CARD SME Bank, Inc., A Thrift Bank

Financial Statements
December 31, 2012 and 2011
and

Independent Auditors' Report

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BOA/PRC Reg. No. 0001,
December 28, 2012, valid until December 31, 2015
SEC Accreditation No. 0012-FR-3 (Group A),
November 15, 2012, valid until November 16, 2015

INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
CARD SME Bank. Inc., A Thrift Bank

Report on the Financial Statements

We have audited the accompanying financial statements of CARD SME Bank, Inc., A Thrift Bank, which comprise the statements of financial position as at December 31, 2012 and 2011, and the statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of CARD SME Bank, Inc., A Thrift Bank as at December 31, 2012 and 2011, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

Report on the Supplementary Information Required Under Revenue Regulations 19-2011 and 15-2010

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required under Revenue Regulations 19-2011 and 15-2010 in Notes 26 and 27 to the financial statements, respectively, is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such information is the responsibility of the management of CARD SME Bank Inc., A Thrift Bank. The information has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

SYCIP GORRES VELAYO & CO.

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March 9, 2013

CARD SME BANK, INC., A THRIFT BANK

STATEMENTS OF FINANCIAL POSITION

	December 31	
	2012	2011
ASSETS		
Cash and Other Cash Items (Note 13)	**₱2,903,536**	₱16,409,109
Due from Bangko Sentral ng Pilipinas (Note 13)	**31,379,001**	14,646,774
Due from Other Banks (Note 21)	**74,480,762**	80,910,070
Available-for-sale Investments (Note 6)	**8,000,000**	9,435,558
Held-to-maturity Investments (Note 7)	**26,236,233**	26,279,591
Loans and Receivables (Note 8)	**556,271,170**	365,754,041
Property and Equipment (Note 9)	**31,705,794**	8,136,577
Investment Properties (Note 10)	**16,188,218**	21,671,491
Assets Held by Special Purpose Vehicle (Note 11)	**5,882,554**	5,882,554
Deferred Tax Assets (Note 20)	**10,178,288**	2,159,609
Retirement Asset (Note 18)	**1,450,585**	–
Other Assets (Note 12)	**7,009,734**	4,018,813
TOTAL ASSETS	**₱771,685,875**	₱555,304,187

LIABILITIES AND EQUITY		
Liabilities		
Deposit Liabilities (Notes 13 and 21)		
Demand	**₱730,357**	₱733,577
Savings	**501,698,935**	321,157,151
	502,429,292	321,890,728
Bills payable (Note 14)	**26,476,877**	65,389,307
Income tax payable	**4,577,903**	4,844,812
Retirement liability (Note 18)	–	4,048,729
Other liabilities (Note 15)	**16,930,853**	16,753,933
	550,414,925	412,927,509
Equity		
Common stock (Note 17)	**215,513,825**	161,008,400
Surplus (Deficit)	**5,757,125**	(19,522,372)
Unrealized gain on available-for-sale investments (Note 6)	–	890,650
	221,270,950	142,376,678
TOTAL LIABILITIES AND EQUITY	**₱771,685,875**	₱555,304,187

See accompanying Notes to Financial Statements.

