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# INDEPENDENT AUDITOR'S REPORT

The Stockholders and the Board of Directors
Cantilan Bank, Inc. (A Rural Bank)
Orozco Street, Cantilan, Surigao del Sur

## Report on the Financial Statements

### Opinion

We have audited the financial statements of CANTILAN BANK, INC. (A RURAL BANK), herein referred to as the Bank, which comprise the statements of financial position as at December 31, 2016 and 2015, and the statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2016 and 2015 and its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards (PFRS).

### 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 Company in accordance with the Code of Ethics for Professional Accountants in the Philippines (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 unmodified opinion.

### 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 by Bureau of Internal Revenue (BIR)

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information in Note 29 to the financial statements is presented for purposes of filing with the BIR and is not a required part of the basic financial statements. Such information is the responsibility of the management. 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.

ROXAS CRUZ TAGLE AND CO.
(Formerly: Alba Romeo & Co.)

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SEC Accreditation No. 1364-A (Individual), Group C, issued on November 28, 2013,
effective until November 27, 2016, effectivity extended until April 30, 2017
SEC Accreditation No. 007-FR-4 (Firm), Group A, issued on July 16, 2015,
effective until July 15, 2018
BIR Accreditation No. 08-001682-3-2014, issued on January 5, 2015,
effective until January 4, 2018
BSP-Registered as external auditor under Category A

April 4, 2017
Makati City

CANTILAN BANK, INC. (A Rural Bank)

STATEMENTS OF FINANCIAL POSITION
December 31, 2016 and 2015
(In Philippine Peso)

| | Notes | 2016 | 2015 |
|---|---|---|---|
| Assets | | | |
| Cash and Other Cash Items | 4 | 222,686,606 | 196,833,508 |
| Due from Bangko Sentral ng Pilipinas | 5 | 53,711,516 | 45,944,391 |
| Due from Other Banks | 6 | 373,025,049 | 283,463,523 |
| Total Cash and Cash Equivalents | | 649,423,171 | 526,241,422 |
| Loans Receivable - Net | 7 | 1,437,902,588 | 1,568,265,580 |
| Held-to-Maturity Investments | 8 | 59,038,000 | 21,997,162 |
| Bank Premises, Furniture, Fixtures and Equipment - net | 9 | 107,777,236 | 109,106,957 |
| Investment Properties - net | 10 | 20,591,560 | 24,089,405 |
| Other Intangible Assets - net | 11 | 22,231,593 | 22,795,145 |
| Deferred Tax Assets | 21,28 | 56,701,670 | 43,126,835 |
| Other Assets - net | 12 | 40,280,359 | 55,137,568 |
| Total Assets | | 2,393,946,177 | 2,370,760,074 |
| Liabilities and Equity | | | |
| Liabilities | | | |
| Deposit Liabilities | 13 | | |
| Savings | | 1,030,415,251 | 829,765,209 |
| Time | | 570,505,884 | 479,047,110 |
| Demand | | 63,231,676 | 39,172,820 |
| | | 1,664,152,811 | 1,347,985,139 |
| Bills Payable | 14 | 243,922,133 | 547,428,048 |
| Accrued Expenses and Other Liabilities | 15 | 90,009,751 | 117,223,265 |
| Retirement Benefits Obligation | 16 | 74,496,253 | 67,156,626 |
| Dividends Payable | 17 | - | 17,104,859 |
| Income Tax Payable | 21 | 13,630,010 | 6,817,961 |
| Total Liabilities | | 2,086,210,958 | 2,103,715,898 |
| Equity | 17 | 307,735,219 | 267,044,176 |
| Total Liabilities and Equity | | 2,393,946,177 | 2,370,760,074 |

(The notes on pages 5 to 71 are an integral part of these financial statements.)

CANTILAN BANK, INC. (A Rural Bank)

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
For the Years Ended December 31, 2016 and 2015
(In Philippine Peso)

| | Notes | 2016 | 2015 |
|---|---|---|---|
| Interest Income on | | | |
| Loans receivable | 7 | 330,605,473 | 324,480,295 |
| Investments | 8 | 545,995 | 441,075 |
| Deposits with banks | 6 | 426,371 | 339,827 |
| Sales contract receivable | | 366,331 | - |
| | | 331,944,170 | 325,261,197 |
| Interest Expense on | | | |
| Deposits liabilities | 13 | 40,012,993 | 35,452,974 |
| Borrowings | 14 | 25,823,508 | 24,767,226 |
| | | 65,836,501 | 60,220,200 |
| Net Interest Income before Provision for Credit Losses on Loan receivables | | 266,107,669 | 265,040,997 |
| Provision for Credit Losses on Loan receivables | 7 | 47,415,027 | 36,828,142 |
| Net Interest Income before OTHER OPERATING INCOME AND OPERATING EXPENSES | | 218,692,642 | 228,212,855 |
| OTHER OPERATING INCOME | 18 | 70,547,469 | 62,287,776 |
| | | 289,240,111 | 290,500,631 |
| OPERATING EXPENSES | | | |
| Compensation and staff benefits | 19 | 102,680,109 | 97,168,688 |
| Depreciation and amortization | 9,10,11 | 28,944,922 | 27,580,629 |
| Taxes and licenses | | 20,217,716 | 23,859,171 |
| Travel and transportation | | 9,421,107 | 12,409,557 |
| Retirement benefits | 16 | 8,927,668 | 9,375,975 |
| Supplies used | 12 | 6,717,693 | 5,878,778 |
| Rent | 20 | 6,377,624 | 5,724,320 |
| Insurance | | 5,646,433 | 4,896,781 |
| Repairs and maintenance | | 4,955,916 | 4,533,375 |
| Professional fees | | 2,821,613 | 992,960 |
| Advertising and publicity | | 414,324 | 464,929 |
| Other operating expenses | 19 | 53,806,995 | 54,596,117 |
| | | 250,932,120 | 247,481,280 |
| INCOME BEFORE TAX EXPENSE | | 38,307,991 | 43,019,351 |
| INCOME TAX EXPENSE | 21 | 11,417,223 | 12,843,813 |
| PROFIT FOR THE YEAR | | 26,890,768 | 30,175,538 |
| OTHER COMPREHENSIVE INCOME | | | |
| ITEMS THAT WILL NOT BE RECLASSIFIED TO PROFIT OR LOSS | | | |
| Actuarial gains on defined benefit obligation | 16 | 1,588,040 | 11,512,524 |
| Deferred tax effect | 21 | (476,412) | (3,453,757) |
| | | 1,111,628 | 8,058,767 |
| TOTAL COMPREHENSIVE INCOME | | 28,002,396 | 38,234,305 |
| BASIC AND DILUTED EPS | 23 | 62 | 78 |

(The notes on pages 5 to 71 are an integral part of these financial statements.)

CANTILAN BANK, INC. (A Rural Bank)

STATEMENTS OF CHANGES IN EQUITY
For the Years Ended December 31, 2016 and 2015
(In Philippine Peso)

| | Notes | PREFERRED Shares | PREFERRED Amount | C O M M O N Shares | C O M M O N Amount (Note 17.3) | Remeasurement Gains (Losses) on Defined Benefit Obligation | Retained Earnings | TOTAL (Note 17) |
|---|---|---|---|---|---|---|---|---|
| Balance, December 31, 2014 | | - | - | 337,853 | 169,055,642 | (24,578,830) | 112,729,159 | 257,205,971 |
| Comprehensive income | | | | | | | | |
| Profit for the year | | - | - | - | - | - | 30,175,538 | 30,175,538 |
| Other comprehensive income for the year | | - | - | - | - | 8,058,767 | - | 8,058,767 |
| Total comprehensive income | | - | - | - | - | 8,058,767 | 30,175,538 | 38,234,305 |
| Transactions with owners | | | | | | | | |
| Additional capital contribution | | - | - | 33,357 | 16,678,504 | - | - | 16,678,504 |
| Cash dividends declared | 17 | - | - | - | - | - | (17,104,859) | (17,104,859) |
| Cash dividends distribution | 17 | - | - | - | - | - | (27,969,745) | (27,969,745) |
| Stock dividends distribution | | - | - | 55,783 | 27,887,886 | - | (27,887,886) | - |
| Balance, December 31, 2015 | | - | - | 426,993 | 213,622,032 | (16,520,063) | 69,942,207 | 267,044,176 |
| Comprehensive income | | | | | | | | |
| Profit for the year | | | | | | - | 26,890,768 | 26,890,768 |
| Other comprehensive income for the year | | - | - | - | - | 1,111,628 | | 1,111,628 |
| Total comprehensive income | | - | - | - | - | 1,111,628 | 26,890,768 | 28,002,396 |
| Transactions with owners | | | | | | | | |
| Additional capital contribution | | - | - | 25,502 | 12,688,647 | - | - | 12,688,647 |
| Cash dividends declared | | - | - | - | - | - | - | - |
| Cash dividends distribution | | - | - | - | - | - | - | - |
| Stock dividends distribution | | - | - | - | - | - | - | - |
| Balance, December 31, 2016 | | - | - | 452,495 | 226,310,679 | (15,408,435) | 96,832,975 | 307,735,219 |

(The notes on pages 5 to 71 are an integral part of these financial statements.)

CANTILAN BANK, INC. (A Rural Bank)

STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2016 and 2015
(In Philippine Peso)

| | Notes | 2016 | 2015 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Income before tax expense | | 38,307,991 | 43,019,351 |
| Adjustments for: | | | |
| Depreciation and amortization | 9,10,11 | 28,944,922 | 27,580,629 |
| Provision for credit losses - loan receivables | 7 | 47,415,027 | 36,828,142 |
| Provision for credit losses - accounts receivable | 12 | 55,986 | 8,161 |
| Provision for impairment losses - investment properties | 10 | 74,287 | 53,459 |
| Provision for retirement benefits | 16,29 | 8,927,668 | 9,375,975 |
| Gain from disposal of property and equipment | 9,18 | (98,504) | (673,044) |
| Gain from sale of investment properties | 10,18 | (6,140,073) | (2,801,828) |
| Interest expense | 13,14 | 65,836,501 | 60,220,200 |
| Operating income before working capital changes | | 183,323,805 | 173,611,045 |
| Changes in operating assets and liabilities | | | |
| Decrease (increase) in loan receivables | | 74,989,263 | (410,650,370) |
| Decrease (increase) in other assets | | 14,801,250 | (18,143,626) |
| Increase in deposit liabilities | | 316,167,672 | 160,652,548 |
| Increase (decrease) in accrued expenses and other liabilities | | (23,255,635) | 13,557,046 |
| Cash provided by (used in) operating activities | | 566,026,355 | (80,973,357) |
| Payment of retirees | 16 | - | (566,174) |
| Interest expense paid | | (69,794,380) | (51,895,572) |
| Income taxes paid | | (18,656,449) | (23,351,160) |
| Net cash provided by (used in) operating activities | | 477,575,526 | (156,786,263) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Additions to bank premises, furniture, fixtures and equipment | 9 | (24,497,399) | (29,833,909) |
| Proceeds from disposal of furniture, fixtures and equipment | 9 | 282,393 | 1,514,614 |
| Additions to held-to-maturity investments | 8 | (81,069,000) | (2,997,162) |
| Maturity of held-to-maturity investments | 8 | 44,028,162 | - |
| Proceeds from sale of investment properties | 10 | 17,136,194 | 8,626,001 |
| Additions to other intangible assets | 11 | (2,352,000) | (4,267,200) |
| Net cash used in investing activities | | (46,471,650) | (26,957,656) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from loan availments | 14 | 259,000,000 | 851,452,970 |
| Payment of loans | 14 | (562,505,915) | (636,633,667) |
| Additional subscription | 17 | 12,688,647 | 16,678,504 |
| Payment of dividends | 17 | (17,104,859) | (27,969,745) |
| Net cash provided by (used in) financing activities | | (307,922,127) | 203,528,062 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | | 123,181,749 | 19,784,143 |
| CASH AND CASH EQUIVALENTS, January 1 | 4,5,6 | 526,241,422 | 506,457,279 |
| CASH AND CASH EQUIVALENTS, December 31 | 4,5,6 | 649,423,171 | 526,241,422 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION | | | |
| Increase in capital stocks due to stock dividends taken from retained earnings | | - | 27,887,886 |

(The notes on pages 5 to 71 are an integral part of these financial statements.)

## NOTE 1 – CORPORATE INFORMATION

### 1.1 Principal place of business and coverage of operations

Cantilan Bank, Inc. (A Rural Bank), the Bank, is organized under the laws and regulations governing the establishments and regulations of Rural Banks in the Philippines under Republic Act (R.A.) No. 720, as amended by R.A. No. 7353 (Rural Bank Act of 1992). Its primary purpose is to carry and engage in the business of extending rural credit to small farmers and tenants and to deserving rural industries or enterprises; to sell, solicit or market insurance products and services as an insurance agent especially for microinsurance products issued by life and non-life insurance companies, authorized by the Insurance Commission, in accordance with Bangko Sentral ng Pilipinas (BSP) rules and regulations; to have and exercise all authority and powers, to do and perform all acts, and to transmit all businesses which may legally be had or done by rural banks organized under and in accordance with the Rural Banks' Act, as it exists or may be amended; and to do all other things incident thereto and necessary and proper in connection with said purpose within such territory, as may be determined by the Monetary Board of the BSP.

The Bank's registered principal place of business is Orozco St., Cantilan, Surigao del Sur. As at December 31, 2016, the Bank has 24 branches and 18 extension offices ( EOs) dispersed in the provinces of Surigao del Sur, Surigao del Norte, Agusan del Sur, Agusan del Norte, Southern Leyte, Misamis Oriental, Davao Oriental and also in the cities of Butuan, Tandag, Surigao, Davao, Tagum and Gingoog.

In its letter dated February 10, 2016, the BSP has approved the request of the Bank for authority to establish a Branch in Malaybalay City (Bukidnon) and 2 Eos in Cateel (Davao Oriental) and Calinan (Davao City), subject to the following conditions:

1. The approved Branch and Eos shall be opened within 3 years from the date of approval thereof, which period shall not be subject to any extension;

2. The approved Eos shall not maintain a separate complete set of books of accounts as its transactions shall be taken up directlt in the books of the Bank's branches to where the Eos shall be attached, as follow:

| Proposed EO | Mother Branch |
|---|---|
| 1. Cateel (Davao Oriental) EO | Lingig (Surigao del Sur) |
| 2. Calinan (Davao City) EO | Davao City |

3. The Bank shall submit to the Central Point of Contact Department III (CPCD III), BSP not later than five (5) banking days from such opening:

   a. A written notice of the actual date of opening as a regular branch with a request for the assignment of a BSP branch code for the Branch and each EO opened (copy furnished Supervisory Data Center); and

   b. A certification signed by the Chief Compliance Officer and the head of the Branches Department with the rank of vice president, or its equivalent or by a higher ranking officer, on compliance with the following:

3. The Bank shall submit to the Central Point of Contact Department II, BSP, not later than 5 banking days from such conversion:

    1. Adequacy of banking facilities including installation of security devices and accessibility to disabled persons under Subsections X181.4 and X160.10, respectively, of the Manual of Regulations for Banks (MORB);

    2. Posting in conspicuous places in the Branch's and EO's premises of the required notices, schedules and other relevant information pertaining to the Branch's and EO's lending and deposit operations under Sections X243 and Subsection X307.4 of the MORB;

    3. Availability of efficient means of reporting/ communication facilities (to be specified) between the head office and the branches; and

    4. The requirements enumerated under Subsection X151.2 of the MORB, as of the time of actual conversion of the Branch/EOs.

4. The Bank shall monitor and review on an ongoing basis, the performance of the approved Branch and Eos and whenever applicable, the Bank shall enhance its risk management and internal control systems to cover the risks arising from the new businesses to be generated by the said additional Branch and EOs;

5. In case the Bank fails to comply with any of the requirements under Subsection X151.2 of the MORB, on the prerequisites for the grant of authority to establish a Branch/EO as of the date of the intended opening of the Branch or EO/s, it shall refrain from opening the said Branch or EO/s on such date until it has complied with all requirements under said Subsection;

6. The Bank shall be immediately charged a processing fee of P73,500, net of 2% creditable withholding tax, for the approved Branch and EOs, to be deducted from its demand deposit account maintained with the BSP; and

7. Failure to operate the approved Branch or EO/s within the 3 year period shall result in the revocation of the Bank's authority to open the said Branch or EO/s and forfeiture of corresponding processing fee paid.

As at December 31, 2016, all of the aforementioned conditions had been complied with by the Bank.

The Bank owns 14 automated tellering machines (ATM) installed in the areas covered by Cantilan, Claver, Alegria, Tandag, Lingig, Madrid, Sogod and Lianga branches.

1.2 Membership in PHILPASS

On its regular meeting held on February 8, 2012, the BOD passed Resolution No. 12-029 granting authority to the management of the Bank to apply for membership with Philippine Payments and Settlement System (PHILPASS). PHILPASS is owned and operated by the BSP and is composed of the following entities, to wit: (a) BSP Payments and Settlements Office; (b) BSP Treasury Department; (c) BSP Provident Fund Office; (d) 35 Commercial Banks; (e) 3 Specialized Banks; (f) 38 Savings and Thrift Banks; (g) 1 Rurak Bank; and (h) 10 Non-Banks with Quasi-Banking Facility (NBQB).

PHILPASS is responsible for the processing and settlement of different banking transactions, such as: (a) inter-bank fund transfers and loan transactions (all and term) among banks and non-bank financial intermediaries performing quasi-banking functions (NBQB); (b) settlement of purchase and sale of government securities under outright and repurchase agreements (RP/RRP) between and among banks, NBQBs and the BSP in connection with BSP's Open Market Operations; and (c) settlement of Philippine Clearing House Corporation's (PCHC) check and electronic peso clearing.

Through its letter dated March 31, 2014, the BSP has approved the Bank's application for participation in PHILPASS. Enclosed in the said letter are signed and approved PHILPASS Participation Agreement, and browser user ID and password. The letter also mentioned that the Bank can already commence initiating online inquiries regarding its demand deposit accounts maintained with the BSP- debits, credits, interim, beginning and end of day balances and initiate interbank payment transactions.

The Bank is already a member of PHILPASS.

### 1.3 Awards and distinctions received

The Bank has been a recipient of the following awards and distinctions in the years 2016 and 2015:

| | |
|---|---|
| 2016 | • European Microfinance Award 2016 – Luxumbourg Top 10 Semifinalist<br>• Land Bank of the Philippines – Gawad CFI No. 1 Most Outstanding Countryside Financial Institution and Best CFI Availer for Agri – Agra Loans.<br>• Small Business Corporation – Gawad MSME Awards Most Distinguished Partner in Credit Guarantee |
| 2015 | 2015 International Microfinance Best Practices Award from Fondazione Giordano Dell'Amore – an Italy-based foundation that promotes awareness on the key role of microfinance as a means of alleviating poverty in developing countries. |

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### 2.1 Basis of preparation

The principal accounting policies applied in the preparation of these financial statements are summarized below. These have been consistently applied in the years presented, unless otherwise indicated.

Statement of compliance

The accompanying financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

Basis of measurement and presentation

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

Use of judgments and estimates

The preparation of financial statements in compliance with PFRS requires the use of certain critical accounting estimates. It also requires the Bank's management to exercise judgment in applying the Bank's accounting policies. The areas where significant judgments and estimates have been made in preparing the financial statements and their effects are disclosed in Note 3.

New and Amended Standards and Interpretations

<u>Standards and amendments effective before or on December 31, 2016</u>

Amendments to PFRS 10 Consolidated Financial Statements, PFRS 12 Disclosure of Interests in Other Entities and Philippine Accounting Standards (PAS) 28 Investments in Associates and Joint ventures: The amendments clarify a number of aspects of PFRS 10, PFRS 12 and PAS 28 in relation to the investment entities consolidation exception:

(i) How intermediate parent entities should apply the general scope exemption from preparing consolidated financial statements provided by PFRS 10.4, when the ultimate parent is an investment entity.

The amendments clarify that so long as the entity's ultimate (or intermediate) parent produces financial statements that are in compliance with PFRS 10 (including an investment entity that accounts for its interests in all of its subsidiaries at fair value rather than consolidating them), the exemption is available to the intermediate parent entity from presenting its own consolidated financial statements (so long as the other criteria of PFRS 10.4(a) have been met).

