 65.00 million preferred shares of PR Savings Bank owned by IFC, with par value of ₱10.00 per share or a total par value of ₱650.00 million. The shares represents 33.72% of the total issued and outstanding capital stock.

On April 5, 2018, the PCC approved the acquisition of PR Savings Bank by the Bank. The acquisition was also approved by the MB of the BSP under MB Resolution No. 1003 dated June 14, 2018. For convenience purposes, the Bank used June 30, 2018 as the date of the business combination.

On July 5, 2018 and July 10, 2018, the BOD and the stockholders, respectively, approved the plan of merger with PR Savings Bank, with the Bank as the surviving entity. Subsequently on December 20, 2018, the MB of the BSP approved the merger subject to certain conditions, including completion of the merger within one year from the date of receipt of the BSP approval and that the merger should be effective on the date the SEC issues the certificate of merger. The BSP granted certain merger incentives, including temporary relief from compliance with the minimum CAR of 10% on solo basis for both the Bank and PRSB from June 2018 until the effectivity of the merger, provided that the Bank's CAR shall not fall below 7%; ten-year amortization of goodwill from July 2018 to June 2028, and staggered booking over a period of 5 years, to start on the year the merger becomes effective, of the resulting capital adjustments on PR Savings Bank based on BSP's examination as of June 30, 2018.

The total consideration for the acquisition of PR Savings Bank amounted to ₱7.02 billion, ₱300.00 million of which shall be released by the Bank directly to the Joint Venture (JV) Company, which is recorded in 'Other payables' under 'Other Liabilities' as at December 31, 2018. As part of the other undertakings relevant to the SPA, the sellers shall cause the relevant Ropali Group entity to execute a joint venture agreement with the Bank to form an incorporated JV Company within one year from closing date or such longer period as the parties may agree upon in writing. The JV Company shall engage in motorcycle dealership. The parties agree that the remaining balance of ₱300.00 million shall be utilized exclusively to fund the capital subscription of the relevant Ropali Group entity in the JV Company.

In 2018, PR Savings Bank reported a total operating income and net loss of ₱844.98 million and ₱42.11 million, respectively. As of December 31, 2018, share in net loss of the Bank related to its investment with PR Savings Bank amounted to ₱21.21 million. Had the acquisition occurred at the beginning of 2018, the share in net loss would have been increased by ₱20.89 million.

Acquisition of PETNET, Inc.
In February 2018, the Bank and Union Properties, Inc. (UPI) signed an SPA with AEVI for the purchase of common shares representing the 51% ownership of AEVI on PETNET, Inc. On May 8, 2018, PCC approved the acquisition of PETNET, Inc. by the Bank. The acquisition was also approved by the BSP on November 23, 2018. The acquisition date, which is the settlement of purchase price, is on December 17, 2018. For convenience purposes, the Bank used December 31, 2018 as the date of the business combination.

In 2018, PETNET reported a total operating income and net loss of ₱303.28 million and ₱32.60 million, respectively. As of December 31, 2018, no share in net loss was recognized related to its investment with PETNET. Had the acquisition occurred at the beginning of 2018, the share in net loss would have increased by ₱13.04 million.

Acquisition of FAIR Bank
In 2017, the Bank recognized gain on bargain purchase amounting to ₱41.29 million upon its acquisition of FAIR Bank which is equivalent to the difference between the consideration paid amounting to ₱56.35 million and the recognized amounts of the identifiable assets acquired and liabilities assumed at the acquisition date amounting to ₱97.64 million.

Acquisition of Progressive Rural Bank, Inc. (PBI)
On January 5, 2018, the Bank, together with UPI and the majority shareholders of PBI, entered into an SPA for the acquisition and subscription of shares of stock in PBI, subject to approval from the BSP. The down payment of ₱15.00 million made in 2017, as acknowledged in the SPA, is recorded under 'Prepayments and Other Resources' account in the 2017 statement of financial position (see Note 15). In 2018, the Bank made additional payments of ₱16.29 million.

The acquisition involves the purchase of 11,980,916 issued and outstanding common shares of stock in PBI. The shares to be sold represent 55% interest of the existing shareholders in PBI, with the Bank and UPI having 49% and 6% ownership interests, respectively. Subsequently, the controlling interest in PBI will be increased to 75% by way of capital infusion through the subscription of 18,000,000 common shares, of which the Bank shall own as much shares to retain its 49% interest after the issuance.

As of December 31, 2018, the acquisition has not been approved yet by the BSP. Accordingly, the total payments made amounting to ₱31.29 million is presented under ‘Prepayments and Other Resources’.

The following table presents the financial information for PR Savings Bank, PETNET, FAIR Bank and CSBLI as of and for the years ended December 31, 2018 and 2017:

	Assets	Liabilities	Revenues	Net Income (Loss)
2018				
PR Savings Bank	**₱10,060,718,902**	**₱7,604,545,520**	**₱1,547,408,948**	**(₱58,861,384)**
PETNET	**1,305,102,173**	**300,988,931**	**644,566,082**	**(32,597,161)**
FAIR Bank	**372,712,787**	**303,110,232**	**47,105,388**	**(29,132,657)**
CSBLI	**7,012,154**	**416,443**	**168,159**	**(42,572)**
2017				
FAIR Bank	₱381,959,685	₱274,370,097	₱62,025,123	₱1,762,079
CSBLI	7,054,678	416,395	476,244	215,367

Acquisition of Bangko Kabayan, Inc. (BKI)
Subsequent to reporting date, in February 2019, the Bank, together with UPI and the shareholders of BKI, entered into an SPA for the acquisition of shares of stock in BKI, subject to the approval of BSP. The Bank and UPI shall acquire 1.80 million and 0.772 million common shares equivalent to 49.00% and 21.00% of the total outstanding shares of BKI, respectively.

BKI operates as a rural bank that serves micro, small, and medium enterprises (MSMEs) and individuals in the Philippines. It offers microfinance, deposit products, loans, OFW housing loans, remittance, and mobile banking services. BKI was founded in 1957 and is based in Ibaan, Batangas.