CARD SME BANK, INC., A THRIFT BANK
STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31	
	2012	2011
INTEREST INCOME ON		
Loans and receivables (Note 8)	**₱220,242,016**	₱153,742,598
Due from BSP and other banks (Note 21)	**5,965,055**	3,550,629
Investments securities (Note 7)	**1,504,322**	1,549,146
	227,711,393	158,842,373
INTEREST EXPENSE ON		
Deposit liabilities (Notes 13 and 21)	**16,907,099**	10,177,320
Bill payable (Note 14)	**2,745,787**	2,833,259
	19,652,886	13,010,579
NET INTEREST INCOME	**208,058,507**	145,831,794
OTHER INCOME		
Gain on initial recognition of investment properties (Note 10)	**1,700,035**	4,873,669
Dividend income (Note 6)	**200,000**	200,000
Loan fees, service fees and penalties	**41,435**	93,955
Miscellaneous (Note 19)	**1,975,808**	3,005,352
TOTAL OPERATING INCOME	**211,975,785**	154,004,770
OPERATING EXPENSES		
Compensation and fringe benefits (Notes 18 and 21)	**80,068,681**	55,326,135
Transportation and travel	**13,664,104**	12,933,194
Taxes and licenses (Note 20)	**13,236,031**	11,662,433
Meetings and seminars (Note 21)	**9,739,107**	3,390,131
Employee trainings (Note 21)	**8,985,844**	5,855,119
Stationery and office supplies	**8,720,514**	6,656,495
Provision for credit and impairment losses (Notes 8 and 10)	**8,380,619**	10,487,781
Occupancy (Notes 21 and 22)	**7,638,548**	4,982,679
Information technology (Note 21)	**6,571,913**	7,542,117
Depreciation and amortization (Notes 9 and 10)	**5,642,611**	3,497,755
Security, messengerial and janitorial	**3,963,614**	3,244,061
Insurance	**3,917,331**	2,595,986
Repairs and maintenance	**2,282,807**	1,478,624
Power, light and water	**2,035,325**	1,235,150
Postage, telephone and cable	**1,530,385**	906,145
Professional fees	**968,740**	2,429,302
Program monitoring	**646,308**	2,003,657
Miscellaneous (Notes 10 and 19)	**5,152,496**	3,031,014
TOTAL OPERATING EXPENSES	**183,144,978**	139,257,778
INCOME BEFORE INCOME TAX	**28,830,807**	14,746,992
PROVISION FOR INCOME TAX (Note 20)	**3,551,310**	6,050,709
NET INCOME	**25,279,497**	8,696,283
OTHER COMPREHENSIVE INCOME		
Unrealized gain (loss) on available-for-sale investments (Note 6)	**(890,650)**	890,650
TOTAL COMPREHENSIVE INCOME	**₱24,388,847**	₱9,586,933

See accompanying Notes to Financial Statements.

CARD SME BANK, INC., A THRIFT BANK

STATEMENTS OF CHANGES IN EQUITY

	Common Stock (Note 17)	**Surplus/ (Deficit)**	**Unrealized Gain (Loss) on Available-for-Sale Investments** (Note 6)	**Total**
Balance at January 1, 2012	**₱161,008,400**	**(₱19,522,372)**	**₱890,650**	**₱142,376,678**
Collection of subscriptions receivable	**54,505,425**	**–**	**–**	**54,505,425**
Total comprehensive income	**–**	**25,279,497**	**(890,650)**	**24,388,847**
Balance at December 31, 2012	**₱215,513,825**	**₱5,757,125**	**₱–**	**₱221,270,950**
Balance at January 1, 2011	₱141,578,900	(₱28,218,655)	₱–	₱113,360,245
Collection of subscriptions receivable	19,429,500	–	–	19,429,500
Total comprehensive income	–	8,696,283	890,650	9,586,933
Balance at December 31, 2011	₱161,008,400	(₱19,522,372)	₱890,650	₱142,376,678

See accompanying Notes to Financial Statements.