(ii) How an investment entity parent should account for a subsidiary that provides services related to its investment activities and is also itself an investment entity

The amendments clarify that an investment entity parent consolidates a subsidiary only when:
- The subsidiary is not itself an investment entity, and
- The subsidiary's main purpose is to provide services that relate to the investment entity's investment activities.

(iii) How PFRS 12 should be applied to an investment entity

The amendments clarify that an investment entity that prepares financial statements in which all of its subsidiaries are measured at fair value through profit or loss (FVTPL) is required to present the disclosures relating to investment entities as required by PFRS 12.

(iv) How a non-investment entity should account for its interests in any associates or joint ventures that are investment entities

The amendments clarify that for an entity that is not itself an investment entity but has an interest in an associate or joint venture that is an investment entity, the noninvestment entity may, when applying the equity method, retain the fair value measurement applied by the investment entity associate or joint venture to account for its own interests in its subsidiaries.

Amendments to PFRS 11 Joint Arrangements: The amendments require an entity to apply all of the principles of PFRS 3 Business Combinations when it acquires an interest in a joint operation that constitutes a business as defined by PFRS 3.

The amendment also includes two new Illustrative Examples:
- Example 7: Accounting for acquisitions of interests in joint operations in which the activity constitutes a business
- Example 8: Contributing the right to use know-how to a joint operation in which the activity constitutes a business.

A consequential amendment to PFRS 1 First-time Adoption of International Financial Reporting Standards has also been made, to clarify that the exemption from applying PFRS 3 to past business combinations upon adoption of PFRS also applies to past acquisitions of interests in joint operations in which the activity of the joint operation constitutes a business.

PFRS 14 regulatory Deferral Accounts: PFRS 14 is an interim standard, pending the outcome of the PASB's more comprehensive Rate-regulated Activities project, which was re-opened in September 2012.

In many countries, industry sectors (including utilities such as gas, electricity and water) are subject to rate regulation where governments regulate the supply and pricing. This can have a significant effect on the amount and timing of an entity's revenue. Some national Generally Accepted Accounting Principles (GAAP) require entities, that operate in industry sectors subject to rate regulation, to recognize associated assets and liabilities.

The scope of PFRS 14 is narrow, with this extending to cover only those entities that:
- Are first-time adopters of PFRS
- Conduct rate regulated activities
- Recognize associated assets and/or liabilities in accordance with their current national GAAP.

Entities within the scope of PFRS 14 would be afforded an option to apply their previous local GAAP accounting policies for the recognition, measurement and impairment of assets and liabilities arising from rate regulation, which would be termed regulatory deferral account balances.

Any regulatory deferral account balances, and their associated effect on profit or loss, would be recognized and presented separately from other items in the primary financial statements. As a result, for those entities that elect to adopt PFRS 14, all other line items and subtotals would exclude the effects of regulatory deferral accounts, meaning that they would be comparable with other entities that report in accordance with PFRS but do not apply PFRS 14.

Application guidance is included in PFRS 14 in respect of other PFRS that would need to be considered alongside the previous national GAAP accounting requirements in order for these regulatory deferral accounts to be accounted for appropriately in an entity's PFRS financial statements, including:

- PAS 10 Events after the Reporting Period
- PAS 12 Income Taxes
- PAS 28 Investments in Associates and Joint Ventures
- PAS 33 Earnings per Share
- PAS 36 Impairment of Assets
- PFRS 3 Business Combinations
- PFRS 5 Non-current Assets Held for Sale and Discontinued Operations
- PFRS 10 Consolidated Financial Statements
- PFRS 12 Disclosure of Interests in Other Entities.

Amendments to PAS 1 Presentation of Financial Statements: The amendments made to PAS 1 include:

- Materiality: Aggregation or disaggregation should not obscure useful information. Materiality applies to each of the primary financial statements, the notes and each specific disclosure required by PFRS.
- Line items in primary financial statements: Additional guidance for the line items required to be presented in primary statements, in particular that it may be appropriate for these to be disaggregated, and new requirements regarding the use of subtotals.
- Notes to the financial statements: Determination of the order of the notes should include consideration of understandability and comparability of financial statements. It has been clarified that the order listed in PAS 1.114(c) is illustrative only.
- Accounting policies: Removal of the examples in PAS 1.120 in respect of income taxes and foreign exchange gains and losses.

In addition, the following amendments to PAS 1 were made which arose from a submission received by the PFRS Interpretations Committee:

- Equity accounted investments: An entity's share of other comprehensive income (OCI) will be split between those items that will and will not be reclassified to profit or loss, and presented in aggregate as single line items within those 2 groups.

Amendments to PAS 16 Property, Plant and Equipment (PPE) and PAS 38 Intangible Assets

Clarification of Acceptable Methods of Depreciation and Amortization

PAS 16 has been amended to prohibit the use of revenue-based methods of depreciation for items of PPE. This is because the revenue generated by an activity that includes the use of an item of PPE generally reflects factors other than the consumption of the economic benefits of the item, such as:

- Other inputs and processes
- Selling activities and changes in sales
- Volumes and prices, and
- Inflation.

Guidance on depreciation has been expanded to state that expected future reductions in the selling price of items produced by an item of PPE could indicate technical or commercial obsolescence (and therefore a reduction in the economic benefits embodied in the item), rather than a change in the depreciable amount or period of the item.

PAS 38 has been amended to incorporate a rebuttable presumption that Amortization based on revenue is not appropriate. The presumption can be rebutted if either:

- The intangible asset is expressed as a measure of revenue; or
- Revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

Amendments to PAS 16 PPE and PAS 41 Agriculture: The amendments extend the scope of PAS 16 to include bearer plants and define a bearer plant as a living plant that:

- Is used in the production process of agricultural produce,
- Is expected to bear produce for more than one period; and
- Has a remote likelihood of being sold (except incidental scrap sales).

The changes made result in bearer plants being accounted for in accordance with PAS 16 using either:

- The cost model, or
- The revaluation model.

As such, bearer plants are no longer within the scope of PAS 41. However, the agricultural produce of bearer plants remains within the scope of PAS 41.

The amendments include the following transitional reliefs for the purposes of first time application:

- Deemed cost exemption – Entities are allowed to use the fair value of the bearer plants at the beginning of the earliest period presented as deemed cost for PAS 16 purposes.
- Disclosures – Quantitative information describing the effect of the first time application as required by PAS 8.28(f) is not required for the current reporting period, but is required for each prior period presented.

Amendments to PAS 27 Separate Financial Statements: The amendments include the introduction of an option for an entity to account for its investments in subsidiaries, joint ventures, and associates using the equity method in its separate financial statements. The accounting approach that is selected is required to be applied for each category of investment.

Before the amendments, an entity accounted for its investments in subsidiaries, joint ventures or associates either at cost or in accordance with PFRS 9 Financial Instruments (or PAS 39 Financial Instruments: Recognition and Measurement for those entities that have yet to adopted PFRS 9). The option to present its investments using the equity method result in the presentation of a share of profit or loss, and other comprehensive income, of subsidiaries, joint ventures and associates with a corresponding adjustment to the carrying amount of the equity accounted investment in the statement of financial position. Any dividends received are deducted from the carrying amount of the equity accounted investment, and are not recorded as income in profit or loss.

A consequential amendment was also made to PAS 28 Investments in Associates and Joint Ventures, to avoid a potential conflict with PFRS 10 Consolidated Financial Statements for partial sell downs.

Amendments to PAS 34 Interim Financial Reporting - Disclosure of information 'elsewhere in the interim financial report': PAS 34 requires certain disclosures to be presented in the notes to the interim financial report, unless they are presented elsewhere in the interim financial report (such as a front end management report).

If the disclosures are presented 'elsewhere' in the interim financial report, such as in the management commentary or the risk report of an entity, a cross reference must be made from the notes to the interim financial statements to where the disclosures have been made. Further, if the disclosures are contained in a separate document from the interim report, that document needs to be available on the same terms and at the same time as the interim report itself.

Annual Improvements to PFRSs (2012 – 2014 Cycle)

PFRS 5 Non-current Assets Held for Sale and Discontinued Operations - Changes in methods of disposal: The amendment clarifies that the reclassification of an asset or disposal group from being held for sale to being held for distribution to owners, or vice versa is considered to be a continuation of the original plan of disposal. Upon reclassification, the classification, presentation and measurement requirements of PFRS 5 are applied. If an asset ceases to be classified as held for distribution to owners, the requirements of PFRS 5 for assets that cease to be classified as held for sale apply.

PFRS 7 Financial Instruments: Disclosures: The amendments to PFRS 7 dealt with two aspects: servicing of contracts and the applicability in interim financial statements of the offsetting amendments made to PFRS 7 in December 2011.

(i) Servicing contracts

The Philippine Accounting Standards Board (PASB) clarified the circumstances in which an entity has continuing involvement from the servicing of a transferred asset. Continuing involvement exists if the servicer has a future interest in the performance of the transferred financial asset. Examples of situations where continuing involvement exist are where a transferor's servicing fee is:
- A variable fee which is dependent on the amount of the transferred asset that is ultimately recovered; or
- A fixed fee that may not be paid in full because of non-performance of the transferred financial asset.

The amendment is required to be applied retrospectively in accordance with PAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. However, the amendment does not need to be applied for any period beginning before the annual period in which the entity first applies the amendments. A consequential amendment has been made to PFRS 1 First-time Adoption of International Financial Reporting Standards, in order that the same transitional provision applies to first time adopters.

(ii) Applicability of offsetting in condensed interim financial statements

A further amendment to PFRS 7 has clarified that the application of the amendment Offsetting Financial Assets and Financial Liabilities (Amendments to PFRS 7) issued in December 2011 is not explicitly required for all interim periods. However, it is noted that in some cases these disclosures may need to be included in condensed interim financial statements in order to comply with PAS 34.

PAS 19 Employee benefits - Discount rate - regional market issue: The guidance in PAS 19 has been clarified and requires that high quality corporate bonds used to determine the discount rate for the accounting of employee benefits need to be denominated in the same currency as the related benefits that will be paid to the employee.

Entities are required to apply the amendment from the earliest comparative period presented in the financial statements, with initial adjustments being recognized in retained earnings at the beginning of that period.

Future Changes in Accounting Policies (ver 28Mar2017)

| Standard/Amendment/Interpretation | Effective for annual periods on or after |
|---|---|
| ▪ Amendments to PAS 7 Statement of Cash Flows, Disclosure Initiative<br>▪ Amendments to PAS 12 Income Taxes, Recognition of Deferred Tax Assets for Unrealized Losses | January 1, 2017 |
| ▪ PFRS 9 Financial Instruments (2014)<br>▪ Amendments to PFRS 2 Share-based Payment, Classification and Measurement of Share-based Payment Transactions | January 1, 2018 |
| ▪ PFRS 16 Leases | January 1, 2019 |
| ▪ Amendments to PFRS 10 Consolidated Financial Statements, PFRS 12 Disclosure of Interests in Other Entities and PAS 28 Investments in Associates and Joint Ventures, Sale or Contribution of Assets between an Investor and its Associate or Joint Venture<br>▪ PFRS 15 Revenue from Contracts with Customers and Amendments, Clarifications to PFRS 15<br>▪ Amendments to PFRS 4 Insurance Contracts, Applying PFRS 9 Financial Instruments with PFRS 4 Insurance Contracts<br>▪ Amendments to PAS 40 Investment Property, Transfers of Investment Property<br>▪ Annual Improvements to PFRSs 2014 - 2016 Cycle<br>- Amendment to PFRS 1 - Deletion of short-term exemptions for first-time adopters<br>- Amendment to PFRS 12 - Clarification of the scope of the standard | Issued by IASB but pending adoption in the Philippines |

| Standard/Amendment/Interpretation | Effective for annual periods on or after |
|---|---|
| - Amendment to PAS 28 - Measuring an associate or joint venture at fair value<br>▪ Philippine Interpretation IFRIC-22, Foreign Currency Transactions and Advance Consideration | |

Effective January 1, 2017

- Amendments to PAS 7 Statement of Cash Flows, Disclosure Initiative
  The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.

  Earlier application is permitted.

- Amendments to PAS 12 Income Taxes, Recognition of Deferred Tax Assets for Unrealized Losses

  The amendment clarifies that unrealized losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the holder expects to recover the carrying amount through sale or use.

  Earlier application is permitted.

Effective January 1, 2018

- PFRS 9 Financial Instruments (2014)
  The new standard replaces PAS 39 and introduces the following changes:
  - Financial assets are either classified and measured at (a) amortized cost, (b) fair value through other comprehensive income (FVTOCI) or (c) fair value through profit or loss (FVPL) based on the following criteria:
    - Amortized cost financial assets are debt instruments that meet the two-stage test: (1) the entity's business model must be to collect the contractual cash flows from the asset and (2) the asset's contractual cash flows represent solely payments of principal and interest.
    - FVTOCI financial assets are debt instruments that meet the SPPI test and are held within a business model whose objective is both to collect the contractual cash flows and sell the financial assets.
    - Entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment that is not held for trading in profit or loss.
    - All other financial assets including those held for trading are subsequently measured at FVPL.
  - Changes in the fair value of a FVPL financial liability that are attributable to changes in the entity's own credit risk will typically be recorded in OCI instead of profit or loss.
  - The amount of impairment recognized for financial assets is based on expected credit losses (ECL). Generally, 12-month ECL is recognized upon initial recognition. However, if the credit risk has increased significantly, lifetime ECL is recognized.
  - The general hedge accounting measurements from PAS 39 have been retained but with a broader range of eligible hedging instruments and hedged items. The effectiveness test has been replaced with the principle of economic relationships and retrospective assessment of hedge effectiveness is no longer required.

  Earlier application is permitted. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

- Amendments to PFRS 2 Share-based Payment, Classification and Measurement of Share-based Payment Transactions

  The amendment clarifies that in estimating the fair value of a cash-settled share-based payment, the accounting for the effects of vesting and non-vesting conditions follow that of equity-settled share-based payments. It also clarifies how to account for a modification of share-based payment from cash-settled to an equity-settled.

Earlier application is permitted.

Effective January 1, 2019

- PFRS 16 Leases
  The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with PFRS 16's approach to lessor accounting substantially unchanged from its predecessor, PAS 17.

  Earlier application is permitted only after the adoption of PFRS 15.

Issued by IASB but pending adoption in the Philippines

- Amendments to PFRS 10 Consolidated Financial Statements, PFRS 12 Disclosure of Interests in Other Entities 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 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.

  The amendments must be applied prospectively. Earlier application is permitted.

  On January 13, 2016, the Financial Reporting Standards Council decided to postpone the original effective date of February 9, 2016 of the above amendments until the International Accounting Standards Board (IASB) has completed 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.

- PFRS 15 Revenue from Contracts with Customers and Amendments, Clarifications to PFRS 15

  PFRS 15 replaces all existing revenue requirements in PFRS and applies to all revenue arising from contracts with customers, unless the contracts are in the scope of other standards. The standard outlines the principles an entity must apply to ensure and recognize revenue. The core principle is that an entity will recognize revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer.

  The principles in PFRS 15 will be applied using a five-step model. 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 their customers.

  The related amendment clarifies certain topics and provides transition relief for modified and completed contracts.

  The standard, together with the related amendment, is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

- Amendments to PFRS 4 Insurance Contracts, Applying PFRS 9 Financial Instruments with PFRS 4 Insurance Contracts

  The amendment allows the use of the overlay approach wherein the company applies PFRS 9 but is permitted to reclassify amounts between profit or loss and OCI for eligible financial assets.

  The standard is effective for annual reporting periods beginning on or after January 1, 2018.

- Amendments to PAS 40 Investment Property, Transfers of Investment Property

  The amendment clarifies that an entity shall transfer a property to or from investment property only when there is an evidence of change in use.

  The amendment is effective for annual reporting periods beginning on or after January 1, 2018. Earlier application is permitted.

- Annual Improvements to PFRSs 2014 - 2016 Cycle
  - Amendment to PFRS 1 - Deletion of short-term exemptions for first-time adopters
    The amendment removes a number of short-term exemptions available to first-time adopters.

    The amendment is effective for annual reporting periods beginning on or after January 1, 2018. Earlier application is permitted.

  - Amendment to PFRS 12 - Clarification of the scope of the standard
    The amendment clarifies that the disclosure requirements required by the standard, except for summarized financial information required by paragraphs B10 – B16, also apply to interests that are classified as held for sale, as held for distribution to owners or as discontinued operations.

    The amendment is effective for annual reporting periods beginning on or after January 1, 2017. Earlier application is permitted.

  - Amendment to PAS 28 - Measuring an associate or joint venture at fair value
    The amendment permits an investment in an associate or joint venture to be measured at fair value through profit or loss, instead of the equity method being applied, if the investment is held directly or indirectly through a venture capital organization, unit trust or similar entities. This election is made on an investment-by-investment basis upon initial recognition.

    The amendment is effective for annual reporting periods beginning on or after January 1, 2018. Earlier application is permitted.

- Philippine Interpretation IFRIC-22, Foreign Currency Transactions and Advance Consideration

  The interpretation clarifies that the exchange rate to use on initial recognition of an asset, expense or income is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

  The interpretation is effective for annual reporting periods beginning on or after January 1, 2018. Earlier application is permitted.

2.2 Financial instruments

Date of recognition

Financial assets and financial liabilities are recognized in the statement of financial position when the Bank becomes a party to the contractual provisions of the instrument. Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on the settlement date. Derivatives are recognized on trade date basis. Deposits, amounts due to banks and customers and loans are recognized when cash is received by the Bank or advanced to the borrowers.

Initial recognition

All financial instruments are initially measured at fair value. Except for financial assets and financial liabilities valued at FVPL, the initial measurement of financial instruments includes transaction costs.

Determination of fair value

The fair value of financial instruments traded in active markets at the financial reporting date is based on their quoted market price or dealer price quotation (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and asking prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

If the financial instruments are not listed in an active market, the fair value is determined using appropriate valuation techniques which include recent arm's length market transactions, net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models, and other relevant valuation models.

Classification of financial instruments

The Bank classifies its financial assets in the following categories: financial assets at FVPL, held-to-maturity (HTM) investments, available-for-sale (AFS) investments and loans and receivables. Financial liabilities are classified as financial liabilities at FVPL and other financial liabilities. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. Management determines the classification of its financial assets and financial liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation at every financial reporting date.

The Bank's accounting policy for each category of financial instruments is as follows:

Financial assets at FVPL

Financial assets at FVPL include financial assets held for trading and financial assets designated upon initial recognition as at FVPL. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments.

The Bank had no financial asset under this category as at December 31, 2016 and 2015.

HTM investments

HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Bank has the positive intention and ability to hold to maturity. After initial measurement, these investments are measured at amortized cost using the effective interest method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate (EIR). Gains and losses are recognized in profit or loss when the HTM investments are derecognized or impaired, as well as through the amortization process.

The Bank had financial asset under this category as at December 31, 2016 and 2015 (Note 8).

AFS investments

AFS investments are non-derivative financial assets that are either designated in this category or are not classified in any of the other categories. After initial measurement, AFS investments are subsequently measured at fair value in the statements of financial position. Changes in the fair value of such assets are reported in other comprehensive income until the investment is derecognized or the investment is determined to be impaired.

On derecognition or impairment, the cumulative gain or loss previously reported in other comprehensive income is transferred to profit or loss. Interests earned on holding AFS investments are recognized in profit or loss using the effective interest method.

The Bank had no financial asset under this category as at December 31, 2016 and 2015.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are entered into with the intention of immediate or short-term resale and are not designated as AFS or financial assets at FVPL. After initial measurement, loans and receivables are carried at amortized cost, less allowance for credit losses and impairment in value. Gains and losses are recognized in income when the loans and receivables are derecognized or impaired, as well as through amortization process. Unearned discount is recognized as income over the life of the loan using the effective interest method. Interest income on non-discounted loan is accrued and earned, except in the case of the past due accounts as required by the existing regulations of the BSP. Interest income on these past due accounts is recognized upon actual collection.

Included in this category are the cash and other cash items, amounts due from BSP and other banks, loans receivable, and other assets (accounts receivables, insurance and refundable deposits) (Notes 4, 5, 6, 7 and 12).