12. Premises, Furniture, Fixtures and Equipment

The composition of and movements in this account follow:

	2018					
	Land	Building	Building Improvements	Leasehold Improvements	Furniture, Fixtures and Equipment	Total
Cost						
Balances at beginning of year	**₱5,442,688**	**₱91,077,148**	**₱23,639,182**	**₱412,487,688**	**₱ 584,523,314**	**₱1,117,170,020**
Additions	**–**	**–**	**1,223,948**	**40,667,738**	**77,596,371**	**119,488,057**
Disposals	**–**	**–**	**–**	**–**	**(4,858,675)**	**(4,858,675)**
Balances at end of year	**5,442,688**	**91,077,148**	**24,863,130**	**453,155,426**	**657,261,010**	**1,231,799,402**
Accumulated Depreciation and Amortization						
Balances at beginning of year	**–**	**78,664,523**	**(13,021,821**	**286,004,916**	**506,532,120**	**884,223,380**
Depreciation and amortization	**–**	**4,850,621**	**4,651,825**	**61,585,655**	**56,644,728**	**127,732,829**
Disposals	**–**	**–**	**–**	**–**	**(3,864,086)**	**(3,864,086)**
Balances at end of year	**–**	**83,515,144**	**17,673,646**	**347,590,571**	**559,312,762**	**1,008,092,123**
Net Book Values	**₱5,442,688**	**₱7,562,004**	**₱7,189,484**	**₱105,564,855**	**₱97,948,248**	**₱223,707,279**

	2017					
	Land	Building	Building Improvements	Leasehold Improvements	Furniture, Fixtures and Equipment	Total
Cost						
Balances at beginning of year	₱5,442,688	₱91,062,148	₱23,164,861	₱402,710,577	₱552,418,961	₱1,074,799,235
Additions	–	15,000	484,235	9,918,354	35,827,715	46,245,304
Disposals	–	–	–	–	(5,620,076)	(5,620,076)
Reclassifications	–	–	(9,914)	(141,243)	1,896,714	1,745,557
Balances at end of year	5,442,688	91,077,148	23,639,182	412,487,688	584,523,314	1,117,170,020
Accumulated Depreciation and Amortization						
Balances at beginning of year	–	73,815,401	8,652,802	211,158,261	428,382,279	722,008,743
Depreciation and amortization	–	4,849,122	4,369,019	74,846,655	78,149,841	162,214,637
Disposals	–	–	–	–	–	–
Balances at end of year	–	78,664,523	13,021,821	286,004,916	506,532,120	884,223,380
Net Book Values	₱5,442,688	₱12,412,625	₱10,617,361	₱126,482,772	₱77,991,194	₱232,946,640

Under BSP rules, investments in bank premises, furniture, fixtures and equipment should not exceed 50% of the Bank's unimpaired capital. As at December 2018 and 2017, the Bank has satisfactorily complied with this requirement.

The Bank recognized gain from disposal of premises, furniture, fixtures and equipment amounting to ₱0.12 million and ₱3.85 million in 2018 and 2017, respectively, and is presented as part of 'Other Income' in the statements of income (see Note 23).

As at December 31, 2018 and December 31, 2017, the cost of fully depreciated assets still in use amounted to ₱427.29 million and ₱396.18 million, respectively.

13. **Investment Properties**

The components and movements in this account follow:

	2018	2017
Cost		
Balances at beginning of year	**₱21,917,813**	₱21,917,813
Accumulated amortization		
Balances at beginning of year	**19,157,930**	17,975,102
Depreciation	**1,182,828**	1,182,828
Balances at end of year	**20,340,758**	19,157,930
Net book values	**₱1,577,055**	₱2,759,883

This account represents condominium units acquired by the Bank that are held to earn rentals. Rental income from investment properties amounted to ₱2.01 million and ₱1.92 million in 2018 and 2017, respectively, and is presented as part of 'Other Income' in the statements of income (see Note 23).

Direct operating expenses arising from the investment properties, pertaining to common area maintenance fee, which were booked as part of 'Membership fees and dues' under 'Operating Expenses' in the statements of income, amounted to ₱3.70 million for both years. It also includes real estate tax amounting to ₱0.09 million for 2018 and 2017.

14. **Intangible Assets**

The components and movements in this account are as follows:

	2018		
	Software	**Branch Licenses**	**Total**
Cost			
Balances at beginning of year	**₱220,236,231**	**₱58,500,000**	**₱278,736,231**
Additions	**114,925,974**	**–**	**114,925,974**
Balances at end of year	**335,162,205**	**58,500,000**	**393,662,205**
Accumulated Amortization			
Balances at beginning of year	**195,020,339**	**–**	**195,020,339**
Amortization	**49,293,747**	**–**	**49,293,747**
Balances at end of year	**244,314,086**	**–**	**244,314,086**
Net Book Values	**₱90,848,119**	**₱58,500,000**	**₱149,348,119**

	2017		
	Software	Branch Licenses	Total
Cost			
Balances at beginning of year	₱204,755,724	₱58,500,000	₱263,255,724
Additions	15,480,507	–	15,480,507
Balances at end of year	220,236,231	58,500,000	278,736,231
Accumulated Amortization			
Balances at beginning of year	164,100,869	–	164,100,869
Amortization	30,919,470	–	30,919,470
Balances at end of year	195,020,339	–	195,020,339
Net Book Values	₱25,215,892	₱58,500,000	₱83,715,892

15. **Prepayments and Other Resources**

This account consists of:

	2018	2017
Unused documentary stamps	**₱147,229,640**	₱98,548,748
Prepaid expenses	**48,086,752**	26,568,844
Security deposits	**41,107,971**	30,407,019
Advance payment for investment (Note 11)	**31,288,090**	15,000,000
Unused stationery and supplies	**2,001,504**	1,331,058
Other investments	**338,817**	346,033
Assets held for sale	**68,050**	68,050
Unused postage stamps	**17,081**	19,206
Others	**299**	454,220
	270,138,204	172,743,178
Allowance for impairment (Note 16)	**(278,662)**	(278,662)
	₱269,859,542	₱172,464,516

Prepaid expenses include prepaid life and health insurance, rental, gross receipts tax, and others.

The advance payment for investment in 2018 and 2017 pertains to the down payment made by the Bank as indicated in the Share Purchase Agreement in relation to the acquisition and subscription of shares of stocks of Progressive Bank, Inc. (see Note 11).