CARD SME BANK, INC., A THRIFT BANK
STATEMENTS OF CASH FLOWS

	Years Ended December 31	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	**₱28,830,807**	₱14,746,992
Adjustments for:		
Retirement expense (Note 18)	**10,806,128**	6,795,000
Provision for credit and impairment losses (Notes 8 and 10)	**8,380,619**	10,487,781
Depreciation and amortization (Notes 9 and 10)	**5,642,611**	3,497,755
Fair value gain on initial recognition of investment properties (Note 10)	**(1,700,035)**	(4,873,669)
Loss (gain) on sale of investment properties (Note 19)	**(121,489)**	302,153
Amortization of premium of held-to-maturity (HTM) investments	**43,358**	784,128
Gain on sale of asset held by special purpose vehicle (Note 19)	**–**	(1,053,342)
Loss on disposal of property and equipment	**–**	35,584
Changes in operating assets and liabilities:		
Increase in the amounts of:		
Loans and receivables	**(198,937,840)**	(115,655,041)
Deposit liabilities	**180,538,564**	94,206,567
Other assets	**(2,990,921)**	(1,917,546)
Other liabilities	**176,920**	7,910,472
Net cash generated from operations	**30,668,722**	15,266,834
Income taxes paid	**(11,836,898)**	(5,658,133)
Contributions to the retirement fund (Note 18)	**(16,305,442)**	(1,770,605)
Net cash provided by operating activities	**2,526,382**	7,838,096
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of:		
Property and equipment (Note 9)	**(25,360,233)**	(4,098,724)
HTM investment	**–**	(27,122,411)
AFS investments	**–**	(4,435,558)
Proceeds from sale or maturities of:		
Investment properties (Note 10)	**4,038,202**	3,500,000
HTM investment	**–**	15,120,000
Asset held by special purpose vehicle	**–**	1,287,163
Property and equipment	**–**	42,500
Net cash used in investing activities	**(21,322,031)**	(15,707,030)
CASH FLOWS FROM FINANCING ACTIVITIES		
Availments of bills payable	**65,000,000**	82,000,000
Settlement of bills payable	**(103,912,430)**	(39,202,514)
Collections of subscriptions receivable (Note 17)	**54,505,425**	19,429,500
Net cash provided by financing activities	**15,592,995**	62,226,986

(Forward)

	Years Ended December 31	
	2012	2011
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(₱3,202,654)**	₱54,358,052
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		
Cash and other cash items	**16,409,109**	2,710,818
Due from Bangko Sentral ng Pilipinas	**14,646,774**	716,802
Due from other banks	**80,910,070**	54,180,281
	111,965,953	57,607,901
CASH AND CASH EQUIVALENTS AT END OF YEAR		
Cash and other cash items	**2,903,536**	16,409,109
Due from Bangko Sentral ng Pilipinas	**31,379,001**	14,646,774
Due from other banks	**74,480,762**	80,910,070
	₱108,763,299	₱111,965,953

OPERATIONAL CASH FLOWS FROM INTEREST		
Interest received	**₱228,313,179**	₱159,987,121
Interest paid	**18,788,456**	12,457,423

See accompanying Notes to Financial Statements.

CARD SME BANK, INC., A THRIFT BANK
NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

CARD SME Bank Inc., A Thrift Bank, (the Bank) was incorporated in the Philippines on October 4, 1961. The Bank was granted the authority to operate by the Bangko Sentral ng Pilipinas (BSP) on May 10, 1962. Its principal place of business is at #61 Insular Building, Rizal Avenue, San Pablo City, Laguna. The Bank offers a wide range of products and services such as deposit and loan products mainly to the consumer market.

In 2007, the Bank (with existing branches in Sto. Tomas, Batangas; Lipa City, Batangas; and Tagaytay City, Cavite) became a member of Center for Agriculture and Rural Development (CARD) – Mutually Reinforcing Institutions (MRI) when CARD, Inc. and CARD Employees' Multipurpose Cooperative, Inc. acquired the majority of its voting stock. The rehabilitation court and the BSP approved the sale and transfer of shares of stock on September 5, 2007 and February 7, 2008, respectively.

The Monetary Board, in its Resolution No. 1757 dated December 9, 2010, has approved the Bank's application for conversion into a regular thrift bank.

The BSP and Philippine Securities and Exchange Commission (SEC) approved on April 8, 2011 and May 11, 2011, respectively, the Bank's amended Articles of Incorporation (AOI) and new by-laws. The approved amendments to the Bank's AOI follow:

a. Change of the corporate name from 'Rural Bank of Sto. Tomas (Batangas), Inc.' to 'CARD SME Bank, Inc., A Thrift Bank';

b. Change of the primary and secondary purposes from that of rural banking to thrift banking;

c. Change of the principal office address from 'General Malvar Avenue, Sto. Tomas, Batangas' to 'San Pablo City, Laguna'; and

d. Extension of the Bank's corporate life for another fifty (50) years from the date of expiration on February 6, 2012.