Financial liability at FVPL

Financial liabilities are classified in this category if these result from trading activities or derivative transactions that are not accounted for as hedges, or when the Bank elects to designate a financial liability under this category.

The Bank had no designated financial liability at FVPL as at December 31, 2016 and 2015.

Other financial liabilities

This classification pertains to financial liabilities that are not held for trading or not designated as FVPL upon the inception of the liability. These include liabilities arising from operations or borrowings (e.g. payables or accruals and long-term debt).

The financial liabilities are recognized initially at fair value and are subsequently measured at amortized cost, taking into account the impact of applying the effective interest method of amortization (or accretion) for any related premium, discount and any directly attributable transaction costs. However, liabilities that have no stated interest and due to be settled within 1 year are measured at the undiscounted amount of cash or other consideration expected to be paid.

Included in this category are the Bank's deposit liabilities, bills payable, accrued expenses and other liabilities (Notes 13, 14 and 15).

Fair value measurement

There were no financial instruments and non-financial assets measured at fair value. Fair values of financial instruments measured at amortized cost are disclosed in Note 27.

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 by 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.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

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
- 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 financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing 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.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

Financial guarantees

A financial guarantee is classified in this category if the entity must provide for payments to be made if and only if the debtor fails to make payment when due. In order for a contract to meet the definition of a guarantee, it would be necessary that the guaranteed party only receives the exact amount of lost advances from the default of the debtor. Such a contract could be structured in two ways: a) the guarantor purchases the defaulted loan for its nominal amount instead of making a payment for the best estimate of loss; or b) on settlement of the final loss, there is a further payment between the guarantor and guaranteed party for any difference between that amount and the initial loss estimate that was paid.

Such contracts are recognized initially at fair value and subsequently carried at the higher of the initial value that would be recognized if PAS 37, Provisions, Contingent Liabilities ad Contingent Assets or PAS 18, Revenue was applied.

The Bank had no financial guarantee as at December 31, 2016 and 2015.

Derecognition of financial assets and liabilities

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized when: a) the rights to receive cash flows from the asset have expired; b) 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; or c) the Bank has transferred its rights to receive cash flows from the asset and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Bank’s continuing involvement in the asset.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

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

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in profit or loss.

Impairment of financial assets

Assessment of impairment

The Bank assesses at each financial reporting date whether 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 asset or group of financial assets that can be reliably estimated. It assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment.

The determination of impairment losses for financial assets is inherently subjective because it requires material estimates, including the amount and timing of expected recoverable future cash flows. These estimates may change significantly from time to time, depending on available information.

Evidence of impairment

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advances by the Bank on terms that the Bank would not otherwise consider, disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers, or economic conditions that correlate with defaults.

Impairment on financial assets carried at amortized cost

The allowance for credit losses is the estimated amount of losses in the Bank's loan portfolio. This is maintained at a level considered adequate to provide for potential losses on receivables and other assets. The level of allowance is based on the higher of management's evaluation of potential losses after consideration of prevailing and anticipated economic conditions, collection and credit experience with specific accounts and an evaluation of potential losses based on existing guidelines of the BSP and the management's judgment as to identifiable losses on specific accounts based on past collection experience, collateral position and account documentation. The BSP requires banks to observe certain criteria and guidelines based largely on the classification of loans in establishing the allowance for credit losses.

The Monetary Board requires banks and other financial intermediaries to set up on a regular basis, valuation reserves or allowance for credit losses against loans and other risk assets in accordance with the following:

| Classification | Allowance |
|---|---|
| a. Unclassified | 0% |
| b. Loans especially mentioned | 5% |
| c. Substandard | |
| - secured | 10% |
| - unsecured | 25% |
| d. Doubtful | 50% |
| e. Loss | 100% |

In addition to the specific allowance for probable losses, a general provision for loan losses shall be set up as follows:

a. Five percent (5%) of the outstanding balance of unclassified restructured loans less the outstanding balance of restructured loans which are considered non-risk under existing laws, rules and regulations; and

b. One percent (1%) of the outstanding balance of unclassified loans other than restructured loans less loans which are considered non-risk under existing laws, rules and regulations.

The allowance for credit losses is established through provisions charged to operations. Loans are written off against the allowance for credit losses when management believes that the collectability nof the principal is remote.

Impairment on financial assets carried at cost

If there is an objective evidence of an impairment loss on an unquoted equity/debt instrument that is not carried at fair value because its fair value cannot be reliably measured, or of a derivative asset that is linked to and must be settled by delivery of such as unquoted equity/debt instrument, 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 discounted at the current market rate of return for a similar financial asset. Such impairment losses shall not be reversed.

Reversal of impairment loss

If, in 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, the previously recognized impairment loss is reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in profit or loss.

Classification of financial instruments between debt and equity

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest relating to a financial instrument or a component that is a financial liability is reported as expense.

A financial instrument is classified as debt if it provides for a contractual obligation to:

(a) deliver cash or another financial assets to another entity; or
(b) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Bank; or
(c) satisfy the obligation other than by the exchange of a fixed amount of cash or other financial asset for a fixed number of own equity shares.

If the Bank does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statements of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the statements of financial position.

Derivatives

Derivatives are initially recognized at fair value on the date in which the derivative transaction is entered into or bifurcated, and are substantially re-measured at fair value. Derivatives are carried as an asset when the fair value is positive and as a liability when the fair value is negative.

The Bank had no derivative transactions as at December 31, 2016 and 2015.

Embedded derivatives

An embedded derivative is separated from the host contract and accounted for as derivative if all of the following conditions are met: (a) economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host contract; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (c) the hybrid or combined instrument is not recognized at FVPL.

The Bank had no transactions with embedded derivatives as at December 31, 2016 and 2015.

2.3 Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, and amounts due from BSP and other banks with maturities of three months or less from dates of placement that have insignificant risk of changes in value.

2.4 Bank premises, furniture, fixtures and equipment

Bank premises, furniture, fixtures and equipment are stated at cost less accumulated depreciation and amortization and any impairment losses. Costs comprise its construction cost or purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the fixed assets have been put into operation, such as repairs and maintenance, are normally charged to operations in the period in which costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of the asset beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of the asset.

Depreciation is computed using the straight-line method over the estimated useful lives of the properties as follows:

| Category | Estimated useful life |
|---|---|
| Bank premises (buildings) | 15 years |
| Furniture, fixtures and equipment | 2 to 5 years |
| Transportation equipment | 5 to 10 years |
| Leasehold rights and improvements | 5 to 10 years |
| Information technology | 5 to 20 years |

Leasehold improvements are amortized over the term of the lease or the life of the improvements, whichever is shorter.

The useful lives and depreciation and amortization methods are reviewed periodically to ensure that the period and methods of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of bank premises, furniture, fixtures and equipment.

An item of bank premises, furniture, fixtures and equipment 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 on 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 period the item is derecognized.

Fully depreciated assets are retained in the accounts until they are no longer in use and no further depreciation is charged to profit or loss.

### 2.5 Investment properties

Property that is held either to earn rental income or for capital appreciation or for both and that is not significantly occupied by the Bank is classified as investment property. Investment properties are measured initially at its cost plus any transaction costs.

An investment property acquired through an exchange transaction is measured at fair value of the asset acquired unless the (a) the exchange transaction lacks commercial substance, or (b) the fair value of neither the asset received nor the asset given up is reliably measurable in which case the investment property acquired is measured at the carrying amount of asset given up.

Real properties acquired (RPA) in settlement of loans through foreclosure or dation in payment are classified under 'Investment Properties' upon: (1) entry of judgment in case of judicial foreclosure; (2) execution of the Sheriff's Certificate of Sale in case of extrajudicial foreclosure; and (3) notarization of the Deed of Dacion in case of dation in payment (dacion en pago).

RPA is initially measured at the carrying amount of the loan (i.e., outstanding loan balance adjusted for any unamortized premium or discount less allowance for credit losses) plus booked accrued interest less allowance for credit losses plus transaction costs incurred upon acquisition (such as non-refundable capital gains tax and documentary stamp tax paid in connection with the foreclosure/purchase of the acquired real estate property). Where the booked amount of RPA exceeds the appraised value of the acquired property, an allowance for credit losses equivalent to the excess of the amount booked over the appraised value is set up. Where the carrying amount of ROPA exceeds P5 million, the appraisal of the foreclosed/purchased asset shall be conducted by an independent appraiser acceptable to the BSP.

The carrying amount of investment properties shall be allocated to land, building and other non-financial assets based on their fair values, which allocated carrying amounts shall become their initial costs.

Subsequent to initial recognition, investment properties, except for land, are stated at cost less accumulated depreciation and any impairment in value. Depreciation is computed on the straight-line method using the estimated useful life of 8 years. Land is stated at cost less any impairment in value.

Investment properties are derecognized when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any resulting gain or loss from the retirement or disposal of an investment property is included in profit or loss in the year of retirement or disposal.

Expenditures incurred after the investment properties have been put into operations, such as repairs and maintenance costs, are normally charged to operations in the year in which the costs are incurred.

Transfers are made to investment properties when, and only when, there is a change in use evidenced by ending of owner occupation, commencement of an operating lease to another party or ending of construction or development. Transfers are made from investment properties when, and only when, there is a change in use evidenced by commencement of owner occupation or commencement of development with a view to sale.

### 2.6 Intangible assets

An intangible asset is measured initially at cost. An intangible asset is recognized if, and only if: (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the Bank; and (b) the cost of the asset can be measured reliably.

Intangible assets consist of the Bank's computer software and other licenses which were separately acquired. The cost of a separately acquired intangible asset comprises: (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and (b) any directly attributable cost of preparing the asset for its intended use.

After initial recognition, intangible assets are carried at its cost less any accumulated amortization and any accumulated impairment losses. The depreciable amount of an intangible asset with a finite useful life is allocated on a systematic basis over its useful life. Amortization begins when the asset is available for use (i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management). The Bank assesses the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

Amortization is computed using the straight-line method over the estimated useful life of the asset as follows:

| Category | Estimated useful life |
|---|---|
| Computer software | 15 years |
| Other licenses | 3-5 years |

The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortization period will be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the amortization method will be changed to reflect the changed pattern. Such changes are accounted for as changes in accounting estimates in accordance with PAS 8.

An intangible asset is derecognized: (a) on disposal; or (b) when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an intangible asset is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset, which is recognized in profit or loss when the asset is derecognized.

## 2.7 Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets such as bank premises, furniture, fixtures and equipment and investment properties are reviewed at each financial reporting date to determine whether there is any indication of impairment or an impairment loss previously recognized no longer exists or may have decreased. If any such indication exists, the asset's recoverable amount is estimated.

An impairment loss is recognized in profit or loss whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount.

The recoverable amount of a non-financial asset is the greater of the asset's fair value less costs to sell and its value in use. The fair value less costs to sell is the amount obtainable from the sale of the asset in an arm's length transaction. 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. For an asset that does not generate cash flows largely independent of those assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized. Reversals of impairment are recognized in profit or loss.

## 2.8 Other assets

### Prepayments

Prepayments represent expenses not yet incurred but already paid in cash. Prepayments are initially recorded as assets and measured at the amount of cash paid. Subsequently, these are charged to profit or loss as they are consumed in the operations or expire with the passage of time.

Stationery and supplies

Stationery and supplies represent items of various supplies already purchased but not yet used/consumed. These are recorded as asset and measured at the amount or cash paid. Subsequently, these are charged to profit or loss as they are consumed.

2.9 Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and reliable estimate can be made of the amount of the obligation. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events. The amount recognized is the best estimate of the expenditure required to settle the present obligation at financial reporting date, that is, the amount the Bank would rationally pay to settle the obligation to a third party.

2.10 Contingent liabilities and contingent assets

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

2.11 Income recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured.

The following specific recognition criteria must be met before revenue is recognized:

Interest income on loan receivables

Interest income on non-discounted receivables is recognized based on the effective interest method, except in case of non-performing receivables which is in accordance with existing BSP regulations. Interest income on these non-performing receivables is recognized only upon collection.

Interest income on bank deposits and investment

Interest income on bank deposits and investments is recognized as the interest accrues usually on a time proportion basis taking into account the effective yield on the asset or EIR. Interest income earned from investments, deposits and placements is presented net of applicable tax withheld by banks.

Service charges and fees from loans

Service charges and fees that are directly related to the acquisition and origination of loans are included in the cost of the receivable and are recognized as income over the term of the loan.
Service charges and fees from providing transaction services

Service charges and fees other than those directly related to acquisition and origination of loans or those arising from other transaction services – such as western union money transfer, conditional cash transfer and others - are recognized as income upon collection or accrued when there is reasonable degree of certainty as to its collectability.

Gains (losses) from sale/de-recognition of non-financial assets

Gains (losses) on sale/derecognition of non-financial assets are recognized when the title of the assets is transferred to the buyer or when collectability of the entire sales is reasonably assured. It is determined as the difference between the net selling price and the carrying amount of the asset, which is recognized in profit or loss in the period of the retirement or disposal.

Miscellaneous income

This includes inspection and filing fees collected relative to the loans released and penalties on past due loans and other income, which are normally recorded at the time these are collected.

2.12 Interest expense

Interest expense on deposit liabilities is recognized in profit or loss when incurred. It is calculated using the effective interest method and is credited to the depositors' account regularly.

Interest incurred on bills payable and other borrowings is recognized in profit or loss when incurred.

2.13 Cost and expense recognition

Costs and expenses are recognized in profit or loss: (a) when a decrease in future economic benefits related to a decrease in an asset or an increase in a liability has arisen that can be measured reliably; (b) on the basis of a direct association between the costs incurred and the earning of specific items of income; (c) on the basis of systematic and rational allocation procedures when economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined; or (d) immediately when an expenditure produces no future economic benefits or when, and to the extent that, future economic benefits do not qualify, or cease to qualify, for recognition in the statements of financial position as an asset. Operating expenses are costs attributable to the general and administrative activities of the Bank.

2.14 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 the specific asset or assets and the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

a. There is a change in contractual terms, other than a renewal or extension of the arrangement;
b. A renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;
c. There is a change in the determination of whether fulfillment is dependent on a specified asset;
d. There is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios (a), (c) or (d) above; and at the date of renewal or extension period for scenario (b).

Bank as lessee

Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Operating lease payments are recognized as expense in profit or loss over the lease term on a straight-line basis.

Bank as lessor

Leases where the Bank does not transfer substantially all the risk and benefits of ownership of the assets are classified as operating leases. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and are recognized over the lease term on the same basis as the rental income. Contingent rents are recognized as revenue in the year in which they are earned.

2.15 Employee benefits

Short-term employee benefits

Short-term employee benefits are recognized as expense in the period when the economic benefits are given. Unpaid benefits at the end of the accounting period are recognized as accrued expense while benefits paid in advance are recognized as prepayment to the extent that it will lead to a reduction in future payments.

Retirement benefits

The Bank has a funded defined benefit pension plan provided based on specific level of benefit for every year of service, which comply with the minimum requirement of RA No. 7641.

The cost of providing benefits under the defined benefit plan is determined using the projected unit credit method. Under this method, the current service cost is the present value of retirement benefits payable in the future with respect to services rendered in the current year.

The net defined benefit liability or asset is the aggregate of the present value of the defined benefit obligation at the end of the financial reporting period reduced by the fair value of plan assets (if any), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

Defined benefit costs comprise the following: a) service cost; b) net interest on the net defined benefit liability or asset; and c) 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 profit or loss. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuaries.

Net interest on the net defined benefit liability or asset is the change during the period in the net defined benefit liability or asset that arises from the passage of time which is determined by applying the discount rate based on government bonds to the net defined benefit liability or asset. Net interest on the net defined benefit liability or asset is recognized as expense or income in profit or loss.

Remeasurements comprising actuarial gains and losses, return on plan assets and any change in the effect of the asset ceiling (excluding net interest on defined benefit liability) are recognized immediately in other comprehensive income in the period in which they arise. Remeasurements are not reclassified to profit or loss in subsequent periods.

Termination benefits

Termination benefits are payable when employment is terminated by the Bank before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Bank recognizes termination benefits when it is demonstrably committed to either: (a) terminate the employments of current employees according to a detailed formal plan without possibility of withdrawal; or (b) provide termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the financial reporting date are discounted to present value.

Compensated absences

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the financial reporting date.

2.16 Income taxes

Current income tax

Current income tax assets and liabilities for the current and the prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are substantively enacted at the financial reporting date.

### Deferred income tax

Deferred income tax is provided on all temporary differences at the financial reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognized for all taxable temporary differences, except:

- Where the deferred tax liability arises from the initial recognition of goodwill or 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 profit nor taxable profit or loss.

- In respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from excess minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT) and unused net operating loss carryover (NOLCO), to the extent that it is probable that sufficient taxable profit will be available against which the deductible temporary differences and carryforward of unused tax credits from MCIT and unused NOLCO can be utilized.

The carrying amounts of deferred tax assets are reviewed at each financial reporting date and reduced to the extent that it is no longer 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 each financial reporting date and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the financial reporting date.

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

## 2.17 Borrowing costs

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds. These are recognized as expense when incurred except when such costs relate to a qualifying asset, in which case, borrowing costs incurred will be capitalized. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

## 2.18 Deposit for stock subscription

Deposit for stock subscription represents cash payments received from stockholders intended for additional capital for the Bank. The Bank classifies a contract to deliver its own equity instrument under equity as a separate account if all of the following elements are present as of the end of the financial reporting period:

1. The unissued authorized capital stock of the entity is insufficient to cover the amount of shares indicated in the contract;
2. There is Board of Directors' approval on the proposed increase in authorized capital stock (for which a deposit was received by the corporation);
3. There is stockholders' approval of said proposed increase; and
4. The application for the approval of the proposed increase has been filed with Securities and Exchange Commission (SEC).

The SEC approved the proposed increase in capital stock on August 8, 2015 (Note 1).

## 2.19 Equity

### Capital stock

Capital stock is determined using the nominal value of shares that have been issued. When the Bank issues more than one class of stock, a separate account is maintained for each class of stock and the number of shares issued.

### Retained earnings

Retained earnings - include all current and prior period results (other comprehensive income) less any dividend declaration/distribution and prior period correction/adjustment, if any.

## 2.20 Dividends on common shares

Cash dividends on common shares are recognized as a liability and deducted from the equity when approved by the BOD and the BSP. Stock dividends are deducted from equity when approved by the BOD, the stockholders and the BSP. Dividends declared during the year but are approved by the BSP after the financial reporting period is dealt with as events after the financial reporting period.

## 2.21 Earnings per share

Basic earnings per share (EPS) is determined by dividing net profit or loss attributable to the ordinary equity holders of the Bank for the year by the weighted average number of ordinary shares outstanding during the year, after considering the retroactive effect of any stock dividends declared during the year, if any.

For the purpose of calculating diluted EPS, the net profit or loss attributable to ordinary equity holders of the Bank and the weighted average number of shares outstanding are adjusted for the effects of all dilutive potential ordinary shares.

## 2.22 Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making the financial and operating decisions. Parties are also considered to be related if they are subject to common control. Key management personnel and post-employment benefit plan are considered related parties.

## 2.23 Events after the end of the reporting period

Post year-end events up to the date of authorization for issue of the financial statements that provide additional information about the Bank’s position at the financial reporting date (adjusting events) are reflected in the financial statements. Post year-end events that are not adjusting events are disclosed in the notes to financial statements when material.

# NOTE 3 – CRITICAL ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the financial statements in compliance with PFRS requires management to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The judgments, estimates and assumptions are based on management’s evaluation of relevant facts and circumstances as of the date of the financial statements. Actual results could differ from these estimates and assumptions used. The effect of any change in estimates will be reflected in the financial statements when they become reasonably determinable.

Judgments, estimates and assumptions are continually evaluated and are based on historical experiences and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The following is a summary of the critical judgments, estimates and assumptions used by the Bank:

3.1 Judgments

Determination of functional currency

PAS 21, The Effects of Changes in Foreign Exchange Rates, requires management to use its judgment to determine the entity's functional currency such that it most faithfully represents the economic effects of the underlying transactions, events and conditions that are relevant to the entity. In making this judgment, the Bank considers the following: (a) the currency that mainly influences sales prices for financial instruments and services (this will often be the currency in which sales prices for its financial instruments and services are denominated and settled); (b) the currency in which funds from financing activities are generated; and (c) the currency in which receipts from operating activities are usually retained.