16. **Allowance for Impairment**

Movements in the allowance for impairment are as follow:

	2018	2017
Balances at beginning of year:		
Loans and receivables	**₱1,138,155,230**	₱1,346,763,457
Other resources	**278,662**	278,662
	1,138,433,892	1,347,042,119
Effect of adoption of PFRS 9 (Note 2)		
Loans and receivables	**532,272,038**	–
Due from other banks	**1,862,016**	–
Balances at January 1, 2018, as restated	**1,672,567,946**	1,347,042,119
Movements during the year:		
Provision for (reversal of) allowance		
Loans and receivables	**63,453,447**	(382,209)
Due from other banks	**3,467,184**	–
Accounts written-off	**(898,459,583)**	(208,226,018)
	(831,538,952)	(208,608,227)
Balances at end of year:		
Loans and receivables (Note 10)	**835,421,132**	1,138,155,230
Due from other banks (Note 8)	**5,329,200**	–
Other resources (Note 15)	**278,662**	278,662
	₱841,028,994	₱1,138,433,892

An analysis of changes in the gross carrying amount and the corresponding ECL allowances in relation to loans (outstanding balances before unearned service fee and unearned interest and discounts, including accrued interest receivables) is as follows:

	December 31, 2018			
	Stage 1	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount as at January 1	**₱55,687,135,422**	**₱714,614,156**	**₱2,366,457,810**	**₱58,768,207,388**
Newly originated assets that remained in Stage 1 as at December 31	**33,676,706,442**	–	–	**33,676,706,442**
Newly originated assets that moved to Stage 2 and Stage 3 as at December 31	–	**30,147,237**	**10,305,386**	**40,452,623**
Movements in loans balance (excluding write-offs)	**(39,983,872,564)**	**(458,192,251)**	**(526,002,506)**	**(40,968,067,321)**
Transfers to Stage 1	**262,938,510**	**(62,106,643)**	**(200,831,867)**	–
Transfers to Stage 2	**(274,577,131)**	**276,774,287**	**(2,197,156)**	–
Transfers to Stage 3	**(907,735,534)**	**(236,872,222)**	**1,144,607,756**	–
Amounts written-off	–	–	**(898,459,583)**	**(898,459,583)**
Gross carrying amount as at December 31	**₱48,460,595,145**	**₱264,364,564**	**₱1,893,879,840**	**₱50,618,839,549**

	December 31, 2018			
	Stage 1	Stage 2	Stage 3	Total
ECL allowance as at January1	**₱426,787,709**	**₱5,625,818**	**₱1,238,013,741**	**₱1,670,427,268**
Newly originated assets that remained in Stage 1 as at December 31	**162,589,720**	**–**	**–**	**162,589,720**
Newly originated assets that moved to Stage 2 and Stage 3 as at December 31	**–**	**2,166,818**	**4,565,730**	**6,732,548**
Effect of collections and other movements in loans (excluding write-offs)	**(111,711,635)**	**(1,648,885)**	**(74,721,693)**	**(188,082,213)**
Transfers to Stage 1	**94,274,592**	**(2,730,839)**	**(91,543,753)**	**–**
Transfers to Stage 2	**(2,601,780)**	**2,897,371**	**(295,591)**	**–**
Transfers to Stage 3	**(21,800,607)**	**(957,163)**	**22,757,770**	**–**
Impact on ECL of exposures transferred between stages and change in model	**(131,507,842)**	**10,894,445**	**202,826,789**	**82,213,392**
Amounts written-off	**–**	**–**	**(898,459,583)**	**(898,459,583)**
ECL allowance as at December 31	**₱416,030,157**	**₱16,247,565**	**₱403,143,410**	**₱835,421,132**

With the foregoing level of allowance for impairment and credit losses, management believes that the Bank has sufficient allowance for any losses that the Bank may incur from the non-collection or nonrealization of its receivables and other risk assets.

17. Deposit Liabilities

The components of deposit liabilities follow:

	2018	2017
Time	**₱34,340,970,795**	₱46,326,147,580
Savings	**2,196,811,493**	1,882,998,087
Demand	**92,655,262**	110,507,762
	₱36,630,437,550	₱48,319,653,429

Deposit liabilities bear annual fixed interest rates ranging from nil to 7.00% and from nil to 3.00% in 2018 and 2017, respectively. Interest expense on deposit liabilities recognized in 2018 and 2017 amounted to ₱1.71 billion and ₱1.42 billion, respectively.

Under existing BSP regulations, thrift banks are subject to statutory and liquidity reserves equivalent to 8.00% (BSP Circular 832 series of 2014). As at December 31, 2018 and December 31, 2017, the Bank is in compliance with the said regulation. Liquidity and statutory reserves included as part of Due from BSP amounting to ₱3.03 billion and ₱4.11 billion as at December 31, 2018 and December 31, 2017, respectively (see Note 7).

18. Bills Payable

This account consists of borrowings from local banks and other financial institutions including related parties (see Note 27) amounting to ₱22.65 billion and ₱14.06 billion as of December 31, 2018 and December 31, 2017, respectively.

Bills payable bear annual interest rates ranging from 2.80% to 6.85% and from 2.80% to 6.00% in 2018 and 2017, respectively.

In 2012, the Bank issued a ₱3.00 billion fixed-rate Note Facility and Security Agreement divided into three tranches and is broken down as follows:

Tranche	Date of Issue	Maturity Period	Face Amount
Tranche 1	March 29, 2012	7 years	₱1,000,000,000
Tranche 2	Apri1 19, 2012	7 years	1,000,000,000
Tranche 3	September 27, 2012	5 years	1,000,000,000
			₱3,000,000,000

The loans related to the Note Facility and Security Agreement above are subject to annual interest rate of 5.25%. These are secured by the assignment of loans receivables related to the Bank's teacher-borrowers with a book value of ₱2.35 billion and ₱3.52 billion as of December 31, 2018 and 2017, respectively (see Note 10). The loans are payable annually at equal payments of 1.00% of the face amount and the balance to be fully paid in 2019 for Tranches 1 and 2. In September 2017, Tranche 3 was fully paid.

On May 12, 2011, the Bank issued a ₱1.20 billion 7-year fixed rate Note Facility and Security Agreement. Fixed interest rate is determined through the benchmark rate plus a margin of 1.10% with a floor of 7.00%. The annual interest rate of the loan is reduced from 7.27% to 4.75% in 2014. The loans are payable annually at ₱0.50 million and the remaining balance was fully paid in 2018.

Interest expense on bills payable recognized in 2018 and 2017 amounted to ₱721.30 million and ₱323.58 million, respectively, inclusive of ₱55.16 million and ₱9.76 million amortization of bond issue costs in 2018 and 2017, respectively. As of December 31, 2018 and 2017, unamortized bond issue costs amounted to ₱67.74 million and ₱10.39 million, respectively.