The Bank was granted by the BSP the authority to operate as a thrift bank on June 15, 2011. On July 25, 2011, the Bank has formally started its operations as a thrift bank.

As a thrift bank, the Bank can now (1) provide short term working capital, medium and long-term financing, to business engaged in agricultural services, industry and housing; (2) provide diversified financial and allied services for its chosen market and constituents especially for small and medium enterprises, microfinance and individuals; and (3) carry on activities specified under Section 10 of RA 7906, otherwise known as *'Thrift Banks Act of 1995'*.

On September 29, 2011, the BSP has approved the conversion of its thirteen (13) existing Other Banking Offices (OBOs) into Micro-Banking Offices (MBOs) including the establishment of sixteen (16) additional MBOs. Likewise, application for three (3) additional branches were approved by the BSP on November 29, 2011, namely; Batangas City Branch, Sta. Rosa City Branch and Cavite City Branch. The branches subsequently opened on March 5, 2012, May 14, 2012 and October 8, 2012, respectively.

Another application for three (3) additional branches was approved by the BSP on October 15, 2012, namely: Calamba City Branch, Dasmariñas City Branch and Balayan, Batangas Branch. Additional application for forty-seven (47) MBOs was approved by the BSP on September 28, 2012.

2. Significant Accounting Policies

Basis of Preparation
The accompanying financial statements have been prepared on a historical cost basis, except for available-for-sale (AFS) investments which have been measured at fair value. The financial statements are presented in Philippine peso, the Bank's functional currency. All values are rounded to the nearest peso unless otherwise indicated.

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

Presentation of Financial Statements
The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery (asset) or settlement (liability) within 12 months after the reporting date (current) and more than 12 months after the reporting date (noncurrent) is presented in Note 16.

Changes in Accounting Policies and Disclosures
The accounting policies adopted are consistent with those of the previous financial year except for the following amended PFRS, which were adopted as of January 1, 2012.

New Standards and Interpretations

PFRS 7*, Financial Instruments: Disclosures - Transfers of Financial Assets* (Amendments)
The amendments require additional disclosures about financial assets that have been transferred but not derecognized to enhance the understanding of the relationship between those assets that have not been derecognized and their associated liabilities. In addition, the amendments require disclosures about continuing involvement in derecognized assets to enable users of financial statements to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognized assets. The amendments have no impact on the disclosures and on the Bank's financial position and performance.

PAS 12*, Income Taxes - Deferred Tax: Recovery of Underlying Assets* (Amendments)
This amendment to PAS 12 clarifies the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that the carrying amount of investment property measured using the fair value model in PAS 40, *Investment Property*, will be recovered through sale and, accordingly, requires that any related deferred tax should be measured on a 'sale' basis. The presumption is rebutted if the investment property is depreciable and it is held within a business model whose objective is to consume substantially all of the economic benefits in the investment property over time ('use' basis), rather than through sale. Furthermore, the amendment introduces the requirement that deferred tax on non-depreciable assets measured using the revaluation model in PAS 16, *Property, Plant and Equipment*, always be measured on a sale basis of the asset.

As at December 31, 2012, the Bank holds its investment properties, and property and equipment under PAS 40 and PAS 16, respectively, carried under the cost model. The amendment has no impact on the financial statements of the Bank.

Summary of Significant Accounting Policies

Cash and Cash Equivalents
For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, amounts due from BSP and other banks that are convertible to known amounts of cash with original maturities of three months or less from dates of placements and that are subject to insignificant risk of changes in value.