Based on the economic substance of the underlying circumstances relevant to the Bank, the functional currency is determined to be the Philippine Peso. It is the currency that mainly influences the Bank's operations and provision of services.

Classification of financial instruments

The Bank classifies a financial instrument, or its component parts, on initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the substance of the contractual agreement and the definitions of a financial asset, a financial liability or an equity instrument. The substance of a financial instrument, rather than its legal form, governs its classification in the statements of financial position.
The classification of financial assets and financial liabilities is presented in Note 27.

Fair value of financial instruments

Where the fair values of financial assets and liabilities recorded as at financial reporting date cannot be derived from active markets, they are determined using internal valuation techniques using generally accepted market valuation models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, estimates are used in establishing fair values. These estimates may include considerations of liquidity, volatility, and correlation.

Disclosures of fair values of the Bank's financial assets and financial liabilities in a way that permit it to be compared with its carrying amounts are shown in Note 27.

Financial assets not quoted in an active market

The Bank classifies financial assets by evaluating, among others, whether the asset is quoted or not in an active market. Included in the evaluation on whether a financial asset is quoted in an active market is the determination on whether quoted prices are readily and regularly available, and whether those prices represent actual and regularly occurring market transactions on an arm's length basis.

HTM investments

The Bank follows the guidance of PAS 39 in classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held to maturity. This classification requires significant judgment. In making this judgment, the Bank evaluates its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than for the specific circumstances (e.g. selling an insignificant amount close to maturity) it will be required to reclassify the entire class as available for sale. The investment would therefore be measured at fair value and not at amortized cost.

Fair value of RPA classified as investment properties

The Bank determines the fair value of RPA classified as investment properties through independent and/or in-house appraisers on the basis of recent sales of similar properties in the same area as the investment properties. It also takes into account the economic conditions prevailing at the time the valuations were made as well as the physical condition of the properties.

The carrying amounts and fair values of investment properties as at December 31, 2016 and 2015 are disclosed in Note 10.

Classification of properties acquired in settlement of loans

The Bank classifies its acquired properties as bank premises, furniture, fixtures and equipment if used in operations, as assets held for sale if expected that the properties will be recovered through sale rather than use, as investment properties if intended to be held for capital appreciation or as financial assets if qualified as such in accordance with PAS 39.

Bank as lessor under operating lease

The Bank has entered into commercial property lease and has determined that the lessor retains all the significant risks and rewards of ownership of these properties which are leased out on operating lease. Moreover, the Bank has entered into lease agreements and leases its ROPA. It has determined that the lessors retain all the significant risks and rewards of ownership of these properties which are leased out on operating lease.

Bank as lessor under operating lease

The Bank has entered into lease agreements with its RPA. It has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out on operating lease.

3.2 Estimates and assumptions

Estimation of allowance for credit losses

Allowance for impairment, which consists of both specific and general loan loss provision, represents management’s estimate for impairment losses inherent in the loan portfolio after consideration of prevailing and anticipated economic conditions, prior loss experience and evaluations made by the BSP.

The Bank observes the certain criteria and guidelines, including the adoption and implementation of an internal credit risk rating system. One component of this system is the Borrower’s Risk Rating (BRR) which requires an assessment of the credit worthiness of the borrower, focusing on the outlook for loan repayment without considering the type or amount of the facility, or its security arrangements.

Recoverability of specific receivables is evaluated based on the BRR focusing on the borrower’s credit quality based on factors such as the borrower’s: a) stability, b) access to financial markets, c) ability to service debt, d) financial position strength, and e) external rating by agencies, where applicable.

BSP regulations require banks to set up a general provision for impairment losses equivalent to 5% of the outstanding balance of unclassified restructured loans less the outstanding balance of restructured loans which are considered non-risk under existing regulations; and 1% of the outstanding balance of unclassified loans other than restructured loans less loans which are considered non-risk under existing regulations.

The allowance for impairment losses is established through provision for impairment losses charged to current operations. Loans are written-off against the allowance for impairment losses when management believes that the collectability of the principal is unlikely.

The carrying values of loans and receivables, net of allowance for credit losses and loan discount, as at December 31, 2016 and 2015 amounted to P1,437,902,588 and P1,568,265,580, respectively. Total allowance for credit losses on loan and receivables as at December 31, 2016 and 2015 amounted to P114,202,129 and P76,184,829, respectively (Note 7).

The carrying values accounts receivable, net of allowance for credit losses amounted to P19,756,709 and P38,540,731 as of December 31, 2016 and 2015, respectively. Total allowance for credit losses on accounts receivables as at December 31, 2016 and 2015 amounted to P101,161 and P47,576, respectively (Note 12).

Estimation of useful lives of bank premises, furniture, fixtures and equipment, investment properties and other intangible assets

The Bank estimates the useful lives of bank premises, furniture, fixtures and equipment, investment properties and other intangible assets based on the period over which the assets are expected to be available for use. The estimated useful lives of bank premises, furniture, fixtures and equipment, investment properties and other intangible assets are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets. In addition, estimation of the useful lives of bank premises, furniture, fixtures and equipment is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future results of operations could be materially affected by changes in estimates brought by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of bank premises, furniture, fixtures and equipment, investment properties and other intangible assets would increase recorded operating expenses and decrease non-current assets. The estimated useful lives of bank premises, furniture, fixtures and equipment, investment properties and other intangible assets are discussed in Notes 2.4, 2.5 and 2.6, which showed no changes in 2016 and 2015.

The carrying values of bank premises, furniture, fixtures and equipment net of accumulated depreciation amounted to P107,777,236 and P109,008,453 as at December 31, 2016 and 2015, respectively (Note 9).

The carrying values of investment properties net of accumulated depreciation and allowance for impairment amounted to P20,591,560 and P24,089,405 as at December 31, 2016 and 2015, respectively (Note 10).

The carrying values of intangible assets net of accumulated amortization amounted to P22,231,593 and P22,795,145 as at December 31, 2016 and 2015, respectively (Note 11).

Impairment of non-financial assets

The Bank assesses at each financial reporting date whether there is an indication that the carrying amount of all non-financial assets may be impaired. If any such indications exist, or when annual impairment testing for an asset is required, the Bank makes an estimate of the asset's recoverable amount. At the financial reporting date, the Bank assesses whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated.

Total allowance for impairment losses on investment properties amounted to P185,543 and P227,013 as at December 31, 2016 and 2015, respectively (Note 10). Based on management's assessment, the net carrying amount of its non-financial assets are recoverable as of the financial reporting date.

The net book values of bank premises, furniture, fixtures and equipment, investment properties, other intangible assets and other assets are disclosed in Notes 9, 10, 11 and 12, respectively.

Recognition of deferred tax assets

The Bank reviews the carrying amounts of deferred income taxes at each financial reporting date and reduces deferred tax assets to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax assets to be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

Estimates of future taxable income indicate that temporary differences will be realized in the future. Deferred tax assets recognized in the statements of financial position amounted to P56,701,670 and P43,126,835 as at December 31, 2016 and 2015, respectively (Note 21).

Actuarial assumptions used in determining the ultimate cost of providing post-employment benefits

The Bank uses actuarial assumptions which include its best estimates of certain demographic and financial assumptions. Financial assumptions are based on market expectations, at the financial reporting dates, over which the retirement benefit obligations are to be settled. Management believes that the assumptions used were neither imprudent nor excessively conservative. These assumptions are disclosed in Note 16.

Present value of retirement liability

The cost of defined retirement pension plan and other post employment benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. The assumed discount rates were determined using the market yields on Philippine government bonds with terms consistent with the expected employee benefit payout as of the financial reporting date. The present values of the retirement liability of the Bank are disclosed in Note 16.

Contingencies

The estimate of the probable costs for the resolution of possible claims has been developed in consultation with outside counsel handling the Bank's defense in these matters and is based upon an analysis of potential results. The Bank is a party to certain lawsuits or claims involving recoveries of sum of money arising from the ordinary course of business. However, the Bank's management and legal counsel believe that the eventual liabilities under these lawsuits or claims, if any, will not have a material impact on the Bank's financial statements. These are recognized in the books only when the claims are finally settled or when judgment is rendered.

## NOTE 4 – CASH AND OTHER CASH ITEMS

Cash and other cash items consist of:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Cash in vault (CIV) | 213,857,313 | 188,052,634 |
| Checks and other cash items (COCI) | 8,829,293 | 8,780,874 |
| | 222,686,606 | 196,833,508 |

Cash and other cash items are included in cash and cash equivalents for statements of cash flows purposes.

## NOTE 5 – DUE FROM BANGKO SENTRAL NG PILIPINAS

The details of the accounts follow:

| | | |
|---|---|---|
| Mandatory reserves (Note 13) | 51,189,218 | 41,223,011 |
| Other than mandatory reserves | 2,522,298 | 4,721,380 |
| | 53,711,516 | 45,944,391 |

The account consists of Demand Deposit Accounts (DDA) maintained with BSP to meet the reserve requirements against deposit and deposit substitute liabilities in accordance with Section X254, Composition of Reserves, of the Manual of Regulations for Banks (MORB) which states that the required reserves shall be kept in the form of deposits placed in the Bank's DDA with the BSP. As at December 31, 2016 and 2015, the Bank had satisfactorily complied with this BSP requirement (Note 13).

Due from BSP is included in cash and cash equivalents for statements of cash flows purposes.

## NOTE 6 – DUE FROM OTHER BANKS

This pertains to funds and other deposits in local currency maintained with other local banks, primarily to facilitate checks or drafts or other similar payment order collections and other banking services.

The details of the account follow:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Demand deposit | 47,200,841 | 56,996,508 |
| Savings deposit | 325,824,208 | 226,467,015 |
| | 373,025,049 | 283,463,523 |

Due from other banks earn interest at the respective deposit rates ranging from 0% to 5% in 2016 and 2015. Interest earned on due from other banks amounted to P426,371 and P339,827 (net of 20% final withholding tax) for the years ended December 31, 2016 and 2015, respectively.

Due from other banks is included in cash and cash equivalents for statements of cash flows purposes.

## NOTE 7 – LOAN RECEIVABLES - NET

This account consists of:

| | | |
|---|---|---|
| Loans to individual for other purposes | 1,048,061,920 | 1,175,000,567 |
| Agrarian reform and other agricultural credit loans | 312,495,116 | 297,129,200 |
| Small and medium enterprise loans | 153,490,108 | 143,286,448 |
| Microfinance loans | 98,884,591 | 97,975,029 |
| | 1,612,931,735 | 1,713,391,244 |
| Allowance for credit losses | (114,202,129) | (76,184,829) |
| Unearned discounts | (60,827,018) | (68,940,835) |
| | 1,437,902,588 | 1,568,265,580 |

The loans earn annual fixed interest rates ranging from 2% to 36% in 2016 and 3% to 36% in 2015. Interest earned on loans receivable amounted to P330,605,473 and P324,480,295 for the years ended December 31, 2016 and 2015, respectively.

Generally, the loans and receivables carry nominal interest rates as at December 31 as follows:

| | 2016 | 2015 |
|---|---|---|
| Maturing in: | | |
| One year | 2% to 36% | 3% to 36% |
| Two to five years | 2% to 18% | 3% to 18% |

Loan receivables include past due and items in litigation totaling P223,801,858 and P12,057,024 in 2016 and P148,150,278 and P12,469,704 in 2015, respectively.

Details of past due loans receivable are shown as follows:

| | | |
|---|---|---|
| Past due by maturity | 124,219,186 | 66,064,833 |
| Technical past due | 99,582,662 | 82,085,445 |
| | 223,801,848 | 148,150,278 |

Moreover, loans with carrying amounts of P149,917,658 and P423,979,656 in 2016 and 2015, respectively, were pledged as collateral to financial institutions to secure the loans obtained by the Bank under rediscounting and other credit privileges amounting to P363,873,607 and P227,385,875 as at December 31, 2016 and 2015, respectively (Note 14).

BSP Reporting

Information on the concentration of credit as to industry/economic sector of loan receivables, gross of unearned discount and capitalized interest and allowance for credit losses, follows:

| | 2016 | Percent to Total | 2015 | Percent to Total |
|---|---|---|---|---|
| | (in Philippine Peso) | | (in Philippine Peso) | |
| Salary based - General Purpose Consumption Loans | 957,106,205 | 59.34% | 1,079,143,813 | 62.98% |
| Agriculture, forestry and fishing | 314,069,288 | 19.47% | 297,833,793 | 17.38% |
| Real estate, renting and business | 132,571,907 | 8.22% | 114,694,799 | 6.69% |
| Wholesale & Retail Trade, Repair of Motor Vehicles, Motorcycles | 88,745,658 | 5.50% | 91,553,242 | 5.34% |
| Accommodation and Food Service Activities | 1,862,194 | 0.12% | 2,520,532 | 0.15% |
| Manufacturing | 1,336,150 | 0.08% | 1,173,446 | 0.07% |
| Education | 1,258,148 | 0.07% | 755,900 | 0.04% |
| Construction, mining and quarrying | 1,219,468 | 0.07% | 633,617 | 0.04% |
| Transport, storage and communications | 1,158,009 | 0.07% | 308,033 | 0.02% |
| Hotel and restaurant | 110,484 | 0.00% | - | 0.00% |
| Health and social work | - | 0.00% | - | 0.00% |
| Other community, social and personal service activities | 113,494,224 | 7.04% | 124,774,069 | 7.28% |
| | 1,612,931,735 | 100.00% | 1,713,391,244 | 100.00% |

The BSP considers that concentration of credit exists when the total loan exposure to a particular industry or economic sector exceeds 30% of the total loan portfolio.

The Bank analyzes the credit risk concentration to an individual borrower, related group of accounts, industry, geographic, internal rating buckets, currency, term and security. To mitigate risk concentration, the Bank constantly checks for breaches in regulatory and internal limits.

One of the most traditional and common practice in mitigating credit risk is requiring security particularly for loans. The Bank implements guidelines on the acceptability of specific classes of collateral for credit risk mitigation. The principal collateral types for loans are:

- Mortgages over real estate properties and chattels; and
- Hold-out on financial instruments such as debt security deposits and equities.

In order to minimize credit loss, the Bank seeks additional collateral from the counterparty when impairment indicators are observed for the relevant individual loans.

Information about the breakdown of the Bank's total unsecured and secured loans, including the type of security follows:

| | 2016 | Percent to Total | 2015 | Percent to Total |
|---|---|---|---|---|
| | (in Philippine Peso) | | (in Philippine Peso) | |
| Loan receivables | | | | |
| Unsecured | 1,165,668,282 | 72.27% | 1,264,778,505 | 73.82% |
| Secured | 447,263,453 | 27.73% | 448,612,739 | 26.18% |
| | 1,612,931,735 | 100.00% | 1,713,391,244 | 100.00% |
| Secured loan receivables | | | | |
| Real estate mortgage | 269,977,792 | 60.36% | 417,490,659 | 93.06% |
| Chattel mortgage and others | 177,285,561 | 39.64% | 31,122,080 | 6.94% |
| | 447,263,353 | 100.00% | 448,612,739 | 100.00% |

Secured loans, which are secured by real estate and chattel mortgages and other collaterals, have terms ranging from less than 1 year to 5 years and with annual interest rates ranging from 2% to 20% in 2016 and 2015.

Unsecured loans are guaranteed by co-makers, who in the event of default will assume the loan balance. These loans have terms of less than 1 year to 7 years with annual interest rates ranging from 2% to 36% and 3% to 36% in 2016 and 2015, respectively.

The Bank does not hold any collateral which it is permitted to sell or re-pledge in the absence of default by the borrower.

In accordance with Section 331 of the MORB, the total outstanding loans, other credit accommodations and guarantees to DOSRI shall not exceed 15% of the total loan portfolio of the Bank or 100% of its net worth whichever is lower. However, in no case shall the total unsecured loans, other credit accommodations and guarantees to the said DOSRI exceed 30% of the aggregate ceiling or the outstanding loans, other credit accommodations and guarantees, whichever is lower.

Loans to DOSRI amounted to P18,773,500 and P18,749,585 as at December 31, 2016 and 2015, respectively, representing 1.16% and 1.09% of the total loan portfolio of the Bank. Substantial portion of DOSRI loans as at December 31, 2016 and 2015 were secured by deeds of assignment of deposits (Note 22).

The contractual maturity dates as at December 31, 2016 and 2015 of the loan receivables follows:

| | | | | |
|---|---|---|---|---|
| Due within 1 year | 491,859,386 | 30.49% | 516,542,825 | 30.15% |
| Due more than 1 year | 1,121,072,349 | 69.51% | 1,196,848,419 | 69.85% |
| | 1,612,931,735 | 100.00% | 1,713,391,244 | 100.00% |

The reconciliation of allowance for credit losses on loan receivables follows:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Balance, January 1 | 76,184,829 | 59,707,927 |
| Provisions | 47,415,027 | 36,828,142 |
| Write off | (9,397,727) | (20,351,240) |
| Balance, December 31 | 114,202,129 | 76,184,829 |

With the foregoing level of allowance for credit losses, management believes that the Bank has sufficient allowance to manage any risk from non-collection or non-realization of the Bank's loan receivables.

As at December 31, 2016 and 2015, the non-performing loans (NPLs) of the Bank follow:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Total NPLs | 210,264,203 | 143,013,773 |
| Less: NPLs classified as Loss by BSP and are fully covered by allowance for credit losses | 63,684,552 | 39,643,173 |
| | 146,579,651 | 103,370,600 |

NPLs represent approximately 6.03% and 4.90% of the loan portfolio as at December 31, 2016 and 2015, respectively.

Current banking regulations allow banks with no un-booked valuation reserves and capital adjustments to exclude from non-performing classification those loans to customers classified as "Loss" in the latest examination of the BSP which are fully covered by allowance for credit losses, provided that interest on said loans shall not be accrued.

Under banking regulations, NPLs shall, as a general rule, refer to loan accounts whose principal and/or interest is unpaid for 30 days or more after due date or after they have become past due in accordance with existing rules and regulations. This shall apply to loans payable in lump sum and loans payable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof shall be considered non-performing. In the case of loans that are payable in monthly installments, the total outstanding balance thereof shall be considered non-performing when 3 or more installments are in arrears. In the case of loans that are payable in daily, weekly, or semi-monthly installments, the total outstanding balance thereof shall be considered non-performing at the same time that they become past due in accordance with existing BSP regulations, i.e., the entire outstanding balance of the loan shall be considered as past due when the total amount of arrearages reaches 10% of the total loan balance. Restructured loans which do not meet the requirements to be treated as performing loans shall also be considered as NPLs.

The Bank has yet to determine the aggregated fair values of the collateral held for NPLs as at December 31, 2016 and 2015.

## NOTE 8 – HELD-TO-MATURITY INVESTMENTS

These consist of investments to:

| | | |
|---|---|---|
| Retail Treasury Bonds (RTB) | 44,038,000 | 6,997,162 |
| SB Corporation | 15,000,000 | 15,000,000 |
| | 59,038,000 | 21,997,162 |

The movements of this account follow:

| | | |
|---|---|---|
| Beginning balance | 21,997,162 | 19,000,000 |
| Additions during the year | 81,069,000 | 2,997,162 |
| Matured during the year | (44,028,162) | - |
| | 59,038,000 | 21,997,162 |

The investment in SB Corporation is an alternative compliance to the provisions of Republic Act 6977, otherwise known as Magna Carta for Small Enterprises', as amended by R.A. 8289 and R.A 9501. Accordingly, the purchase by lending institutions or any party otherwise required to make mandatory allocation of credit resources to micro, small and medium enterprises, shall be deemed as compliance with the mandated loan portfolio allocation percentage as required under Section 15.

The investment in SB Corporation of P15 million consists of:

| Amount | Compliance validity | Date issued | Due date | Rate | Compliance details |
|---|---|---|---|---|---|
| P 5,000,000 | 730 days | June 28, 2016 | June 28, 2018 | 1.59% p.a | Medium (2%) |
| 10,000,000 | 5 years | December 9, 2015 | December 9, 2019 | 1.88% p.a | Medium (2%) |

A 730 days investment in SB Corporation amounting to P5,000,000 issued on June 28,2014 was matured on June 28, 2016.