19. **Accounts Payable and Accrued Expenses**

This account consists of:

	December 31		January 1
	2018	2017 (As restated - Note 2)	2017 (As restated - Note 2)
Accounts payable - borrowers	**₱613,871,572**	₱548,595,700	₱621,314,440
Accrued interest payable	**230,381,176**	140,187,835	113,772,312
Accrued expenses	**137,234,549**	138,240,522	74,798,298
Accounts payable	**95,221,562**	134,890,690	179,269,410
Accrued other taxes and licenses	**37,548,004**	48,907,481	52,544,931
	₱1,114,256,863	₱1,010,822,228	₱1,041,699,391

Accounts payable - borrowers represents collections from DepEd held for refund to the Bank's borrowers. This liability arises when DepEd continues to deduct from the salaries of the teachers the amortization of the existing loans prior to re-loan, while the Bank already deducts the full outstanding amount of the existing loan from the proceeds of the new loan.

Accounts payable and accrued expenses represent payables and accruals for operating expenses such as repairs and maintenance, management and professional fees, security services, electricity and water, postage and telephone, fines and penalties, and others.

20. Other Liabilities

This account consists of:

	2018	2017
Payable related to PR Savings Bank acquisition	**₱300,000,000**	₱–
Pension liability (Note 24)	**12,246,079**	64,353,679
Withholding tax payable	**5,302,918**	36,242,451
Others	**8,223,101**	12,694,134
	₱325,772,098	₱113,290,264

Payable related to PR Savings Bank acquisition is the consideration for the acquisition of PR Savings Bank amounting to ₱300.00 million which shall be released by the Bank directly to the JV Company (see Note 11).

21. Maturity Analysis of Assets and Liabilities

The following tables show an analysis of assets and liabilities analyzed according to whether they are expected to be recovered or settled within one year and beyond one year from reporting date:

	2018			2017		
	Up to One Year	**Over One Year**	**Total**	Up to One Year	Over One Year	Total
Financial Assets						
Cash and other cash items	**₱408,712,128**	**₱–**	**₱408,712,128**	₱383,208,812	₱–	₱383,208,812
Due from BSP	**3,034,359,867**	**–**	**3,034,359,867**	5,907,098,253	–	5,907,098,253
Due from other banks	**2,868,575,206**	**–**	**2,868,575,206**	1,351,812,028	–	1,351,812,028
SPURA	**8,882,000,000**	**–**	**8,882,000,000**	9,442,008,358	–	9,442,008,358
Loans and receivables:						
Loans:						
Consumption	**3,726,058,949**	**45,956,686,383**	**49,682,745,332**	3,046,036,001	54,523,071,334	57,569,107,335
Agricultural	**142,607,525**	**106,302,995**	**248,910,520**	351,566,234	282,675,272	634,241,506
Real estate	**692,158**	**–**	**692,158**	25,053	5,456,893	5,481,946
Commercial	**50,000,000**	**5,016,822**	**55,016,822**	36,096,433	3,706,619	39,803,052
	3,919,358,632	**46,068,006,200**	**49,987,364,832**	3,433,723,721	54,814,910,118	58,248,633,839
Unquoted debt securities	**361,240,787**	**16,502,408**	**377,743,195**	358,554,191	48,387,422	406,941,613
Accounts receivable	**2,004,909,765**	**146,170,404**	**2,151,080,169**	1,895,734,450	100,871,896	1,996,606,346
Accrued interest receivable	**631,474,717**	**–**	**631,474,717**	519,573,549	–	519,573,549
	6,916,983,901	**46,230,679,012**	**53,147,662,913**	6,207,585,911	54,108,285,564	60,315,871,475
Prepayments and other resources	**3,926,662**	**37,520,125**	**41,446,787**	–	30,753,052	30,753,052
	22,114,557,764	**46,268,199,137**	**68,382,756,901**	23,291,713,362	54,994,922,488	78,286,635,850
Nonfinancial Assets						
Investment in Associates	**–**	**7,999,381,478**	**7,999,381,478**	–	98,387,004	98,387,004
Premises, Furniture, Fixtures and Equipment	**–**	**223,707,279**	**223,707,279**	–	232,946,640	232,946,640
Investment properties	**–**	**1,577,055**	**1,577,055**	–	2,759,883	2,759,883
Intangible assets	**–**	**149,348,119**	**149,348,119**	–	83,715,892	83,715,892
Deferred tax assets	**–**	**647,523,263**	**647,523,263**	–	891,437,944	891,437,944
Prepayments and other resources	**197,335,277**	**31,356,140**	**228,691,417**	126,922,076	15,068,050	141,990,126
	197,335,277	**9,052,893,334**	**9,250,228,611**	126,922,076	1,324,315,413	1,451,237,489
Less: Allowance for impairment and credit losses			**841,028,994**			1,138,433,892
Unearned discounts and other deferred income			**1,356,083,456**			1,638,563,295
Total Assets			**₱75,435,873,062**			₱76,960,876,152

(Forward)

	2018			2017		
	Up to One Year	Over One Year	Total	Up to One Year	Over One Year	Total
Financial Liabilities						
Deposit liabilities:						
Demand	**₱92,655,262**	**₱–**	**₱92,655,262**	₱110,507,762	₱–	₱110,507,762
Savings	**2,196,811,493**	**–**	**2,196,811,493**	1,882,998,087	–	1,882,998,087
Time	**25,876,627,870**	**8,464,342,925**	**34,340,970,795**	38,485,846,004	7,840,301,576	46,326,147,580
	28,166,094,625	**8,464,342,925**	**36,630,437,550**	40,479,351,853	7,840,301,576	48,319,653,429
Bills payable	**22,580,457,024**	**70,800,826**	**22,651,257,850**	12,096,414,233	1,964,192,569	14,060,606,802
Accounts payable and accrued expenses	**1,114,256,863**	**–**	**1,114,256,863**	1,010,822,228	–	1,010,822,228
	51,860,808,512	**8,535,143,751**	**60,395,952,263**	53,586,588,314	9,804,494,145	63,391,082,459
Nonfinancial Liabilities						
Income tax payable	**114,210,522**	**–**	**114,210,522**	389,325,925	–	389,325,925
Other liabilities	**313,526,018**	**12,246,080**	**325,772,098**	48,936,585	64,353,679	113,290,264
	427,736,540	**12,246,080**	**439,982,620**	438,262,510	64,353,679	502,616,189
Total Liabilities	**₱52,288,545,052**	**₱8,547,389,831**	**₱60,835,934,883**	₱54,024,850,824	₱9,868,847,824	₱63,893,698,648

22. Equity

Capital stock consists of

	Shares		Amount	
	2018	2017	**2018**	2017
Common - ₱1,000 par value				
Authorized - 300,000 shares				
Issued and outstanding				
Balances at beginning and end of year	**258,256**	258,256	**₱258,256,000**	₱258,256,000

In 2018, upon the full adoption of PFRS 9, the BSP has required the appropriation for the difference of the 1% general loan loss provision over the computed ECL allowance for impairment losses related to Stage 1 accounts. The Bank appropriated ₱297.90 million as of December 31, 2018.