Foreign Currency Transactions
For financial reporting purposes, foreign currency-denominated monetary assets and liabilities are translated to Philippine pesos based on the Philippine Dealing and Exchange Corporation (PDEx) closing rate prevailing at end of the year, and foreign-currency-denominated income and expenses at the rate at transaction date. Foreign exchange differences arising from restatements of foreign currency-denominated monetary assets and liabilities are credited to or charged against operations.

Financial Instruments - Initial Recognition and Subsequent Measurement
Date of recognition
Purchases or sales of financial assets that require delivery of the assets within the time frame established by regulation or convention in the marketplace are recognized on the settlement date. Deposits, amounts due to banks and loans receivables are recognized when cash is received by the Bank or advanced to the borrowers.

Initial recognition of financial instruments
All financial instruments are initially measured at fair value. Except for financial assets and financial liabilities at fair value through profit or loss (FVPL), the initial measurement of financial assets and liabilities includes transaction costs. The Bank classifies its financial assets in the following categories: financial assets at FVPL, held-to-maturity (HTM) investments, AFS investments, and loans and receivables. The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market, and for HTM investments, the ability and intention to hold the investment until maturity. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date. Financial liabilities are classified into financial liabilities at FVPL and other financial liabilities at amortized cost.

As at December 31, 2012 and 2011, the Bank has no financial assets and financial liabilities at FVPL.

Determination of fair value
The fair value for financial instruments traded in active markets at the reporting date is based on their quoted market prices or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction is used since it 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.

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

AFS investments
AFS investments are nonderivative financial assets which are designated as such or do not qualify to be classified as financial assets at FVPL, HTM investments or loans and receivables. These are purchased and held indefinitely and may be sold in response to liquidity requirements or changes in market conditions.

After initial measurement, AFS investments are subsequently measured at fair value. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-denominated AFS debt securities, is reported in the statement of comprehensive income. The unrealized gains and losses arising from the fair valuation of AFS investments are excluded, net of tax, from reported income and are reported as 'Unrealized gain on available-for-sale investments' in other comprehensive income in the statement of comprehensive income.

When the security is disposed of, the cumulative gain or loss previously recognized in other comprehensive income is recognized in profit or loss. Interest earned on holding AFS debt investments are reported as 'Interest income' using the effective interest rate (EIR) method. Dividends earned on holding AFS equity investments are recognized in the statement of income as 'Dividend income' when the right of payment had been established. The losses arising from impairment of such investments are recognized as 'Provision for credit and impairment losses' in the statement of comprehensive income.

HTM investments
HTM investments are quoted nonderivative financial assets with fixed or determinable payments and fixed maturities for which the Bank's management has the positive intention and ability to hold to maturity. After initial measurement, these investments are subsequently measured at amortized cost using the EIR method, less any 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 EIR. The amortization is included in 'Interest income' in the statement of comprehensive income. The losses arising from impairment of such investments are recognized in the statement of comprehensive income under 'Provision for credit and impairment losses'.

If the Bank sells more than an insignificant amount of HTM investments prior to maturity (other than in specific circumstances), the entire category would be tainted and reclassified as AFS investments. Furthermore, the Bank would be precluded from using the HTM investment category for the following two years.

Loans and receivables
This accounting policy relates to the statement of financial position captions 'Due from BSP', 'Due from other banks', and 'Loans and receivables'. These are nonderivative financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as financial assets at FVPL or designated as AFS investments.

After initial measurement, loans and receivables are subsequently measured at amortized cost using the EIR method, less allowance for credit losses and unearned interest income. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortization is included in the 'Interest income' in the statement of comprehensive income. The losses arising from impairment are recognized in 'Provision for credit and impairment losses' in the statement of comprehensive income.

Other financial liabilities at amortized cost
This category represents issued financial instruments or their components, which are not designated at FVPL where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares. The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue. The liabilities are classified under 'Deposit liabilities', 'Bills payable', or other appropriate financial liability accounts in the statement of financial position.

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

<u>Classification of Financial Instruments between Debt and Equity</u>
A financial instrument is classified as debt if it provides for a contractual obligation to:
- deliver cash or another financial asset to another entity;
- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Bank; or
- satisfy the obligation other than by the exchange of a fixed amount of cash or another 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.