The RTBs form part of the National Government's program to make the government securities available to small investors which are issued by the Bureau of Treasury which earns interest at a coupon rate and yield-to-maturity (YTM) of 5.875%. The additional investments of P76,069,000 represent investments in 10-year RTB due on 2026. These investments were purchased at face value.

Investment income earned from the investments in SB Corporation and RTB amounted to P85,975 and P460,020, nil and P441,075 in 2016 and 2015, respectively, and are presented as interest income on investments.

## NOTE 9 – BANK PREMISES, FURNITURE, FIXTURES AND EQUIPMENT - NET

The details of bank premises, furniture, fixtures and equipment follow:

| | 2016 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Land | Construction in progress | Building | Furniture and fixtures | Transportation equipment | Information technology | Leasehold rights and improvements | Total |
| | (in Philippine Peso) | | | | | | | |
| Costs | | | | | | | | |
| At January 1 | 23,479,522 | 10,162,566 | 66,947,749 | 79,365,021 | 32,749,288 | 18,807,429 | 16,492,718 | 248,004,293 |
| Additions | 3,500,000 | - | 1,960,030 | 7,710,801 | 6,554,379 | 1,550,015 | 3,222,174 | 24,497,399 |
| Reclassification | - | (10,162,566) | 10,162,566 | - | 172,100 | - | (172,100) | - |
| Disposals | - | - | - | - | (959,863) | - | (1,498,792) | (2,458,655) |
| At December 31 | 26,979,522 | - | 79,070,345 | 87,075,822 | 38,515,904 | 20,357,444 | 18,044,000 | 270,043,037 |
| At January 1 | - | - | 28,849,846 | 65,845,532 | 22,536,331 | 12,573,709 | 9,190,421 | 138,995,840 |
| Depreciation | - | - | 5,517,467 | 9,896,854 | 4,167,067 | 3,705,188 | 2,356,656 | 25,643,231 |
| Reclassification | - | - | 26,056 | | - | - | (26,056) | - |
| Disposals/adjustments | - | - | - | - | (959,856) | - | (1,413,414) | (2,373,270) |
| At December 31 | - | - | 34,393,369 | 75,742,386 | 25,743,542 | 16,278,897 | 10,107,607 | 162,265,801 |
| Net book values | | | | | | | | |
| At December 31 | 26,979,522 | - | 44,676,976 | 11,333,436 | 12,772,362 | 4,078,547 | 7,936,393 | 107,777,236 |

| | 2015 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Land | Construction in progress | Building | Furniture and fixtures | Transportation Equipment | Information technology | Leasehold rights and improvements | Total |
| | (in Philippine Peso) | | | | | | | |
| Costs | | | | | | | | |
| At January 1 | 20,677,473 | 1,290,309 | 64,150,258 | 72,601,691 | 31,755,305 | 17,574,183 | 15,012,778 | 223,061,952 |
| Additions | 2,802,049 | 8,872,257 | 3,388,915 | 6,836,821 | 5,220,681 | 1,233,246 | 1,479,940 | 29,833,909 |
| Disposals | - | - | (591,379) | (73,491) | (4,226,698) | - | | (4,891,568) |
| At December 31 | 23,479,522 | 10,162,566 | 66,947,794 | 79,365,021 | 32,749,288 | 18,807,429 | 16,492,718 | 248,004,293 |
| At January 1 | - | - | 24,180,504 | 56,430,497 | 22,161,678 | 9,009,495 | 6,923,752 | 118,705,926 |
| Depreciation | - | - | 5,488,965 | 8,950,091 | 4,070,017 | 3,564,214 | 2,266,671 | 24,339,958 |
| Disposals/ adjustments | - | - | (819,623) | 464,944 | (3,695,364) | - | - | (4,050,043) |
| At December 31 | - | - | 28,849,846 | 65,845,532 | 22,536,331 | 12,573,709 | 9,190,421 | 138,995,840 |
| Net book values | | | | | | | | |
| At December 31 | 23,479,522 | 10,162,566 | 38,097,948 | 13,519,489 | 10,212,957 | 6,233,720 | 7,302,297 | 109,008,453 |

Certain transportation equipment with carrying amounts of nil and P162,951 as at December 31, 2016 and 2015, respectively, has been mortgaged in favor of Banco de Oro Unibank (BDO) as discussed in Note 14.

The purchased land in 2016 is located in Butuan and in 2015 are located in Tubod, Lianga and Butuan City. The purchases were made in view of future construction of new office building.

Gain on sale of items of the bank premises, furniture, fixtures and equipment is presented as part of 'miscellaneous income' under 'other operating income' which amounted to P98,444 and P673,044 in 2015 (Note 18). On the other hand, proceeds from the actual sale of bank premises, furniture, fixtures and equipment amounted to P282,393 in 2016 and P1,514,614 in 2015.

Fully depreciated items of bank premises, furniture, fixtures and equipment that are still being used in the operations amounted to P52,508,768 and P52,217,144 in 2016 and 2015, respectively.

The management believes that there is no indication of impairment on the banks premises, furniture and equipment and that its net carrying amount can be recovered through use in operations.

As at December 31, 2016 and 2015, the Bank had no contractual commitments for acquisitions of bank premises, furniture, fixtures and equipment.

Under BSP rules, investments in bank premises, furniture, fixtures and equipment should not exceed 50% of the Bank's unimpaired capital. However, as at December 31, 2016 and 2015 the total investments of the Bank to its bank premises, furniture, fixtures and equipment was 48.73% and 49.02% respectively, of its unimpaired capital determined in accordance with the computation required by Section X111 of the MORB.

## NOTE 10 – INVESTMENT PROPERTIES - NET

This account consists of real properties, other than those used for banking purposes or held for investment, acquired by the Bank in settlement of loans through foreclosure or dation in payment and/or for other reasons, whose carrying amount will be recovered principally through a sale transaction.

The details of investment properties follow:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Real properties acquired, at cost | 21,923,603 | 25,488,065 |
| Accumulated depreciation | (1,146,500) | (1,171,647) |
| Allowance for impairment losses | (185,543) | (227,013) |
| | 20,591,560 | 24,089,405 |

The reconciliation of cost, accumulated depreciation and allowance for impairment losses on investment properties follows:

| | | |
|---|---|---|
| Land | | |
| Balance, January 1 | 22,163,765 | 22,722,996 |
| Additions | 6,338,702 | 5,730,940 |
| Disposals | (10,248,164) | (6,290,171) |
| Balance, December 31 | 18,254,303 | 22,163,765 |

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Building | | |
| Balance, January 1 | 3,324,300 | 3,244,300 |
| Additions | 1,620,000 | 80,000 |
| Disposals | (1,275,000) | - |
| Balance, December 31 | 3,669,300 | 3,324,300 |
| Total cost | 21,923,603 | 25,488,065 |
| Accumulated depreciation | | |
| Balance, January 1 | 1,171,647 | 656,390 |
| Additions | 386,139 | 515,257 |
| Disposals | (411,286) | - |
| Balance, December 31 | 1,146,500 | 1,171,647 |
| Allowance for impairment loss | | |
| Balance, January 1 | 227,013 | 639,552 |
| Provisions (Note 19) | 74,287 | 53,459 |
| Disposals | (115,757) | (465,998) |
| Balance, December 31 | 185,543 | 227,013 |

Provision for impairment losses on investment properties is recognized as part of "other operating expenses" in the statements of comprehensive income (Note 19).

Appraised values of investment properties as at December 31, 2016 and 2015 amounted to P45,241,564 and P54,537,132, respectively, as determined by in-house appraisers on the basis of recent sales of similar properties in the same area as the investment properties and taking into account the economic conditions prevailing at the time the valuations were made.

In accordance with Section 394.2 of the MORB, if the carrying amount of Real and Other Properties Acquired (ROPA) exceeds P5.0 million, the appraisal of the foreclosed/purchased asset shall be conducted by an independent appraiser acceptable to the BSP. As of December 31, 2016 and 2015, the Bank did not have any ROPA with carrying amounts in excess of P5.0 million.

Gain from sale of investment properties amounted to P6,024,316 and P2,801,828 in 2016 and 2015, respectively (Note 18). On the other hand, proceeds on the sale of investment properties amounted to P17,136,194 and P8,626,001 in 2016 and 2015, respectively.

Total incidental income earned from investment properties amounted to P2,817,774 and P3,610,402 in 2016 and 2015, respectively and presented as 'miscellaneous income' under 'other operating income'. No direct operating expenses were incurred for the rental of these investment properties.

Real property taxes and other taxes paid related to maintaining these investments amounted to P436,959 and P333,261 and in 2016 and 2015 which were recognized under 'taxes and licenses' account.

As at December 31, 2016 and 2015, cost of foreclosed investment properties still subject to redemption period by the borrower amounted to P7,428,702 and P9,287,940, respectively.

## NOTE 11 – OTHER INTANGIBLE ASSETS - NET

Intangible assets consist of the Bank's computer software and other licenses which were separately acquired. The details of the movement of the account follow:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Cost | | |
| Balance, January 1 | 29,810,410 | 25,543,210 |
| Additions | 2,352,000 | 4,267,200 |
| Balance, December 31 | 32,162,410 | 29,810,410 |
| Accumulated amortization | | |
| Balance, January 1 | 7,015,265 | 4,289,851 |
| Additions | 2,915,552 | 2,725,414 |
| Balance, December 31 | 9,930,817 | 7,015,265 |
| Net carrying value | 22,231,593 | 22,795,145 |

## NOTE 12 – OTHER ASSETS - NET

These consist of:

| | | |
|---|---|---|
| Account receivables | 19,857,870 | 38,588,308 |
| Stationery and supplies | 10,451,753 | 11,829,192 |
| Sales contract receivable | 1,500,000 | - |
| Insurance | 1,489,827 | 1,749,841 |
| Refundable deposits | 452,978 | 1,603,822 |
| Petty cash fund | 118,500 | 113,500 |
| Prepaid expenses | 74,962 | 921,424 |
| Miscellaneous assets | 6,822,750 | 379,056 |
| | 40,768,640 | 55,185,143 |
| Allowance for credit losses on account receivables | (101,161) | (47,576) |
| Unamortized discount | (387,120) | - |
| | 40,280,359 | 55,137,567 |

Accounts receivable

Accounts receivable include amounts due from customers, employees and other parties, including staff salary and miscellaneous advances, payable in 30 days or less (those payable in more than 30 days are considered as loans). Receivables from employees include those amounts pertaining to the Conditional Cash Transfer project of the government being carried out by certain branches. These amounts are treated as receivable from responsible employees and are to be liquidated by those employees.

Stationery and supplies

Stationery and supplies include office supplies, certificates of time deposit, official receipts, etc. Total amount of supplies used and charged to profit or loss amounted to P6,717,693 and P5,878,778 in 2016 and 2015, respectively.

Sales contract receivable

This represents the balance of the selling price of ROPA in 2016, whereby the title will be transferred to buyer upon full payment of the selling price

Insurance

Insurance pertains to life insurance coverage made by the Bank on behalf of certain employees in 2008. This was previously recognized by the Bank as plan asset, however, the same was not considered as plan assets in the latest actuarial valuation due to pending registration with the BIR.

Refundable deposits

Refundable deposits pertains deposits and advance rental payments that will be reimbursed by the lessor upon the termination of the lease contracts, unless the leased properties suffer damages of the Bank has arrears on utility bills, in which case, the said damages and arrears will be paid out of the deposit and advance payments.

Prepaid expenses

Prepaid expenses include prepayments on insurance, medical, uniform and other taxes.

Miscellaneous assets

Included as part of the Bank's miscellaneous assets are those items which cannot be classified under any of the asset accounts of the Bank. Among these are those cash bond to certain filed case, advance payments made for the acquisition of supplies and equipment.

Allowance for credit losses on accounts receivables

The reconciliation of allowance for credit losses on account receivables follows:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Balance, January 1 | 47,576 | 39,415 |
| Provisions | 55,986 | 8,161 |
| Reversal | (2,401) | - |
| Balance, December 31 | 101,161 | 47,576 |

Unamortized discount

This represents the unamortized discount on sales receivable arising from sale of ROPA accounts in 2016.

## NOTE 13 – DEPOSIT LIABILITIES

The Peso interest earning deposit liabilities of the Bank earn annual fixed interest rates ranging from 1.0% to 9.0% in 2016 and 2015. While demand deposits do not earn interest, the total interest expense on interest earning deposit liabilities and its corresponding range of annual interest rates for the years ended December 31, 2016 and 2015 follow:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Amount | Interest rates | Amount | Interest rates |
| | (in Philippine Peso) | | (in Philippine Peso) | |
| Savings | 7,664,408 | 1.0% to 2.0% | 7,464,422 | 1.0% to 2.0% |
| Time | 32,348,585 | 4.0% to 09% | 27,988,552 | 4.0% to 9.0% |
| | 40,012,993 | | 35,452,974 | |

The savings accounts include dormant accounts of P31,591,661 and P21,420,464 in 2016 and 2015, respectively.

Maturity profile of time deposit follows:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Matures within 1 year | 396,144,085 | 317,225,256 |
| Matures beyond 1 year | 174,361,799 | 161,821,854 |
| | 570,505,884 | 479,047,110 |

In 2014, the BSP issued Circular Nos. 830 and 832 increasing the required reserves against deposit substitute liabilities to 3% for savings and time deposits and 5% for demand deposits.

Total statutory/legal reserves as reported to the BSP follows:

| | | |
|---|---|---|
| Due from BSP (Note 5) | 53,711,516 | 45,944,391 |
| Time and savings deposit liabilities | 1,600,921,135 | 1,308,812,319 |
| Reserve rate | 3% | 3% |
| Required statutory/legal reserve for time and savings deposit liabilities | 48,027,634 | 39,264,370 |
| Demand deposit liabilities | 63,231,676 | 39,172,820 |
| Reserve rate | 5% | 5% |
| Required legal reserve for demand deposit liabilities | 3,161,584 | 1,958,641 |
| Total required statutory/legal reserve | 51,189,218 | 41,223,011 |

The Bank is in compliance with the regulations as at December 31, 2016 and 2015.

## NOTE 14 – BILLS PAYABLE

Bills payable consists of loans from:

| | | |
|---|---|---|
| Land Bank of the Philippines (LBP) | 135,834,325 | 393,979,656 |
| People's Credit and Finance Corporation (PCFC) | 43,501,129 | 62,615,197 |
| Small Business Corporation (SBC) | 22,500,000 | 20,000,000 |
| Philippine Business for Social Progress (PBSP) | 19,570,370 | - |
| United Coconut Planters Bank (UCPB) | 14,083,333 | 30,000,000 |
| National Livelihood Development Corporation (NLDC) | 8,432,976 | 40,833,195 |
| | 243,922,133 | 547,428,048 |

LBP

These lines are collateralized by the following:

1. Rediscounting line:

   - Assignment of sub-borrowers' PN and all underlying collaterals
   - Assignment of proceeds from AGFP Guarantee or PCIC Insurance claims for unsecured crop production loans.

2. Short-term loan – Microfinance line: Continuing assignment of receivables

3. Short-term loan – Working capital line and standby clearing line: REM on a certain property of the Bank, including all improvements thereon.

The loans will mature on various dates in 2016 and 2017. A credit line of P394,000,000 was awarded to the Bank and in December 31, 2016, new credit line of P595,000,000 was awarded to the Bank.

The carrying amounts of loans receivable pledged as collateral for LBP rediscounting line amounted to P334,882,707 and P200,500,482 as at December 31, 2016 and 2015, respectively.

PCFC

The PCFC loans represent availments from an approved credit line of P100 million that bear interest from and 4.5% to 12% in 2016 and 2015, respectively. The proceeds were used exclusively for relending to microfinance loans. These are collateralized by issuance of post-dated checks (PDC). These loans will mature on various dates from 2016 to 2019.

SBC

Loan obtained from SBC represents availments from an approved omnibus credit line (OCL) (with increase) of P30 million and is intended for extending loans to qualified borrowers for microfinance and small and medium enterprises. This bears interest rate of 8% per annum in 2016 and 6.8% to 8% in 2015. The loans will mature on various dates in 2017.

PBSP

This represents the loan obtained for Agricultural Credit Financing programs in 2016. These are loans collateralized by REM and deed of continuing assignment of receivables. Availed loans bear interest from 4.5% to 4.9%. The loans will mature on various dates in 2017.

NLDC

The loans from NLDC represent loan availments from an approved revolving credit line of P75 million in 2016 and 2015 for the purpose of extending loans to eligible borrowers. This is secured by deed of continuing assignment of active eligible sub-borrowers PN and all underlying collaterals, if any, and issuance of PDC. The loan is payable within 2 years, with interest rate at 4% to 9% per annum. These loans will mature on various dates in 2017. The credit line will expire on July 31, 2017.

UCPB

The loan from the Coconut Industry Investment Fund (CIIF) of the UCPB was obtained for release to coconut-related projects from the approved credit line of P30 million under the Rural Financial Institution Micro-Enterprise Credit Program (Window II) to qualified borrowers. This bears interest rates of 9% in 2016 and 8.0% to 10.5% in 2015, to be paid quarterly while the principal is to be paid in full at maturity. This is collateralized by deeds of assignment on loan receivables and PDC.

The carrying amounts of loans pledged as collateral for UCPB rediscounting line amounted to P28,990,900 and P26,885,393 as at December 31, 2016 and 2015, respectively.

New credit line of P5,000,000 from UCPB separate from the CIIF in 2016.

The reconciliation of the carrying amount of the bills payable for the period follows:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Balance, January 1 | 547,428,048 | 332,608,745 |
| Availments | 259,000,000 | 851,452,970 |
| Payments | 562,505,915 | 636,633,667 |
| Balance, December 31 | 243,922,133 | 547,428,048 |

The contractual maturities of the Bank's bills payable follow:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Due within 1 year | 142,772,225 | 411,170,667 |
| Due beyond 1 year | 101,149,908 | 136,257,381 |
| | 243,922,133 | 547,428,048 |

The Bank's bills payable are subject to annual fixed interest rates ranging from 4% to 12% in 2016 and 3.75% to 12% in 2015. Interest expense on bills payable for the years ended December 31, 2016 and 2015 amounted to P25,823,508 and P24,767,226 respectively.

## NOTE 15 – ACCRUED EXPENSES AND OTHER LIABILITIES

This account consists of:

| | | |
|---|---|---|
| Accounts payable | 37,398,990 | 64,476,492 |
| Accrued interest expense on financial liabilities | 37,282,905 | 35,624,799 |
| Accrued other expenses | 13,518,361 | 13,817,189 |
| SSS, Philhealth, Employer's Compensation Premiums and Pag-IBIG Contributions Payable | 1,575,150 | 2,861,869 |
| Other payables | 234,345 | 442,916 |
| | 90,009,751 | 117,223,265 |

Accounts payable

These represent the amount of payable to customers and employees incurred in the normal course of the Bank's business. This also includes funds received for the CCT program not yet distributed to qualified beneficiaries.

Accrued interest expense on financial liabilities

Accrued interest expense on financial liabilities represent amounts of interest expense accrued for time deposits and bills payable and compensation bonus amounting to P30,532,447, P6,750,458 and P2,100,000 in 2016 and P27,303,780, P8,320,703 and nil in 2015, respectively.

Accrued other expenses

Accrued other expenses include accrued rent expense (PAS 17), accrued taxes and licenses (gross receipts tax) and others (e.g. power, light and water, communications, etc.) which amounted to P20,482, P912,477 and P776,557 as at December 31, 2016 and P140,070, P1,453,909 and P7,643,776 as at December 31, 2015, respectively.

Other payables

Other payables include mortgaged certificates payable (MCP) of nil and P70,196 as at December 31, 2016 and 2015, respectively, in favor of BDO for the acquisition of certain transportation equipment for Tagum, Socorro, Surigao and Davao branches in 2011. The MCP bears an interest of 32.58% per annum and will mature on various dates in 2015. These are secured with chattel mortgage on the acquired equipment with carrying amount as at December 31, 2016 and 2015 of nil and P70,196, respectively (Note 9).