Capital Management
It is the Bank's policy to maintain a strong capital base to sustain the development of its business and to meet regulatory capital requirements at all times. It also seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity possible with greater leverage.

When managing capital, the Bank determines the levels of risk weighted asset growth and the optimum amount of capital required to support planned business growth. As part of its management policy, capital generated in excess of planned requirements is returned to stockholders normally by way of dividends.

Regulatory Qualifying Capital
Under current banking regulations, the Bank's compliance with regulatory requirements and ratios is based on the "unimpaired capital" (regulatory net worth) reported to the BSP, which is determined on the basis of regulatory policies, which differ from PFRS in some respects. Moreover, the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, should not be less than ten percent (10.00%). Qualifying capital and risk-weighted assets are computed based on BSP regulations.

The qualifying capital of the Bank for purposes of determining the capital-to-risk assets ratio to total equity excludes:
(a) unbooked valuation reserves and other capital adjustments as may be required by the BSP;

(b) total outstanding unsecured credit accommodations, both direct and indirect, to directors, officers, stockholders and their related interests (DOSRI);
(c) deferred tax asset or liability; and,
(d) other regulatory deductions.

Risk assets consist of total assets after exclusion of cash on hand, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits, and other non-risk items as determined by the Monetary Board of the BSP.

Effective January 1, 2014, the Bank complied with BSP Circular No. 781, *Basel III Implementing Guidelines on Minimum Capital Requirements*, which provides the implementing guidelines on the revised risk-based capital adequacy framework particularly on the minimum capital and disclosure requirements for universal banks and commercial banks, as well as their subsidiary banks and quasi-banks, in accordance with the Basel III standards.

The Circular sets out a minimum Common Equity Tier 1 (CET1) ratio of 6.00% and Tier 1 capital ratio of 7.50%. It also introduces a capital conservation buffer of 2.50% comprised of CET1 capital. The BSP's existing requirement for Total CAR remains unchanged at 10.00% and these ratios shall be maintained at all times.

The Bank's capital-to-risk assets ratio (CAR) of the Bank as reported to the BSP as of December 31, 2018 and 2017 based on the Basel 3 risk-based capital adequacy framework are shown in the table below (amounts in thousands):

	2018	2017
Tier 1 capital	**₱5,681,614**	₱12,905,251
Tier 2 capital	**379,728**	522,333
Total qualifying capital	**₱6,061,342**	₱13,427,584
Risk-weighted assets	**₱68,097,537**	₱73,064,920
Capital ratios:		
Total regulatory capital expressed as a percentage of total risk-weighted assets	**8.90%**	18.38%
Total tier 1 capital expressed as a percentage of total risk weighted assets	**8.34%**	17.66%

As discussed in Note 11, BSP provided a temporary relief to the Bank from compliance with the minimum CAR of 10% from June 2018 to the effectivity of merger, provided that the Bank shall not fall below 7%. Subsequent to the merger, as of March 31, 2019, the CAR of the combined banks is 11.87%.

The capital requirements as of December 31, 2018 and 2017 are shown below (amounts in thousands):

	2018	2017
Capital requirements		
Credit risk	**₱55,380,518**	₱62,173,843
Market risk	**–**	–
Operational risk	**12,717,019**	10,891,077
Total capital requirements	**₱68,097,537**	₱73,064,920

In 2014, the BSP, in line with their aim to further strengthen the banking system, increased the minimum capital requirement for all bank categories. For thrift banks, both the location of the head office and size of the physical network are considered in tiering the minimum capital requirements. The revised minimum capital requirement of the Bank is set at ₱800.00 million.

23. Other Income

This consists of

	2018	2017 (As restated - Note 2)
Loan related fees and penalties	**₱169,976,964**	₱125,343,958
Recovery of written off accounts	**105,634,550**	6,522,073
ATM fees	**5,109,514**	4,942,229
Deposit-related fees	**3,902,401**	9,486,552
Rental income (Notes 13 and 25)	**2,007,231**	1,923,618
Gain from disposal of premises, furniture, fixtures and equipment (Note 12)	**119,569**	3,850,874
Gain on bargain purchase (Note 11)	**–**	41,290,645
Others	**8,872,959**	2,368,767
	₱295,623,188	₱195,728,716

24. Retirement Plan

The Bank maintains a funded, tax-qualified, noncontributory post-employment benefit plan that is being administered by a trustee that is legally separated from the Bank. The post-employment plan covers all regular full-time employees.

The normal retirement age is 60 or completion of 30 years of service whichever is earlier. The service of any employee, however, may be extended from year to year beyond the normal retirement date, provided such an extension of service is with the consent of the employee concerned and the express approval of the Bank. The plan also provides for an early retirement after completion of at least 10 years of service. Normal retirement benefit is an amount equivalent to 100% of the employees' final basic monthly salary multiplied by the number of years of service prior to January 1, 2008 and 150% of the final basic monthly salary for services rendered starting January 1, 2008.

The cost of defined benefit retirement plans as well as the present value of the benefit obligation is determined using actuarial valuations. The actuarial valuation involves making various assumptions. The principal assumptions used are shown below:

	2018	2017
Discount rates	**7.41%**	5.25%
Expected rate of salary increases	**6.00%**	6.00%
Turnover rate	**A scale ranging from 5% at age 18 to 0% at age 60**	A scale ranging from 5% at age 18 to 0% at age 60
Average remaining working lives	**16**	16

The amounts of post-employment defined benefit obligation recognized in the statements of financial position are determined as follows:

	2018	2017
Present value of the obligation	**₱280,104,143**	₱295,224,730
Fair value of plan assets	**(267,858,064)**	(230,871,051)
Net pension liability	**₱12,246,079**	₱64,353,679

Changes in the present value of the defined benefit obligation follow:

	2018	2017
Balance at beginning of year	**₱295,224,730**	₱268,024,330
Current service cost	**47,998,028**	50,311,955
Interest expense	**15,499,298**	14,955,758
Remeasurements - actuarial losses (gains) arising from:		
Changes in demographical assumptions	**–**	(22,058,982)
Experience adjustments	**1,653,519**	(17,342,736)
Changes in financial assumptions	**(77,653,177)**	11,897,749
Benefits paid	**(2,618,255)**	(10,563,344)
Balance at end of year	**₱280,104,143**	₱295,224,730

Changes in the fair value of plan assets follow:

	2018	2017
Balance at beginning of year	**₱230,871,051**	₱177,278,896
Contributions to the plan	**46,160,232**	54,657,384
Benefits paid	**(2,618,255)**	(10,563,344)
Interest income	**12,120,730**	9,892,162
Return on plan assets (excluding amounts included in net interest)	**(18,675,694)**	(394,047)
Balance at end of year	**₱267,858,064**	₱230,871,051

The fair value of plan assets by each class is as follows:

	2018	2017
Assets		
Cash and cash equivalents	**₱127,727,610**	₱116,547,316
Investment in unit investment trust funds	**60,282,085**	63,387,685
Investment in government securities (treasury bills)	**16,699,297**	–
Debt instruments	**20,072,357**	–
Equity instruments		
Holding	**12,332,329**	16,433,571
Real estate	**11,303,230**	11,969,871
Financial institutions	**9,219,416**	10,862,184
Energy and power	**9,326,088**	11,016,931
Mining	**56,507**	110,819
Telecommunications	**11,250**	14,800
Accrued interest and other receivables	**895,760**	563,013
	₱267,925,929	₱230,906,190

(Forward)

	2018	2017
Liabilities		
Accrued trust fee payable	**(₱67,865)**	(₱35,139)
	₱267,858,064	₱230,871,051

Plan assets do not comprise any of the Bank's own financial instruments or any of its assets occupied and/or used in its operations.

Cash and cash equivalents include cash in savings deposit and time deposit accounts. Unit investment trust funds (UITFs) are open-ended pooled trust funds denominated in peso, operated and administered by a trust entity and made available by participation. The investments of the retirement fund in UITFs consist of various bond and equity funds. Equity instruments consist of shares traded in the local stock exchange, which include equity securities of the Parent Bank amounting to ₱9.22 million and ₱10.86 million as at December 31, 2018 and December 31, 2017, respectively (see Note 27).

To efficiently manage the retirement plan, the Bank ensures that the investment positions are managed in accordance with its asset-liability matching strategy to achieve that long-term investments are in line with the obligations under the retirement scheme. The Bank actively monitors how the duration and the expected yield of the investments are matching the expected cash outflows arising from the retirement obligations. In view of this, investments are made in reasonably diversified portfolio, such that the failure of any single investment would not have a material impact on the overall level of assets.

The fair values of the above equity and debt securities are determined based on quoted market prices in active markets. The remaining plan assets are carried at their carrying amounts since the carrying amounts approximate the fair values.

Details of compensation and employee benefits are presented below.

	2018	2017
Short-term employee benefits	**₱759,361,792**	₱734,676,804
Post-employment benefits	**51,376,596**	55,375,551
	₱810,738,388	₱790,052,355

The amounts included in 'Compensation and employee benefits' expense in the statements of income are as follows:

	2018	2017
Current service costs	**₱47,998,028**	₱50,311,955
Net interest expense	**3,378,568**	5,063,596
	₱51,376,596	₱55,375,551

The movements in 'Remeasurement losses on net retirement liability' follow:

	2018	2017
Balance at beginning of period	**(₱49,787,516)**	(₱68,764,461)
Actuarial gain arising on defined benefit obligation	**75,999,658**	27,503,969
Actuarial losses on return on plan assets	**(18,675,694)**	(394,047)
Income tax effect	**(17,197,189)**	(8,132,977)
Remeasurement gain on retirement	**40,126,775**	18,976,945
Balance at end of period, net of tax	**(₱9,660,741)**	(₱49,787,516)

The sensitivity analysis below has been determined based on reasonably possible changes of each significant assumption on the defined benefit obligation as of the end of the reporting period, assuming if all other assumptions were held constant:

	Impact of Post-employment Defined Benefit Obligation		
	Change in Assumption	**Increase in Assumption**	**Decrease in Assumption**
December 31, 2018			
Discount rate	**+/-1.0%**	**(₱27,435,675)**	**₱32,418,822**
Salary growth rate	**+/-1.0%**	**34,302,148**	**(29,449,075)**
December 31, 2017			
Discount rate	+/-1.0%	(₱34,379,633)	₱41,230,826
Salary growth rate	+/-1.0%	42,343,381	(35,918,500)

Shown below is the maturity analysis of the undiscounted benefit payments:

	2018	2017
Within 1 year	**₱47,481,233**	₱37,395,161
More than 1 year to 5 years	**46,197,331**	32,204,283
More than 5 years to 10 years	**165,139,735**	145,056,092
More than 10 years to 15 years	**264,590,130**	220,512,003
More than 15 years to 20 years	**603,805,081**	516,867,927
More than 20 years	**1,669,988,802**	1,640,151,763
	₱2,797,202,312	₱2,592,187,229

The Bank expects to contribute ₱53.38 million to the fund in 2019 based on the funding valuation in 2018.

The weighted average duration of the defined benefit obligation in 2018 and 2017 is 19.89 years and 20.42 years, respectively.

25. **Leases**

Operating Lease Commitments - Bank as Lessee

The Bank has operating lease contracts covering its offices occupied by some branches, ranging from one (1) to twenty five (25) years. The lease contracts provide for escalation in rental rate ranging from 5.00% to 10.00% in 2018 and 2017, respectively, and are renewable upon mutual agreement of both parties.

The future minimum rentals payable under the operating leases follow:

	2018	2017
Within one year	**₱89,355,593**	₱76,816,833
After one year but not more than five years	**204,200,494**	209,621,681
More than five years	**2,717,683**	5,282,377
	₱296,273,770	₱291,720,891

26. **Income Taxes**

Under Philippine tax laws, the Bank is subject to percentage and other taxes (presented as 'Taxes and licenses' in the statements of income) as well as income taxes. Percentage and other taxes paid consist principally of documentary stamp tax and gross receipts tax (GRT).

Income taxes include corporate income taxes and final tax paid at the rate of 20.00%, which represents final withholding tax on gross interest income from government securities and other deposit substitutes. These income taxes, as well as the deferred tax benefits, are presented as 'Provision for income tax' in the statements of income.

Current tax regulation provides that the RCIT rate shall be 30.00%. Interest expense allowed as deductible expense is reduced by an amount equivalent to 33.00% of interest income subjected to final tax. The regulations also provide for MCIT of 2.00% of modified gross income and allow a NOLCO benefit. Both the MCIT and NOLCO may be applied against regular tax liability and taxable income, respectively, over three years from the year of inception.