## NOTE 16 – RETIREMENT BENEFITS OBLIGATION

### 16. 1 Defined benefit obligation (DBO)

The Bank provides for a retirement scheme covering all regular and full time employees. The retirement scheme of the Bank complies with the R.A. No. 7641 or Retirement Law. Retirement obligations and costs are determined in accordance with the actuarial studies made for the scheme. The calculation of the defined benefit obligations and annual costs are determined using the Projected Unit Credit Method.

The scheme is exposed to a number of risks, including:

Investment risk: movement of discount rate used (high quality corporate bonds) against the return from plan assets

Longevity risk: changes in the estimation of mortality rates of current and former employees.

Salary risk: increases in future salaries increase the gross defined benefit obligation.

Actuarial valuations are made annually. The latest actuarial valuation as at and for the years ended December 31, 2016 and 2015 was made in February 28, 2017. In 2015, the Bank availed of the services of a licensed actuary to determine its DBO and defined benefit cost. The licensed actuary determined that the Bank does not have a formal retirement plan and is therefore still unfunded as at December 31, 2016 and 2015.

### 16. 2 Reconciliation of defined benefit obligation

Below is the reconciliation of balances:

| | Defined Benefit Obligation | |
|---|---|---|
| | 2016 | 2015 |
| | (in Philippine Peso) | |
| Balance, January 1 | 67,156,626 | 69,859,349 |
| Service cost – current | 3,283,959 | 6,239,290 |
| Net interest cost | 5,643,709 | 3,136,685 |
| Included in profit or loss | 8,927,668 | 9,375,975 |
| Benefits paid directly from book reserve | - | (566,174) |
| Remeasurement of (gain)/loss | | |
| a. Changes in financial assumptions | (7,081,718) | (4,974,753) |
| b. Changes in demographic assumptions | 9,322,012 | - |
| c. Experience | (3,828,334) | (6,537,771) |
| Included in OCI | (1,588,041) | (11,512,524) |
| Balance, December 31 | 74,496,253 | 67,156,626 |

The defined benefit cost recognized in OCI as at and for the years ended December 31 follows:

| | | |
|---|---|---|
| Accumulated OCI, beginning** | 26,600,091 | 38,112,615 |
| Actuarial (gain)/losses recognized for the year | (1,558,041) | (11,512,524) |
| Accumulated OCI, ending** | 22,012,050 | 26,600,091 |

**Amounts of remeasurement gains/(losses) presented in the statements of changes in equity are net of tax

16.3 Sensitivity analysis, year-end defined benefit obligation

| | | | |
|---|---|---|---|
| a. | 1. Decrease in DBO due to 100 bps, increase in discount rate | (12,273,665);(16.5%) | (10,759,664);(16.0%) |
| | 2. Increase in DBO due to 100 bps, decrease in discount rate | 15,331,508;20.6% | 13,274,984;19.8% |
| b. | 1. Increase in DBO due to 100 bps, increase in salary increase rate | 13,719,117;18.4% | 11,795,711;17.6% |
| | 2. Decrease in DBO due to 100 bps, decrease in Salary increase rate | (11,374,913);(15.3%) | (9,908,548);(14.8%) |
| c. | Increase in DBO, no attrition rates | 53,993,915;72.5% | 70,689,954;105.3% |

16. 4 Defined benefit obligation - actuarial assumptions

The principal actuarial assumptions used to determine retirement benefits obligation of the Bank for the years ended December 31, follows:

<u>As at December 31, 2016 and 2015</u>

| | |
|---|---|
| Mortality rate | The 2001 CSO Table – Generational (Scale AA, Society of Actuaries) |
| Disability rate | The Disability Study, Period 2 Benefit 5 (Society of Actuaries) |
| Normal retirement age | 60 years old |
| Projected retirement benefit | Hired before November 1, 2014: 175% of the latest monthly salary for every year of service<br><br>Hired November 1, 2014 onwards: 125% of latest monthly salary for every year of service |
| Manner of benefits | Lump sum |

| | 2016 | 2015 |
|---|---|---|
| Discount rate | 5.38% | 4.89% |
| Salary increase rate | 10.00% | 10.00% |

The following are additional information as presented in the latest actuarial report:

| | | |
|---|---|---|
| Weighted average duration of the DBO (years) | 18.6 | 24.4 |
| Salary increase rate | 10.00% | 10.00% |

Maturity analysis: Expected future benefit payments

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Year 1 | 924,739 | 638,270 |
| Year 2 | - | - |
| Year 3 | - | - |
| Year 4 | 1,414,714 | - |
| Year 5 | 5,909,218 | 585,974 |
| Year 6- Year 10 | 8,487,352 | 17,423,791 |

| | 2016 | 2015 |
|---|---|---|
| Maturity profile: Weighted average duration of the DBO | 18.6 years | 24.4 years |
| Number of lives covered | 379 | 368 |
| Average age in years | 31.5 | 31.5 |
| Average remaining working life | 28.5 | 28.5 |
| Average years past service | 5.8 | 5.7 |
| Annual covered payroll | P52,051,672 | P49,579,470 |

## NOTE 17 – EQUITY (CAPITAL FUNDS)

### 17.1 Capital stock

Capital funds consist of:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Capital stock – common and preferred - P500 par value per share | | |
| Authorized | | |
| Preferred – 10,000 shares | 5,000,000 | 5,000,000 |
| Common – 590,000 shares | 295,000,000 | 295,000,000 |
| | 300,000,000 | 300,000,000 |
| Common - issued and outstanding – 452,495 shares in 2016 and 426,993 shares in 2015 | 226,310,679 | 213,622,032 |
| Remeasurement losses on DBO | (15,408,435) | (16,520,063) |
| Retained earnings | 96.832,975 | 69,942,207 |
| | 307,735,219 | 267,044,176 |

Preferred shares are available only for subscription by the government and, in case of sale to private shareholders, shall automatically become convertible to common shares as provided under R.A. No.720, as amended. Preferred shares are non-voting and preferred only as to assets upon liquidation and share in dividend distribution up to a maximum of 2% without preference.

### 17.2 Dividend declarations

Resolution No. 15-248 was passed by the BOD in its regular meeting held on November 13, 2015, approving the declaration of cash dividends of 8% of the subscribed stockholdings as of December 31, 2015 amounting to P17,104,859. This was paid in 2016.

### 17.3 Fractional shares

Presented as part of the common stocks are fractional shares aggregating to P248,179 and P165,532 as at December 31, 2016 and 2015, respectively. These fractional shares which were temporarily issued with scrip certificates arose from the reverse share split in 2011, the additional subscriptions, and stock dividend declarations during the years then ended. The scrip certificates may be redeemed in cash or the stockholders holding such scrip certificates may negotiate with other stockholders for the purchase or sale of such shares to convert them into full shares.

The movement and the reconciliation of the number of issued and outstanding shares (including fractional shares) as at December 31, 2016 and 2015 follow:

| | Number of whole shares issued | Equivalent amount (a) | Equivalent number of fractional shares | Equivalent amount (b) | Total (a + b) |
|---|---|---|---|---|---|
| Balance, December 31, 2015 | 426,993 | P213,496,500 | 251.06 | 125,532 | P213,622,032 |
| Additional subscriptions for 2016 | 25,000 | 12,500,000 | 377.29 | 188,647 | 12,688,647 |
| Fractional shares converted to full shares | 502 | 66,000 | (502) | (66,000) | - |
| Balance, December 31, 2016 | 452,495 | 226,062,500 | 126.35 | 248,179 | 226,310,679 |

As presented in the table, the Bank's total actual subscribed and issued common (full) shares of 452,495 and 426,993 amounted to P226,062,500 and P213,492,890 as at December 31, 2016 and 2015, respectively. The total fractional shares amounting to P248,179 and P165,532 make up the total reported common shares of the Bank of P226,310,679 and P213,622,032 as at December 31, 2016 and 2015, respectively.

## NOTE 18 – OTHER OPERATING INCOME

The details of this account follow:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Service charges, fees and commissions | 37,968,299 | 36,541,537 |
| Miscellaneous: | | |
| Inspection, filing fees and penalties | 9,531,491 | 5,610,878 |
| Gain on sale of investment property (Note 10) | 6,024,316 | 2,801,828 |
| Gain on disposal of bank premises and furniture, fixtures and equipment (Note 9) | - | 673,044 |
| Others | 17,023,363 | 16,660,489 |
| | 70,547,469 | 62,287,776 |

Service charges, fees and commission

These refer to service charges, fees and commissions income from services offered by the Bank such as for utility and other bills (e.g. ATM, telecommunication, electric and water companies) and taxes. These also include fees and commissions income from intermediation services such as those relating to deposit and lending services.

Miscellaneous

Gains from sale/de-recognition of non-financial assets

These represent income or loss from sale and/or retirement of foreclosed properties and disposed/damaged bank premises, furniture, fixtures and equipment. It is determined as the difference between the net disposal proceeds/insurance proceeds and the carrying amount of the asset and is recognized in profit or loss in the period of the retirement or disposal.

Other income

Other income includes ATM, dormancy, fund transfers, Western Union fees, and appraisal fees and other fees collected relative to the loans released and penalties on past due loans, microinsurance commission and others, which are normally recorded at the time these are collected.

## NOTE 19 – COMPENSATION AND STAFF BENEFITS AND OTHER OPERATING EXPENSES

The breakdown of the accounts follows:

| | | |
|---|---|---|
| Compensation and staff benefits | | |
| Salaries and wages | 58,385,014 | 54,501,211 |
| Staff benefits | 35,119,711 | 33,935,114 |
| SSS, Medicare and Pag-ibig premium | 5,203,976 | 4,660,020 |
| Directors' and committee fees | 3,198,625 | 3,376,050 |
| Provident fund contribution | 697,608 | 623,643 |
| Mutual relief contribution | 75,175 | 72,650 |
| | 102,680,109 | 97,168,688 |

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Other operating expenses | | |
| Security, messengerial and janitorial services | 15,517,269 | 14,660,561 |
| Communications | 8,256,118 | 7,431,853 |
| Power, light and water | 7,045,059 | 6,464,406 |
| Entertainment, amusement and recreation | 2,944,980 | 1,005,054 |
| Marketing and promotion | 2,304,752 | 3,887,050 |
| Meetings and events | 1,862,998 | 3,203,439 |
| Banking fees | 1,043,295 | 844,098 |
| Donations and charitable contributions | 676,360 | 753,051 |
| Information and technology | 100,597 | 171,185 |
| Provision for impairment losses on investment properties (Note 10) | 55,986 | 53,459 |
| Provision for credit losses on account receivables (Note 12) | 74,287 | 8,161 |
| Miscellaneous | 11,068,895 | 14,062,041 |
| | 53,806,995 | 54,596,117 |

Miscellaneous

Included in 'miscellaneous' are those expenses incurred for periodical and magazine subscriptions, membership fees and dues, notarial fees, freight expenses, seminars and trainings and other expenses which were aggregated and presented as single line item.

## NOTE 20 – LEASE COMMITMENTS

The Bank leases the premises for some of its branches and other offices from various lessors at escalating rentals every 2 to 10 years. The rent expense charged to operations amounted to P6,377,624 in 2016 and P5,724,320 in 2015 (inclusive of accrued rent payable of P20,482 and P140,070 in 2016 and 2015, respectively, recognized in accordance with PAS 17 Leases as indicated in Note 15).

Future minimum lease payments based on existing operating lease contracts follow:

| | | |
|---|---|---|
| Due not later 1 year | 2,790,048 | 2,918,019 |
| Due later than 1 year but not later than 5 years | 5,980,921 | 6,931,032 |
| Due later than 5 years | 650,865 | 530,526 |
| | 9,421,834 | 10,379,577 |

## NOTE 21 – INCOME TAXES

Under Philippine tax laws, the Bank is subjected to percentage and other taxes (included in Taxes and licenses in the statement of profit or loss) as well as income taxes. Percentage and other taxes paid consist principally of gross receipt tax (GRT) and documentary stamp taxes (DST).

Income taxes include 30% RCIT and 20% final income taxes paid, which is a final withholding tax on gross interest income from government securities and other deposit substitutes. Interest allowed as a deductible expense is reduced by an amount equivalent to 33% of interest income subjected to final tax.

Republic Act (RA) No. 9337, An Act Amending National Internal Revenue Code (NIRC), provides that the RCIT rate shall starting January 1, 2009 shall be 30%. Interest expense allowed as a deductible expense is reduced by 33% starting January 1, 2009.

RA No. 9504, An Act Amending NIRC, provides that starting July 1, 2008, the optional standard deduction (OSD) equivalent to 40% of gross income may be claimed as an alternative deduction in computing for the RCIT. The Bank elected to claim itemized expense deductions instead of the OSD in computing for the RCIT in 2016 and 2015.

In addition, current tax regulations provide for the ceiling on the amount of entertainment, amusement and recreation (EAR) expense that can be claimed as a deduction against taxable income. Under the regulation, EAR expense allowed as a deductible expense for a service company like the Bank is limited to the actual EAR paid or incurred but not to exceed 1% of net revenue. The regulations also provide for MCIT of 2% on modified gross income and allow a NOLCO. The Bank's MCIT and NOLCO may be applied against the Bank's income tax liability and taxable gross income, respectively, over a 3 year period from the year of inception.

The Bank does not have transactions booked under foreign currency deposit unit.

The provision for income tax consists of:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Current | 25,468,499 | 20,113,280 |
| Deferred | (14,051,276) | (7,269,467) |
| | 11,417,223 | 12,843,813 |

The current provision for income tax in 2016 and 2015 represent the Bank's tax obligations under the RCIT. The deferred provision for income tax in 2016 and 2015 relate to the origination and reversal of temporary differences.

Deferred income tax benefit recognized in:

| | | |
|---|---|---|
| Profit or loss | (14,051,276) | (7,269,467) |
| OCI | (476,412) | (3,453,757) |
| | (14,527,688) | (10,723,224) |

The components of the Bank's deferred tax assets presented under "Deferred tax assets" account in the statements of financial position correspond to the deferred tax effect of the following:

| | | |
|---|---|---|
| Retirement benefits obligation (Note 16) | 22,348,876 | P20,146,988 |
| Allowance for credit/impairment losses on | | |
| Loan receivables (Notes 7) | 34,260,639 | 22,855,449 |
| Investment properties (Note 10) | 55,663 | 68,104 |
| Account receivables (Note 12) | 30,348 | 14,273 |
| Accrued rent payable (Note 15) | 6,144 | 42,021 |
| | 56,701,670 | 43,126,835 |

The deferred tax asset on accrued rent payable pertains to the temporary difference on the straight-line recognition of rental expense in accordance with PAS 17. This deferred tax asset will be utilized upon actual payment of rentals (Note 20).

The deferred tax asset benefits of the allowance for impairment losses and retirement benefit obligations will be realized upon actual write off of and actual realization of losses from the related assets and actual settlement of the retirement obligation, respectively.

The Bank believes that it is reasonably probable that the tax benefits of these temporary differences will be realized in the future.

The reconciliation of the provision for income tax computed at the statutory tax rate to the provision for income tax shown in the statements of profit or loss and other comprehensive income follow:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Income before income tax expense | 38,307,991 | 43,019,350 |
| Tax computed at statutory rate of 30% | 11,492,397 | 12,905,805 |
| Tax effects of: | | |
| Income subjected to final tax and other items | (127,991) | (101,948) |
| Non-deductible items | 52,817 | 39,956 |
| | 11,417,223 | 12,843,813 |

The reconciliation of income tax payable is as follow:

| | | |
|---|---|---|
| Beginning | 6,817,961 | 10,055,840 |
| Provisions | 25,468,498 | 20,113,281 |
| Payments | (18,656,449) | (23,351,160) |
| Ending | 13,630,010 | 6,817,961 |

## NOTE 22 – RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability, directly or indirectly, 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 such as subsidiaries and associates of subsidiaries or other related parties. Related parties may be individuals or corporate entities. Transactions between related parties are based on terms similar to those offered to non-related parties.

The Bank, in its regular conduct of business, has transactions with its officers and other related parties (including key employees). Significant related party transactions include the following:

### 22.1 Significant transactions and balances with related parties

a. The significant transactions with related parties and their effect on the Bank's financial statements as at and for the years ended December 31, 2016 and 2015 were as follows:

| Related Parties | Relationship | Cut-off Period | Loans Availments/ (Payments) | Finance income recognized | Deposits | Interest Expense |
|---|---|---|---|---|---|---|
| | | | (in Philippine Peso) | | | |
| Officers and BOD | Key management personnel | December 31, 2016 | 18,773,500 | 2,308,905 | 14,562,817 | 218,442 |
| | | December 31, 2015 | 12,023,600 | 1,461,798 | 13,238,925 | 198,584 |

b. The amount of outstanding balances, including their terms and conditions, security, and the nature of the consideration to be provided in settlement, and details of any guarantees given or received are as follows:

| Related Parties | Relationship | Cut-off Period | Loans Receivable | Deposit Liabilities | Terms and Conditions | Security | Nature of Consideration to be Provided Upon Settlement | Guarantees Given or Received |
|---|---|---|---|---|---|---|---|---|
| | | | (in Philippine Peso) | | | | | |
| Officers and BOD | Key management personnel | December 31, 2016 | 30,707,627 | 14,562,817 | 1 to 28 years; monthly amortization; 5% to 12% per annum | Real estate and chattel mortgage and deed of assignment | Cash | None |
| | | December 31, 2015 | 19,393,124 | 13,122,575 | 1 to 28 years; monthly amortization; 5% to 12% per annum | Real estate and chattel mortgage and deed of assignment | Cash | None |

Related party transactions are not offset for monitoring purposes.

c. Provision for credit losses on loans receivables related to the amount of outstanding balances of the Bank's loans receivable to related parties amounted to P274,300 and P293,114 as at December 31, 2016 and 2015, respectively.

22.2 Key management personnel (KMP) compensation

KMP are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director of that entity.

Compensation includes all benefits constituting all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. Short-term employee benefits include wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidized goods or services) for current employees.

The compensation of KMP includes both short-term benefits and post-employment benefits. Short-term benefits recognized in 2016 and 2015 amounted to P20,293,016 and P15,292,789, respectively.

22.3 BSP Reporting

Loans and other credit accommodations to directors, officers, stockholders and their related interests (DOSRI)

In accordance with Section 330 of the MORB, the individual ceiling for the total outstanding loans, other credit accommodations and guarantees to each of the Bank's DOSRI should be limited to an amount equivalent to their respective unencumbered deposits and book value of their paid-in capital contribution in the Bank, 70% of which must be secured.

In accordance with Section 331 of the MORB, the aggregate ceiling for total outstanding loans, other credit accommodations and guarantees to DOSRI, of which 70% must be secured, should not exceed 15% of the total loan portfolio of the Bank or 100% of its net worth, whichever is lower.

In the ordinary course of business, the Bank has loans and other transactions with certain DOSRI. Under the Bank's policy, these loans and other transactions are made substantially on the same terms as with other individuals and businesses of comparable risks.

As at December 31, 2016 and 2015, information about the loans and other credit transactions with certain DOSRI follow:

| | 2016 | 2015 |
|---|---|---|
| Loans and other credit transactions with certain DOSRI (Note 7) | P18,773,500 | P18,749,585 |
| Outstanding total loan portfolio | P1,612,931,734 | P1,713,391,244 |
| Percent of DOSRI loans to total loan portfolio | 1.16% | 1.09% |
| Percent of unsecured DOSRI loans to total DOSRI loans | 3.31% | 5.84% |
| Percent of past due DOSRI loans to total DOSRI loans | 0.00% | 0.00% |
| Percent of non-performing DOSRI loans to total DOSRI loans | 0.00% | 0.00% |

Terms and conditions

The loans granted to DOSRI as at December 31, 2016 and 2015 are subject to interest of 12% per annum with maturity periods of 1 year. Substantial portion of the DOSRI loans as at December 31, 2016 and 2015 were secured by hold-out on Certificate of Time Deposits of the respective DOSRI-borrowers.

## NOTE 23 – EARNINGS PER SHARE (EPS)

The following table presents information necessary to calculate the EPS:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Profit for the year attributable to ordinary equity holders | 28,002,396 | 30,175,537 |
| Weighted average number of shares outstanding | 452,495 | 388,477 |
| Basic and diluted EPS | 62 | 78 |

There are no dilutive potential ordinary shares for the years ended December 31, 2016 and 2015. Therefore, the Bank's basic and diluted EPS are equal for the years ended December 31, 2016 and 2015.