Provision for income tax consists of:

	2018	2017 (As restated - Note 2)
Current		
RCIT	**₱427,097,001**	₱1,315,901,708
Final	**75,101,902**	35,359,097
	502,198,903	1,351,260,805
Deferred	**386,648,317**	96,216,831
	₱888,847,220	₱1,447,477,636

The components of the net deferred tax assets follow:

	December 31		January 1
		2017 (As restated - Note 2)	2017 (As restated - Note 2)
Deferred tax assets on:			
Deferred service fees	**₱406,593,854**	₱491,048,229	₱544,001,684
Allowance for impairment	**252,308,698**	341,530,168	404,859,211
Others	**5,269,533**	39,553,443	19,703,227
	₱664,172,085	₱872,131,840	₱968,564,122

(Forward)

	December 31		January 1
		2017 (As restated - Note 2)	2017 (As restated - Note 2)
Deferred tax liability on:			
Retirement benefit obligation	**₱466,494**	₱2,031,403	₱2,246,853
Unamortized bond issue cost	**20,322,646**	–	–
	20,789,140	2,031,403	2,246,853
Deferred income tax asset related to retirement benefit obligation recognized in other comprehensive income	**4,140,318**	21,337,507	29,470,483
	₱647,523,263	₱891,437,944	₱995,787,752

Provision for deferred income tax recognized directly against OCI for the years ended December 31, 2018 and 2017 amounted to ₱17.20 million and ₱8.13 million, respectively. Provision for deferred income tax recognized against Surplus as at January 1, 2018 as a result of the adoption of PFRS 9 amounted to ₱160.24 million.

Reconciliation between the statutory income tax rate and the effective income tax rate follows:

	2018	2017 (As restated - Note 2)
Statutory income tax rate	**₱819,292,358**	₱1,442,989,944
Tax effects of:		
Income subjected to final tax	**(39,527,661)**	(18,837,057)
Nondeductible expenses	**75,535,476**	59,054,714
Nontaxable income	–	(12,501,856)
Others	**33,547,047**	(23,228,109)
Effective income tax rate	**₱888,847,220**	₱1,447,477,636

27. Related Party Transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if they are subjected to common control or common significant influence such as subsidiaries, associates of subsidiaries, affiliates or other related parties.

The Bank has several business relationships with related parties. Under the Bank's policies, transactions with related parties are made substantially on the same terms and conditions as transactions with other individuals and businesses of comparable risks.

Related party transactions of the Bank by category of related party are presented below.

	Amount of Transactions		Outstanding Balances	
Related Party Category	**2018**	2017	**2018**	2017
Parent Bank				
UBP				
Purchase of services	**₱76,976,327**	₱31,867,208	**₱–**	₱–
Deposits	**–**	–	**497,374,302**	444,446,868
Interest income on deposits	**2,876,263**	3,262,431	**–**	–
Major Stockholder of Parent Bank				
AEVI				
Purchase of services	**1,183,416**	1,886,383	**–**	–
Bills payable	**19,862,247,980**	21,360,840,094	**2,550,000,000**	–
Interest expense on borrowings	**67,631,818**	48,988,014	**14,243,750**	592,813
Entities under common control				
Purchase of services	**188,890,618**	239,828,394	**2,008,192**	3,479,680
Bills payable	**24,589,306,667**	10,744,677,121	**5,970,000,000**	74,000,000
Interest expense on borrowings	**204,834,698**	25,273,258	**46,698,000**	96,982
Deposit liabilities	**49,672,714,390**	–	**1,146,911,403**	14,617,088,754
Interest expense on deposits	**50,511,493**	62,159,024	**2,176,638**	–
Key management personnel				
Compensation	**185,149,957**	160,047,120	**–**	–
Other related parties				
Loans	**–**	2,772,329	**–**	65,585,470

Purchases of Services
Services are presented as part of 'Operating Expenses' in the statements of income. The related outstanding payables for services obtained in 2018 and 2017 are presented as part of 'Accrued expenses' under the Accounts Payable and Accrued Expenses account in the statements of financial position (see Note 19). Such payables are noninterest-bearing, unsecured and settled in cash within three months.

Deposits
The deposits with Parent Bank and entities under common control pertain to current or savings accounts with interest rates ranging from nil to 0.90% in 2018 and 2017.

Bills payable
These borrowings are unsecured and are settled in cash upon maturity with interest rates ranging from 3.19% to 6.45% and 4.50% to 8.00% in 2018 and 2017, respectively.

Remuneration of Key Management Personnel
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly. The Bank considers the members of the Committee to constitute key management personnel for purposes of PAS 24.

	2018	2017
Short-term benefits	**₱173,466,723**	₱147,657,117
Post-employment benefits	**11,683,234**	12,390,003
	₱185,149,957	₱160,047,120

The short-term and post-employment benefits are included as part of 'Compensation and employee benefits' in the statements of income.

Loans
Under the General Banking Act and BSP regulations, the amount of direct credit accommodations to each of the Bank's directors, officers and stockholders, of which 70.00% must be secured, should not exceed the amount of their respective deposits and book value of their respective investments in the Bank. In the aggregate, loans to DOSRI generally should not exceed the total equity or 15.00% of the total loan portfolio of the Bank, whichever is lower.

As at December 31, 2018 and 2017, the Bank has no outstanding DOSRI loans and is in compliance with these regulatory requirements.

On November 23, 2008, the BSP approved the proposed Special Financing Plan (SFP) to the Bank's officers effective November 26, 2008. The objective of the SFP is to provide financial assistance to the Bank's officers as part of their fringe benefits and to meet their housing, transportation, household and personal needs of their officers. The approved SFP is subject to the following conditions, that:

- the Bank shall strictly comply with the provisions of Sec. 83 of RA 337, General Banking Act, as amended, and its implementing regulations on financial assistance;

- the Bank shall strictly comply with guidelines/regulations governing financial plans for bank officers and employees provided under Sec. 2337 of the Manual Regulations for Banks and Other Financial Intermediaries, Book II;

- the aggregate amount of the loans to be granted under the program shall at no time exceed 5.00% of total loan portfolio;

- the Bank's investment in equipment and other chattels under its fringe benefit program for officers and employees shall be included in determining the extent of the investment of the Bank in real estate and equipment for purposes of Sec. 25 of RA 337; and,

- any amendments to the SFP shall be submitted to the Department of Thrift Banks and Non-Bank Financial Institutions for prior approval within 30 calendar days from approval thereof by the Bank's BOD.