The weighted average number of ordinary shares used as the denominator in the calculating basic and diluted EPS as of December 31, 2016 and 2015 is determined as follows:

| Date | Number of shares issued | Number of shares outstanding | Weighted average number of shares issued |
|---|---|---|---|
| January 1, 2016 | 426,993 | 426,993 | 426,993 |
| June 30, 2016 | 25,502 | 452,495 | 439,744 |
| December 29, 2016 | - | 452,495 | 439,744 |
| | 452,495 | | 439,744 |
| January 1, 2015 | 337,853 | 337,853 | 337,853 |
| March 31, 2015 | 55,783 | 393,636 | 379,690 |
| June 30, 2015 | 8,000 | 401,636 | 383,690 |
| July 29, 2015 | 28 | 401,664 | 383,702 |
| August 28, 2015 | 11,503 | 413,167 | 387,536 |
| September 30, 2015 | 2,714 | 415,881 | 388,215 |
| October 30, 2015 | 637 | 416,518 | 388,321 |
| November 27, 2015 | 1,877 | 418,395 | 388,477 |
| December 29, 2015 | 8,598 | 426,993 | 388,477 |
| | 426,993 | | 388,477 |

## NOTE 24 – BASIC QUANTITATIVE INDICATORS OF FINANCIAL PERFORMANCE

In accordance with Section 190.4 of the MORB, the required basic quantitative indicators of financial performance of the Bank follow:

| | 2016 | 2015 |
|---|---|---|
| Return on average equity | 8.88% | 10.69% |
| Return on average assets | 1.23% | 1.40% |
| Net interest margin | 14.37% | 15.40% |
| Capital to risk assets ratio (Note 26) | 10.550% | 10.637% |

## NOTE 25 – FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

Risk is inherent in the Bank's activities but it is managed through process of ongoing identification, measurement and monitoring subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

### Risk management structure

The BOD is ultimately responsible for the formulation of written policies and procedures relating to the management of risks throughout the Bank. The risk management policy includes: a comprehensive risk management approach; a detailed structure of limits; guidelines and other parameters used to govern risk-taking; a clear delineation of lines of responsibilities for managing risks; an adequate system for measuring risks; and effective internal controls and a comprehensive risk-reporting process.

### Risk management committee

The Risk Management Committee has the overall responsibility for the development and oversight of the Bank's Risk Management Program and Development of the risk management strategies geared towards loss prevention or minimization to preserve the Bank's earnings and capital in the short term, increase shareholder value in the medium term and capital allocation across all risk-taking activities in the long-term.

### Risk management

The initial activity in identifying and facilitating the activities needed by the Risk Management Committee to undertake its risk management program development and oversight function rests with Risk Management (RM).

### Bank treasury

Bank Treasury is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also responsible for the funding and liquidity risks of the Bank.

### Internal audit

Risk management processes throughout the Bank are audited regularly by the internal audit function that examines both the adequacy of the procedures and the Bank's compliance with the procedures, adequacy of the Bank's internal control and compliance with existing laws, rules and regulations. Internal Audit discusses the results of all assessments with management and reports its findings and recommendations to the Audit Committee.

### Credit risk

Credit risk refers to the risk that counterparty will default and/or fail to honor its financial or contractual obligations, resulting in financial loss to the Bank.

The Bank drives credit risk fundamentally via its credit policies which are regularly reviewed and updated to reflect changing risk conditions. The credit policies include the Bank's credit structure, target markets, and credit evaluation, administration, monitoring and collection guidelines. Moreover, the Bank monitors credit exposures, and continually assesses the creditworthiness of borrowers. It also obtains sufficient security, enters into collateral arrangements, and limits the duration of exposures, where appropriate.

The Bank's maximum exposure to credit risk before collateral held or other credit enhancements as at December 31 follows:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Loans and receivables | | |
| COCI (Note 4) | 8,829,293 | P8,780,874 |
| Due from BSP (Note 5) | 53,711,516 | 45,944,391 |
| Due from other banks (Note 6) | 361,104,842 | 271,543,316 |
| Loans receivable - net (Note 7) | 1,437,902,588 | 1,568,265,580 |
| Other assets (Note 12): | | |
| Accounts receivables – net | 19,756,709 | 38,540,732 |
| Refundable deposits | - | 1,603,822 |
| Held-to-maturity | | |
| Held to maturity investments (Note 8) | 59,038,000 | 21,997,162 |
| | 1,940,342,948 | 1,956,675,877 |

Excessive risk concentration

Credit risk concentrations can arise whenever a significant number of borrowers have similar characteristics and are affected similarly by changes in economic or other conditions. The Bank analyzes the credit risk concentration to an individual borrower, related group of accounts, industry, internal rating buckets, and security. For risk concentration monitoring purposes, the financial assets are broadly categorized as loans and receivables. To mitigate risk concentration, the Bank constantly checks for breaches in regulatory and internal limits.

Concentration of risks of financial assets with credit risk exposure

An analysis of concentrations of credit risk by industry at the reporting date based on the carrying amount (gross of allowance for credit losses and unearned interest and discounts) is shown below:

| | December 31, 2016 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Loans and receivables | | | | | | |
| Concentration by industry | Loan receivables (Note 7) | Due from BSP and other banks (Notes 5 & 6) | COCI (Note 4) | Other assets (Note 12) | Total loans and receivables | Held-to-maturity investments (Note 8) | Total |
| | (in Philippine Peso) | | | | | | |
| Salary based - General Purpose Consumption Loans | 957,106,205 | - | - | - | 957,106,205 | - | 957,106,205 |
| Agriculture, forestry and fishing | 314,069,288 | - | - | - | 314,069,288 | - | 314,069,288 |
| Real estate, renting and business | 132,571,907 | - | - | - | 132,571,907 | - | 132,571,907 |
| Other community, social and personal service activities | 113,494,224 | - | - | - | 113,494,224 | - | 113,494,224 |
| Wholesale & Retail Trade, Repair of Motor Vehicles, Motorcycles | 88,745,658 | - | - | - | 88,745,658 | - | 88,745,658 |
| Accommodation and Food Service Activities | 1,862,194 | | - | - | 1,862,194 | - | 1,862,194 |
| Manufacturing | 1,336,150 | - | - | - | 1,336,150 | - | 1,336,150 |
| Education | 1,258,148 | - | - | - | 1,258,148 | - | 1,258,148 |
| Construction, mining and quarrying | 1,219,468 | - | - | - | 1,219,468 | - | 1,219,468 |
| Transport, storage and communications | 1,158,009 | - | - | - | 1,158,009 | - | 1,158,009 |
| Hotel and restaurant | 110,484 | - | - | - | 110,484 | - | 110,484 |
| Financial intermediaries | - | 414,816,358 | 8,829,293 | - | 423,645,651 | 59,038,000 | 482,683,651 |
| Others | - | - | - | 21,929,348 | 21,929,348 | - | 21,929,348 |
| | 1,612,931,735 | 414,816,358 | 8,829,293 | 21,929,348 | 2,058,506,734 | 59,038,000 | 2,117,544,734 |

| | December 31, 2015 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Loans and receivables | | | | | | |
| Concentration by industry | Loan receivables (Note 7) | Due from BSP and other banks (Notes 5 & 6) | COCI (Note 4) | Other assets (Note 12) | Total loans and receivables | Held-to-maturity investments (Note 8) | Total |
| | (in Philippine Peso) | | | | | | |
| Salary based - General Purpose Consumption Loans | 1,079,143,813 | - | - | - | 1,079,143,813 | - | 1,079,143,813 |
| Agriculture, forestry and fishing | 297,833,793 | - | - | - | 297,833,793 | - | 297,833,793 |
| Other community, social and personal service activities | 124,774,069 | - | - | - | 124,774,069 | - | 124,774,069 |
| Real estate, renting and business | 114,694,799 | - | - | - | 114,694,799 | - | 114,694,799 |
| Wholesale & Retail Trade, Repair of Motor Vehicles, Motorcycles | 91,553,242 | - | - | - | 91,553,242 | - | 91,553,242 |
| Accommodation and Food Service Activities | 2,520,532 | | - | - | 2,520,532 | - | 2,520,532 |
| Manufacturing | 1,173,446 | - | - | - | 1,173,446 | - | 1,173,446 |
| Education | 755,900 | - | - | - | 755,900 | - | 755,900 |
| Construction, mining and quarrying | 633,617 | - | - | - | 633,617 | - | 633,617 |
| Transport, storage and communications | 308,033 | - | - | - | 308,033 | - | 308,033 |
| Financial intermediaries | - | 242,777,899 | 8,780,874 | - | 251,558,773 | 21,997,162 | 273,555,935 |
| Others | - | - | - | 40,144,554 | 40,144,554 | - | 40,144,554 |
| | 1,713,391,244 | 242,777,899 | 8,780,874 | 40,144,554 | 2,005,094,571 | 21,997,162 | 2,027,091,733 |

The aging analyses of financial assets follow:

| | December 31, 2016 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | Past due but not impaired | | | | |
| | Total | Neither past due nor impaired | Less than 30 days | 30-90 days | 90-180 days | 180-360 days | Impaired |
| | (in Philippine Peso) | | | | | | |
| Loans and receivables | | | | | | | |
| Cash and cash equivalents (Note 4) | 8,829,293 | 8,829,293 | - | - | - | - | - |
| Due from BSP (Note 5) | 53,711,516 | 53,711,516 | - | - | - | - | - |
| Due from other banks (Note 6) | 373,025,049 | 373,025,049 | - | - | - | - | - |
| Loans receivable (Note 7) | 1,612,931,735 | 1,274,927,758 | 33,194,221 | 66,388,441 | 93,164,390 | 31,054,796 | 114,202,129 |
| Other asset (Note 12): | | | | | | | |
| Accounts receivables | 19,857,870 | 38,588,308 | - | - | - | - | - |
| Held-to-maturity (Note 8) | | | | | | | |
| Held-to-maturity investments | 59,038,000 | 59,038,000 | - | - | - | - | - |
| | 2,127,393,463 | 1,808,119,924 | 33,194,221 | 66,388,441 | 93,164,390 | 31,054,796 | 114,202,129 |

| | December 31, 2015 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | Past due but not impaired | | | | |
| | Total | Neither past due nor impaired | Less than 30 days | 30-90 days | 90-180 days | 180-360 days | Impaired |
| Loans and receivables | | | | | | | |
| Cash and cash equivalents (Note 4) | 8,780,874 | 8,780,874 | - | - | - | - | - |
| Due from BSP (Note 5) | 45,944,391 | 45,944,391 | - | - | - | - | - |
| Due from other banks (Note 6) | 283,463,523 | 283,463,523 | - | - | - | - | - |
| Loans receivable (Note 7) | 1,713,391,244 | 1,552,772,462 | 17,605,010 | 24,565,463 | 29,741,776 | 24,505,601 | 64,200,932 |
| Other assets (Note 12): | | | | | | | |
| Accounts receivables | 38,588,308 | 38,588,308 | - | - | - | - | - |
| Refundable deposits | 1,603,822 | 1,603,822 | - | - | - | - | - |
| Held-to-maturity (Note 8) | | | | | | | |
| Held-to-maturity investments | 21,997,162 | 21,997,162 | - | - | - | - | - |
| | 2,113,769,324 | 1,953,150,542 | 17,605,010 | 24,565,463 | 29,741,776 | 24,505,601 | 64,200,932 |

With respect to credit risk arising from the other financial assets, such as cash and cash equivalents (excluding cash on hand), the Bank's exposure to credit risk which arises from possible default of other counterparties, with a maximum exposure equal to the carrying amounts of these instruments is addressed by investing its excess funds with various credit worthy universal / commercial banks.

Credit quality per class of financial assets

The credit quality of financial assets is determined based on the Bank's historical experience with the corresponding parties as follows:

Due from BSP, due from other banks, cash and cash equivalents, HTM investments and other assets (accounts receivable) - based on the nature of the counterparty and the Bank's internal rating system.

Loans receivable – high grade pertains to fully secured loans with least likelihood of default; standard grade consists of fully secured loans with relatively low defaults; and substandard grade pertains to either secured or clean loans with history of default payments.

The tables below show the credit quality by class of neither past due nor impaired financial assets (gross of allowance for credit losses and unearned interest and discounts) as at December 31, 2016 and 2015:

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | High grade | Standard grade | Substandard grade | Total |
| | (in Philippine Peso) | | | |
| Loans and receivables | | | | |
| Cash and cash equivalents (Note 4) | - | 8,829,293 | - | 8,829,293 |
| Due from BSP (Note 5) | 53,711,516 | - | - | 53,711,516 |
| Due from other banks (Note 6) | 373,025,049 | - | - | 373,025,049 |
| Loans receivable (Note 7) | 1,612,931,735 | - | - | 1,612,931,735 |
| Other asset (Note 12): | | | | |
| Accounts receivables | 19,857,870 | - | - | 19,857,870 |
| Refundable deposits | - | 452,978 | - | 452,978 |
| Held-to-maturity (Note 8) | | | | |
| Held-to-maturity investments | 59,038,000 | - | - | 59,038,000 |
| | 2,118,564,170 | 9,282,271 | - | 2,127,846,441 |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | High grade | Standard grade | Substandard grade | Total |
| Loans and receivables | | | | |
| Cash and cash equivalents (Note 4) | - | 8,780,874 | - | 8,780,874 |
| Due from BSP (Note 5) | 45,944,391 | - | - | 45,944,391 |
| Due from other banks (Note 6) | 283,463,523 | - | - | 283,463,523 |
| Loans receivable (Note 7) | 1,713,391,244 | - | - | 1,713,391,244 |
| Other assets (Note 12): | | | | |
| Accounts receivables | 38,588,308 | - | - | 38,588,308 |
| Refundable deposits | - | 1,603,822 | - | 1,603,822 |
| Held-to-maturity (Note 8) | | | | |
| Held-to-maturity investments | 21,997,162 | - | - | 21,997,162 |
| | 2,103,384,628 | 10,384,696 | - | 2,113,769,324 |

Liquidity risk

Liquidity risk refers to the risk that the Bank will not be able to meet its financial obligations as they fall due.

The Bank seeks to manage its liquidity profile to be able to finance its operations, capital expenditures and deposit liability withdrawal requirements. To cover its financing requirements, the Bank intends to use internally generated funds and to maintain credit facility with certain creditors.

As at December 31, 2016 and 2015, the following were the outstanding credit limits and outstanding unpaid loan availments:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Credit Limit | Unpaid | Credit Limit | Unpaid |
| | (in Philippine Peso) | | (in Philippine Peso) | |
| LBP | 595,000,000 | 135,834,325 | 394,000,000 | 393,979,656 |
| PCFC | 100,000,000 | 43,501,129 | 100,000,000 | 62,615,197 |
| NLDC | 75,000,000 | 8,432,976 | 75,000,000 | 40,833,195 |
| BPI Globe | 60,000,000 | - | 60,000,000 | - |
| UCPB | 30,000,000 | 14,083,333 | 30,000,000 | 30,000,000 |
| SBC | 30,000,000 | 22,500,000 | 30,000,000 | 20,000,000 |
| PBSP | 30,000,000 | 19,570,370 | - | - |
| BSP | 25,650,000 | - | 25,650,000 | - |
| | 945,650,000 | 243,922,133 | 714,650,000 | 547,428,048 |

Since the Bank’s financial liabilities are principally short-term, the Bank manages and matches its financial assets by investing its excess funds in ordinary bank deposits, and granting its loan receivables at short-term periods maturing within 1 year.

The table below summarizes the maturity profile of financial instruments based on its contractual undiscounted cash flows. The maturity grouping of financial liabilities is based on the remaining period from the end of the reporting period to the contractual maturity date. When counterparty has a choice of when the amount is paid, the liability is allocated to the earliest period in which the Bank can be required to pay.

| | December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Total | On demand | Due within 3 months | Due within 4-12 months | Due within 2 to 5 years | Due beyond 5 years |
| | | | (in Philippine Peso) | | | |
| Financial assets | | | | | | |
| Loans and receivables | | | | | | |
| Cash and cash equivalents (Note 4) | 8,829,293 | - | - | - | - | - |
| Due from BSP (Note 5) | 53,711,516 | 53,711,516 | - | - | - | - |
| Due from other banks (Note 6) | 373,025,049 | 373,025,049 | - | - | - | - |
| Loans receivable (Note 7) | 1,612,931,735 | 204,941,410 | 122,964,847 | 163,953,129 | 478,080,016 | 642,992,333 |
| Other asset (Note 12): | | | | | | |
| Accounts receivables | 19,857,870 | 19,857,870 | - | - | - | - |
| Refundable deposits | 452,978 | - | - | - | 452,978 | - |
| Held-to-maturity (Note 8): | | | | | | |
| Held-to-maturity investments | 59,038,000 | - | - | 5,000,000 | 10,038,000 | 44,000,000 |
| | 2,127,846,441 | 651,535,845 | 122,964,847 | 168,953,129 | 488,570,994 | 686,992,333 |
| Financial liabilities | | | | | | |
| Other financial liabilities | | | | | | |
| Deposit liabilities (Note 13) | 1,664,152,811 | 459,375,761 | 343,471,750 | 686,943,501 | 116,241,199 | 58,120,600 |
| Bills payable (Note 14) | 243,922,133 | - | 4,746,400 | 138,025,825 | 9,0124,908 | 11,025,000 |
| Accrued interest and other expenses* (Note 15) | 78,648,328 | - | 78,648,328 | - | - | - |
| | 1,986,723,272 | 459,375,761 | 426,866,478 | 824,969,326 | 206,366,107 | 69,145,600 |
| Net asset (liability) | 141,123,169 | 192,160,084 | (303,901,631) | (656,016,197) | 282,204,887 | 617.846,733 |

*excluding statutory payables

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Total | On demand | Due within 3 months | Due within 4-12 months | Due within 2 to 5 years | Due beyond 5 years |
| | | | (in Philippine Peso) | | | |
| Financial assets | | | | | | |
| Loans and receivables | | | | | | |
| Cash and cash equivalents (Note 4) | 8,780,874 | - | - | - | - | - |
| Due from BSP (Note 5) | 45,944,391 | 45,944,391 | - | - | - | - |
| Due from other banks (Note 6) | 283,463,523 | 283,463,523 | - | - | - | - |
| Loans receivable (Note 7) | 1,713,391,244 | 76,622,791 | 49,029,962 | 505,543,073 | 650,298,773 | 431,896,645 |
| Other assets (Note 12): | | | | | | |
| Accounts receivables | 38,588,308 | 38,588,308 | - | - | - | - |
| Refundable deposits | 1,603,822 | - | - | - | 1,603,822 | - |
| Held-to-maturity (Note 8) | | | - | - | - | - |
| Held-to-maturity investments | 21,997,162 | - | - | 7,997,162 | 10,000,000 | 4,000,000 |
| | 2,113,769,324 | 444,619,013 | 49,029,962 | 513,540,235 | 661,902,595 | 435,896,645 |
| Financial liabilities | | | | | | |
| Other financial liabilities | | | | | | |
| Deposit liabilities (Note 13) | 1,347,985,139 | 891,752,051 | 53,558,884 | 276,215,121 | 120,020,606 | 6,438,477 |
| Bills payable (Note 14) | 547,428,048 | - | 95,034,385 | 316,136,282 | 125,232,381 | 11,025,000 |
| Accrued interest and other expenses* (Note 15) | 114,361,396 | - | 114,361,396 | - | - | - |
| | 2,009,774,583 | 891,752,051 | 262,954,665 | 592,351,403 | 245,252,987 | 17,463,477 |
| Net asset (liability) | 103,994,741 | (447,133,038) | (213,924,703) | (78,811,168) | 416,649,608 | 418,433,168 |

*excluding statutory payables

Market risks

Market risk refers to the risk that changes in market prices, such as foreign exchange rates, interest rates and other market prices will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

The Bank is subject to certain market risks, including risks from changes in interest rates and currency exchange rates. There have been no changes to the Bank's exposure to market risks or the manner in which it manages and measures the risk.

Foreign currency risk

Currency risk arises when transactions are denominated in foreign currencies.

The Bank is not exposed to significant foreign currency risk given that financial assets and liabilities are denominated in the Bank's functional currency.