As at December 31, 2018 and December 31, 2017, the Bank's outstanding loans under the SFP, amounted to ₱71.08 million and ₱65.59 million, respectively, and are presented as part of 'Loans and Receivables' in the statements of financial position. These unsecured loans are repaid through salary deductions. Interest rates from these loans ranges from 3.28% to 8.00% in 2018 and 2017. Interest income amounted to ₱1.54 million and ₱2.78 million in 2018 and 2017, respectively, and is presented as part of 'Interest Income on Loans and Receivables' in the statements of profit or loss.

Retirement Plan
The Bank's retirement fund for its defined benefit post-employment plan is administered and managed by a trustee duly appointed by the Bank. UBP is currently handling the fund of the Bank. The fair value and the composition of the plan assets as at December 31, 2018 and 2017 are presented in Note 24.

As at December 31, 2018 and December 31, 2017, equity securities of the retirement fund consist of investments in corporations listed in the PSE, which include investments in shares of stock of the following related parties.

	2018	2017
AEVI	**₱12,035,705**	₱16,193,494
APC	**9,291,356**	10,998,742
UBP	**9,219,416**	10,862,184
	₱30,546,477	₱38,054,420

The retirement fund neither provides any guarantee or surety for any obligation of the Bank nor its investments covered by any restrictions or liens.

28. Offsetting of Financial Assets and Liabilities

The amendments to PFRS 7 require the Bank to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under enforceable master netting agreements or similar arrangements. The effects of these arrangements are disclosed in the succeeding tables.

2018

Financial assets recognized at end of reporting period by type	Gross carrying amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in the statement of financial position [a-b]	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria: Financial instruments	Fair value of financial collateral	Net exposure [c-d]
	[a]	[b]	[c]	[d]		[e]
Securities purchased under resale agreement	**₱8,882,000,000**	**₱–**	**₱8,882,000,000**	**₱8,882,000,000**	**₱–**	**₱–**

2017

Financial assets recognized at end of reporting period by type	Gross carrying amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in the statement of financial position [a-b]	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria: Financial instruments	Fair value of financial collateral	Net exposure [c-d]
	[a]	[b]	[c]	[d]		[e]
Securities purchased under resale agreement	₱9,442,008,358	₱–	₱9,442,008,358	₱9,442,008,358	₱–	₱–

29. Financial Performance

The following basic ratios* measure the financial performance of the Bank:

	2018	2017 (As restated - Note 2)
Return on average equity	**13.33%**	28.65%
Return on average assets	**2.42%**	4.57%
Net interest margin	**7.34%**	10.18%

**The ratios are based on the respective statements of income accounts divided by average balance which is equal to the sum of beginning and ending balances of the respective statements of financial statement accounts as of the end of the period divided by two.*

30. **Commitments and Contingencies**

In the normal course of the Bank's operations, there are various outstanding commitments and contingent liabilities which are not reflected in the accompanying financial statements. The Bank recognizes in its books any losses and liabilities incurred in the course of its operations as soon as these become determinable and quantifiable.

As at December 31, 2018 and 2017, the Bank has certain suits and claims that remain unsettled. Management believes, based on the opinion of its legal counsels, that the ultimate outcome of such cases and claims will not have a material effect on the Bank's financial position and results of operations.

As at December 31, 2018 and 2017, the Bank has unused credit lines with various depository banks and related parties amounting to ₱17.28 billion and ₱14.38 billion, respectively.

Management believes that as at December 31, 2018 and December 31, 2017, no additional material losses or liabilities are required to be recognized in the financial statements as a result of the above commitments and contingencies.

31. **Notes to Statements of Cash Flows**

Noncash investing activities include acquisitions of premises, furniture, fixtures and equipment which remain unpaid amounting to ₱8.04 million and ₱11.43 million as of December 31, 2018 and December 31, 2017, respectively.

Presented below is the Bank's liabilities arising from financing activities:

	2018	2017
Balance at January 1	**₱14,060,606,802**	₱8,932,732,039
Cash flows from financing activities		
Availments of bills payable	**56,343,889,919**	54,528,344,185
Settlements of bills payable	**(47,698,078,124)**	(49,390,708,574)
Non-cash financing activities		
Amortization of bond issue cost	**(55,160,747)**	(9,760,848)
Balance at December 31	**₱22,651,257,850**	₱14,060,606,802

32. **Supplementary Information Required by the Bureau of Internal Revenue**

Presented below is the supplementary information which is required by the BIR under its existing Revenue Regulations No. 15-2010 to be disclosed as part of the notes to financial statements. This supplementary information year is not a required disclosure under PFRS.

Gross Receipts Tax
In lieu of the value-added tax (VAT), the Bank is subject to GRT which is imposed on all banks and non-bank financial intermediaries pursuant to Section 121 of the Tax Code.

In 2018, the Bank reported total GRT amounting to ₱383.52 million and is presented under 'Taxes and licenses' in the statements of income. Total GRT payable as at December 31, 2018 amounted to ₱37.55 million, which is included as part of 'Accrued other taxes and licenses', ₱15.17 million of which pertains to creditable percentage taxes withheld as at December 31, 2018.

Documentary Stamp Tax
For the year ended December 31, 2018, DST purchased and affixed through the electronic DST amounted to ₱702.00 million and ₱610.70 million, respectively. The Bank passes on the DST of loans to its teacher-borrowers; hence, DST charged to profit and loss under 'Taxes and licenses' amounted to ₱272.65 million only.

Taxes on Importation
The Bank has no taxes on importation as there were no importations made in 2018.

Withholding Taxes
Details of total withholding taxes for the year ended December 31, 2018 are shown below:

Final withholding taxes	₱1,174,681
Tax on compensation and benefits	841,591
Expanded withholding taxes	3,286,646
	₱5,302,918

Taxes and Licenses
Details of taxes and licenses of the Bank for the year ended December 31, 2018 are as follows:

GRT	₱383,518,025
DST	272,647,423
Business Permits	37,418,036
Real Property Tax	882,836
BIR Registration Fees	53,600
Miscellaneous	4,264,810
	₱698,784,730

Taxes and licenses are presented under 'Operating Expenses' in the statements of income.

The Bank also incurred fringe benefits tax amounting to ₱4.23 million which is presented under Operating Expenses as part of Compensation and employee benefits in the statements of income.

Excise Tax
The Bank does not have excise taxes accrued or paid since it does not have any transactions subject to excise tax in 2018.

Deficiency Tax Assessments and Tax Cases
As at December 31, 2018, the Bank does not have any final deficiency tax assessments from the BIR nor does it have tax cases outstanding or pending in courts or bodies outside of the BIR in any of the open taxable years.