Interest rate risks

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the fair value of a financial instrument will fluctuate due to changes in market interest rates.

Cash flow interest rate risk exposure, particularly on the Bank's loan receivables is managed within parameters approved by the management. Currently, loans had been offered at the approved fixed interest rates, ranging from 2.0% to 36% in 2016 and 3.0% to 36% and 2015.

The annual interest rates for the interest-bearing financial instruments in 2016 follow:

| | Within 1 Year | 2 - 5 Years |
|---|---|---|
| Due from other banks | 0% to 5.0% | - |
| Loans receivable | 2.0% to 36% | 2% to 18% |
| HTM investments | 1.57% to 1.90% | 1.88 to 5.88% |
| Deposit liabilities | 10% to 14% | 10% to 14% |
| Bills payable | 3.75% to 9.0% | 4.50% to 12.0% |

The annual interest rates for the interest-bearing financial instruments in 2015 follow:

| | Within 1 Year | 2 - 5 Years |
|---|---|---|
| Due from other banks | 0% to 5.0% | - |
| Loans receivable | 2.0% to 36% | 3% to 18% |
| HTM investments | 1.57% to 1.90% | 1.88 to 5.88% |
| Deposit liabilities | 10% to 14% | 10% to 14% |
| Bills payable | 5.05% to 9.0% | 4.0% to 12.0% |

The cash flow interest rate risk of the Bank's financial instruments (principally composed of loans receivable and deposit liabilities), are highly controllable by the Bank. Any changes, thereof, have been subjected to thorough review and approval by the BOD.

The following table demonstrates the sensitivity of net profit before tax for the years ended December 31, 2016 and 2015 to a reasonably possible change in interest rates, with all other variables held constant:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| Increase/(decrease) in market basis points | 1% | (1%) | 1% | (1%) |
| Effect on income before tax | 404,080 | (404,080) | 430,194 | (430,194) |
| Effect on equity | 282,856 | (282,856) | 301,135 | (301,135) |

The maturity profile of the Bank's interest-bearing financial instruments follows:

| | December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Total | On demand | Due within 3 months | Due within 4-12 months | Due within 2 to 5 years | Due beyond 5 years |
| | (in Philippine Peso) | | | | | |
| Financial assets | | | | | | |
| Loans and receivables | | | | | | |
| Due from other banks (Note 6) | 373,025,049 | 373,025,049 | - | - | - | - |
| Loan receivables (Note 7) | 1,612,931,735 | 204,941,410 | 122,964,847 | 163,953,129 | 478,080,016 | 642,992,333 |
| Held-to-maturity (Note 8) | | | | | | |
| Held-to-maturity investments | 59,038,000 | - | - | 5,000,000 | 10,038,000 | 44,000,000 |
| | 2,044,994,784 | 577,966,459 | 122,964,847 | 168,953,129 | 488,118,016 | 686,992,333 |
| Financial liabilities | | | | | | |
| Other financial liabilities | | | | | | |
| Deposit liabilities (Note 13) | 1,664,152,811 | 459,375,761 | 343,471,750 | 686,943,501 | 116,241,199 | 58,120,600 |
| Bills payable (Note 14) | 243,922,133 | - | 4,746,400 | 142,772,225 | 85,378,508 | 11,025,000 |
| | 1,908,074,944 | 459,375,761 | 348,218,150 | 829,715,726 | 201,619,707 | 69,145,600 |

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Total | On demand | Due within 3 months | Due within 4-12 months | Due within 2 to 5 years | Due beyond 5 years |
| | (in Philippine Peso) | | | | | |
| Financial assets | | | | | | |
| Loans and receivables | | | | | | |
| Due from other banks (Note 6) | 283,463,523 | 283,463,523 | - | - | - | - |
| Loan receivables (Note 7) | 1,713,391,244 | 76,622,791 | 49,029,962 | 505,543,073 | 650,298,773 | 431,896,645 |
| Held-to-maturity (Note 8) | | | | | | |
| Held-to-maturity investments | 21,997,162 | - | - | 7,997,162 | 10,000,000 | 4,000,000 |
| | 2,018,851,929 | 360,086,314 | 49,029,962 | 513,540,235 | 660,298,773 | 435,896,645 |
| Financial liabilities | | | | | | |
| Other financial liabilities | | | | | | |
| Deposit liabilities (Note 13) | 1,347,985,139 | 891,752,051 | 53,558,884 | 276,215,121 | 120,020,606 | 6,438,477 |
| Bills payable (Note 14) | 547,428,048 | - | 95,464,125 | 316,136,282 | 125,232,381 | 11,025,000 |
| | 1,895,413,187 | 891,752,051 | 263,384,405 | 592,351,403 | 245,252,987 | 17,463,477 |

## NOTE 28 – CAPITAL RISK MANAGEMENT

The primary objective of the Bank's capital management is to ensure that it complies with externally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholder's value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital structure, or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Regulatory capital consists of Tier 1 capital, which comprises share capital, retained earnings including current year profit and deferred income tax. Certain adjustments are made in PFRS-based results and reserves, as prescribed by the BSP to come up with the Tier 1 capital. The other component of regulatory capital is Tier 2 capital, which includes general loan loss provision (limited to 1.00% of credit risk weighted assets) and preferred shares.

The following table shows the required regulatory capital analysis as at December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| | (in millions) | |
| Tier 1 capital | 251.340 | 239.928 |
| Total qualifying capital | 264.876 | 223.821 |
| Risk-weighted assets | 2,382.177 | 2,397.626 |
| Tier 1 capital ratio | 10.55% | 10.007% |
| Total capital ratio (Note 24) | 11.12% | 9.34% |

Regulatory capital consists of Tier 1 capital and Total qualifying capital which comprises the following:

| | | |
|---|---|---|
| Share capital (Note 17) | 226.311 | 213.622 |
| Retained earnings (Note 17)* | 81.425 | 53.420 |
| Unsecured credit accommodation to DOSRI | (1.164) | (1.095) |
| Deferred tax asset (Note 21) | (56.702) | (43.126) |
| Tier 1 capital | 249.870 | 223.821 |
| General loan loss provision | 15.006 | 15.117 |
| Total qualifying capital | 264.876 | 238.938 |

*net of P15,408,435 and P16,520,063 remeasurement losses on DBO as at December 31, 2016 and 2015, respectively.

Total risk-weighted assets comprise the following:

| | | |
|---|---|---|
| Total credit risk-weighted assets | 1,920.889 | 1,972.055 |
| Total operational risk-weighted assets | 461.288 | 425.571 |
| | 2,382.177 | 2,397.626 |

Under existing BSP regulations, the determination of the Bank's compliance with regulatory requirements and ratios is based on the amount of the Bank's unimpaired capital (regulatory net worth) as reported to the BSP, which is determined on the basis of regulatory accounting policies which differ from PFRS in some aspects.

Under existing banking regulations, the combined capital accounts of each rural bank should not be less than an amount equal to 10.00% of its risk assets. Risk weighted assets are defined as total assets less cash on hand, due form 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 determined by the Monetary Board of the BSP.

Implementation of Basel 1.5

Stand-alone thrift banks (TBs), rural banks (RBs) and cooperative banks (Coop Banks) are covered by a separate risk-based capital adequacy framework referred to by the BSP as the Basel 1.5 framework which is a simplified version of Basel II in view of the simple operations of these covered banks. The implementing guidelines of Basel 1.5 are contained in Circular Nos. 688 and 740 dated May 26, 2010 and November 16, 2011, respectively, which took effect on January 1, 2012.

Revised risk-based capital adequacy framework for stand-alone thrift banks, rural banks and cooperative banks

The monetary board in its Resolution No. 232 dated February 7, 2015 approved the amendments to Appendix 63c and other related provisions of the MORB on the revised risk-based capital adequacy framework for stand-alone thrift banks, rural banks and cooperative banks. The implementing guidelines of the revised risk-based capital adequacy are contained in Circular No. 827 dated February 28, 2015 which shall take effect starting with the CAR reporting period ending March 31, 2015.

Minimum capitalization

Pursuant to the BSP Circular No. 854 series of 2015 dated October 29, 2015, the required minimum capitalization for a rural bank whose head office is located in "all cities up to 3rd class municipalities with 11 to 50 branches" is P40M.

The Bank and its individually regulated operations have complied with all externally imposed capital requirements throughout the period.

## NOTE 27 – FAIR VALUE MEASUREMENT

Categories of financial assets and financial liabilities

The following table summarizes the carrying values and fair values of the Bank's financial assets and financial liabilities by class:

| | December 31, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| | Carrying values | Fair values | Carrying values | Fair values |
| | (in Philippine Peso) | | (in Philippine Peso) | |
| Financial assets | | | | |
| Loans and receivables | | | | |
| Cash and cash equivalents (Note 4) | 222,686,606 | 222,686,606 | 196,833,508 | 196,833,508 |
| Due from BSP (Note 5) | 53,711,516 | 53,711,516 | 45,944,391 | 45,944,391 |
| Due from other banks (Note 6) | 373,025,049 | 373,025,049 | 283,463,523 | 283,463,523 |
| Loans receivable- net (Note 7) | 1,437,902,588 | 1,437,902,588 | 1,568,265,580 | 1,568,265,580 |
| Other assets (Note 12): | | | | |
| Accounts receivables | 19,857,870 | 19,857,870 | 38,588,308 | 38,588,308 |
| Refundable deposits | 452,978 | 452,978 | 1,603,822 | 1,603,822 |
| Held-to-maturity (Note 8) | | | | |
| Held-to-maturity investments | 59,038,000 | 59,038,000 | 21,997,162 | 21,997,162 |
| | 2,166,674,607 | 2,166,674,607 | 2,156,696,294 | 2,156,696,294 |
| Financial liabilities | | | | |
| Other financial liabilities | | | | |
| Deposit liabilities (Note 13) | 1,664,152,811 | 1,664,152,811 | 1,347,985,139 | 1,347,985,139 |
| Bills payable (Note 14) | 243,922,133 | 243,922,133 | 547,428,048 | 547,428,048 |
| Accrued interest and other expenses* (Note 15) | 78,648,328 | 78,648,328 | 114,361,396 | 114,361,396 |
| | 1,986,723,272 | 1,986,723,272 | 2,009,774,583 | 2,009,774,583 |

*excluding statutory payables

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

Cash and other cash items, due from BSP and other banks, other assets (petty cash fund and accounts receivable), deposit liabilities, bills payable, accrued interest and other expenses and deposit for future subscription - Carrying amounts approximate its fair values in view of the relatively short-term maturities of these financial instruments.

Loans and receivables - Fair values of the Bank's loan receivables are estimated using the discounted cash flow methodology, using current incremental lending rates for similar types of loans. Where the instrument re-prices on a quarterly basis or has a relatively short maturity, the carrying amounts approximated fair values.

HTM investments – Fair values of debts securities are generally based on quoted market prices. Where the debt securities are not quoted or market prices not readily available, the Bank applies discounted cash flow methodology.

Items of income, expense, gains or losses on financial assets and financial liabilities

Items of income, expense, gains or losses recognized with respect to financial assets and financial liabilities in the statements of comprehensive income were as follow:

| | 2016 | 2015 |
|---|---|---|
| | (in Philippine Peso) | |
| Total interest income on financial assets measured at amortized cost | | |
| Loan receivables (Note 7) | 330,605,473 | 324,480,295 |
| HTM investments (Note 8) | 545,995 | 441,075 |
| Due from other banks (Notes 6) | 426,371 | 339,827 |
| | 331,577,839 | 325,261,197 |
| Total interest expense on financial liabilities measured at amortized cost | | |
| Deposit liabilities (Note 13) | 40,012,993 | 35,452,974 |
| Bills payable (Note 14) | 25,823,508 | 24,767,226 |
| | 65,836,501 | 60,220,200 |
| Fee income and expense arising from financial assets measured at amortized cost | | |
| Service charges, fees and commissions (Note 18) | 37,968,299 | 36,541,537 |
| Miscellaneous income (Note 18) | 9,531,491 | 5,610,878 |
| | 47,499,790 | 42,152,415 |
| Impairment losses | | |
| Loans and receivables (Note 7) | 47,415,027 | 36,828,142 |
| Accounts receivable (Note 12) | 55,986 | 8,161 |
| | 47,471,013 | 36,836,303 |

Fair value of assets and liabilities

The following tables summarize the carrying values and fair values of the Bank's assets and liabilities which fair values are disclosed (not measure at fair value):

| | December 31, 2016 | | | | |
|---|---|---|---|---|---|
| | | Fair Value | | | |
| | Carrying value | Level 1 | Level 2 | Level 3 | Total Fair Value |
| | (in Philippine Peso) | | | | |
| ASSETS FOR WHICH FAIR VALUES ARE DISCLOSED | | | | | |
| Non-financial assets | | | | | |
| Investment properties | 20,591,560 | - | 45,241,564 | - | 45,241,564 |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | | Fair Value | | | |
| | Carrying value | Level 1 | Level 2 | Level 3 | Total Fair Value |
| | (in Philippine Peso) | | | | |
| ASSETS FOR WHICH FAIR VALUES ARE DISCLOSED | | | | | |
| Non-financial assets | | | | | |
| Investment properties | 24,089,405 | - | 50,970,948 | - | 50,970,948 |

Fair value measurement of non-financial assets

Investment properties – Fair value of investment properties was determined by in-house appraisers on the basis of recent sales of similar properties in the same area as the investment properties and taking into account the economic conditions prevailing at the time the valuations were made. The in-house appraisers provide the fair value of the Bank's investment properties at least every other year as required under: provided, that immediate re-appraisal shall be conducted on items which materially decline in value in accordance with Section X394.2 (g) of the MORB.

The Bank's investment properties with fair values disclosed fall under levels 2 category as at December 31, 2016 and 2015. There were no transfers from and out of level 2 to other category levels in both years.

## NOTE 28 – OTHER MATTERS AND EVENTS AFTER THE REPORTING PERIOD

- There are pending lawsuits in favor of the Bank involving recoveries of sum of money arising in the normal course of its business. These are recognized in the books only when the claims are finally settled or when judgment is rendered.

- The financial statements in 2016 and 2015 were approved and authorized for issue by the President on behalf of the BOD on April 4, 2017.

## NOTE 29 – SUPPLEMENTARY INFORMATION REQUIRED BY THE BUREAU OF INTERNAL REVENUE (BIR)

A. Revenue Regulations (RR) No. 15-2010

On November 25, 2010, the BIR issued RR No. 15-2010 which prescribes additional procedural and/or documentary requirements in connection with the preparation and submission of financial statements accompanying the tax returns. Under the said RR, companies are required to disclose, in addition to the disclosures mandated under PFRS and such other standards and/or conventions that may heretofore be adopted, in the Notes to the Financial Statements, information on taxes, duties and license fees paid or accrued during the taxable year. In compliance with the requirements set forth by RR 15-2010 hereunder are the information on taxes, duties and license fees paid or accrued during the taxable year.

1. The amount of VAT output tax declared during the year and the account title and amount/s upon which the same was based

   The Bank is a non-VAT registered company engaged in the business of rural banking and paid and/or accrued the total amount of P17,250,033 as percentage (gross receipt) tax pursuant to Section 121 of the Tax Code, as amended by RA 9238 effective January 1, 2004, and RA 9337 effective November 1, 2005 and based on the amount of the taxable gross receipts of P63,733,067, P222,121,324 and P100,004,563 with percentage tax rate of 7%, 5% and 1%, respectively.

2. Documentary stamp tax (DST)

   The DST paid/accrued on the following transactions are:

| Transaction | 2016 (in Philippine Peso) |
|---|---|
| Loans and time deposits | 2,600,339 |
| Rediscounting availments (part of taxes and licenses) | 1,319,489 |
| Total | 3,919,828 |

3. Withholding taxes

   The amount of withholding taxes paid and/or accrued for the year amounted to:

| | |
|---|---|
| Final withholding tax (cash dividend and interest) | 4,974,063 |
| Withholding tax on compensation | 3,148,669 |
| Expanded withholding tax | 713,894 |
| Total | 8,836,626 |

4. Other taxes and licenses

| | 2016 |
|---|---|
| | (in Philippine Peso) |
| a. Local | |
| Business permit | 2,129,998 |
| Real estate tax | 436,959 |
| Community tax | 16,536 |
| Others | 575,004 |
| b. National | |
| Capital gains tax | 631,210 |
| BIR annual registration | 14,515 |
| | 3,804,222 |

5. Periods covered and amounts of deficiency tax assessments, whether protested or not

   In 2016, the Bank was assessed of deficiency taxes on expanded withholding tax, gross receipts tax, documentary stamps tax and income tax for the year 2015 of P1,015,278. This was paid in 2016.

B. RR No. 19-2011

RR No. 19-2011 was issued on December 9, 2011 to prescribe the new BIR forms that will be used for Income Tax filing covering and starting with Calendar Year 2011, and to modify Revenue Memorandum Circular No. 57-2011. Pursuant to Section 244 in relation to Sections 6(H), 51(A)(1), and 51(A)(2) of the National Internal Revenue Code of 1997 (Tax Code), as amended, these Regulations prescribed to revise BIR Form Nos. 1700, 1701 and 1702 to reflect the changes in information requested from the said BIR Forms and to enable the said forms to be read by an Optical Character Reader. Under the Guidelines and Instructions of BIR Form No. 1702 - Page 4, the following schedules are prescribed under existing revenue issuances which must form part of the Notes to the Audited Financial Statements:

1. Sales/receipts/fees

   Source of revenue is from interest income on loan receivables amounting to P330,605,473 which is subjected to the regular rate.

2. Cost of services

| Schedule of Cost of Services | Amount Under Regular Rate |
|---|---|
| | (in Philippine Peso) |
| Salaries and wages and employee benefits | 102,680,109 |
| Interest expense on deposit liabilities and borrowed funds | 65,660,622 |
| Insurance-PDIC | 2,673,805 |
| Supervision fees | 433,635 |
| Total Cost of Services | 171,448,171 |

3. Other Income

| Nature of Income | |
|---|---|
| Service charges, fees and commission | 37,968,299 |
| Investment income | 882,326 |
| Other income | 32,579,170 |
| Total Other Income | 71,429,795 |

4. Itemized Deductions

| Nature of Expense / Deduction | Taxable under Regular Rate |
|---|---|
| | (in Philippine Peso) |
| Depreciation and amortization | 28,944,922 |
| Taxes and licenses | 20,217,716 |
| Security, messengerial and janitorial services | 15,517,269 |
| Communications, power, light and water | 15,301,177 |
| Transportation and travel | 9,421,107 |
| Bad debts | 9,397,727 |
| Office supplies | 6,717,693 |
| Rent | 6,377,624 |
| Repairs and maintenance | 4,955,916 |
| Insurance – others | 2,972,628 |
| Entertainment, amusement and recreation | 2,944,980 |
| Litigation on assets acquired | 2,856,339 |
| Professional fees | 2,821,613 |
| Advertising | 414,324 |
| Miscellaneous | 16,861,068 |
| Total Expenses | 145,722,103 |

5. Taxes and licenses

| | | 2016 |
|---|---|---|
| | | (in Philippine Peso) |
| a. | Local | |
| | Business permit | 2,129,998 |
| | Real estate tax | 436,959 |
| | Community tax | 16,536 |
| | Others | 575,004 |
| b. | National | |
| | Capital gains tax | 631,210 |
| | BIR annual registration | 14,515 |
| | | 3,804,222 |

C. RR No. 2-2015

RR No. 2-2015 was issued on January 24, 2015 to prescribe the new BIR forms, which in effect amended the prescribed forms under RR-2011 that will be used for income Tax filing covering and starting with Calendar Year 2013. Pursuant to Section 244 in relation to Sections 6(H), 51(A)(1), and 51(A)(2) of the National Internal Revenue Code of 1997 (Tax Code), as amended, these Regulations are issued to prescribe the use of the revised income tax forms with bar codes, and to reflect the changes in information requested from said form and enable the said form to be read by an Optical Character Reader. Under the Guidelines and Instructions of BIR Form No. 1702RT, the following schedules are prescribed under existing revenue issuances which must form part of the Notes to the Audited Financial Statements:

Taxes and licenses

Refer to RR 15-2010 above (A5 a and b) for the schedule of other taxes and licenses.