<u>Derecognition of Financial Assets and Liabilities</u>
Financial assets
A financial asset (or, where applicable a part of a financial asset or part of a group of financial assets) is derecognized when:
- the rights to receive cash flows from the asset have expired;
- 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
- the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained the risk and rewards of the asset but has transferred the control over the asset.

Where 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 over 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 original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Financial liabilities
A financial liability is derecognized when the obligation under the liability is discharged or cancelled or has expired. Where 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 the statement of comprehensive income.

<u>Offsetting Financial Instruments</u>
Financial assets and financial liabilities are only offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognized amounts and the Bank intends to either settle on a net basis, or to realize the asset and the liability simultaneously. This is not generally the case with master-netting agreements, and the related assets and liabilities are presented gross in the statement of financial position.

<u>Impairment of Financial Assets</u>
The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets at amortized cost
For loans and receivables, due from BSP and other banks, and HTM investments which are carried at amortized cost, the Bank first 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 the Bank determines that no objective evidence of impairment exists for individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the counterparties' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of loss is charged to the statement of comprehensive income. Financial assets at amortized cost, together with the associated allowance accounts, are written off when there is no realistic prospect of future recovery and all collateral has been realized. If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is reduced by adjusting the allowance account. If a future write-off is later recovered, any amounts formerly charged are credited to the 'Provision for credit and impairment losses' in the statement of comprehensive income.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of such credit risk characteristics as industry, collateral type, past-due status and term. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with changes in related observable data from period to period (such changes in unemployment rates, property prices, payment status, or other factors that are indicative of incurred losses in the Bank and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

Restructured loans
Where possible, the Bank seeks to restructure loans, which may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews restructured loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original EIR. The difference between the recorded value of the original loan and the present value of the restructured cash flows, discounted at the original EIR, is recognized in 'Provision for credit and impairment losses' in the statement of comprehensive income.

AFS investments
For AFS investments, the Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired.

In the case of debt instruments classified as AFS investments, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of 'Interest income' in the statement of comprehensive income. If subsequently, the fair value of a debt instrument increased and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of comprehensive income, the impairment loss is reversed through the statement of comprehensive income.

In the case of equity investments classified as AFS investments, this would include a significant or prolonged decline in the fair value of the investments below its cost. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the profit or loss is removed from equity and recognized in the profit or loss. Impairment losses on AFS investments are not reversed through the statement of comprehensive income. Increases in fair value after impairment are recognized directly in other comprehensive income.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization and accumulated impairment losses, if any.

The initial cost of property and equipment consists of its purchase price, including taxes and any directly attributable costs to bring the asset to its working condition and location for its intended use. Expenditures incurred after items of property and equipment have been put into operation, such as repairs and maintenance are normally charged against operations in the period in which the 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 an item property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property and equipment.
Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets.

The estimated useful lives of the depreciable assets are as follows:

Furniture, fixtures and equipment	2-5 years
Leasehold improvements	2-5 years or the terms of the related leases, whichever is shorter
Transportation equipment	2-5 years
Building	25 years

The useful life and the depreciation and amortization method are reviewed periodically to ensure that the period and the method of depreciation and amortization are consistent with the expected pattern of economic benefits from items of property and equipment.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of comprehensive income in the year the asset is derecognized.

The carrying values of the property and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, an impairment loss is recognized under 'Provision for credit and impairment losses' in the statement of comprehensive income.

Investment Properties

Investment properties are measured initially at cost, including transaction costs. An investment property acquired through an exchange transaction is measured at fair value of the asset acquired unless the fair value of such an asset cannot be measured in which case the investment property acquired is measured at the carrying amount of asset given up. Foreclosed properties are classified under 'Investment properties' upon either:

- of entry of judgment in case of judicial foreclosure;
- execution of sheriff's certificate of sale in case of extra-judicial foreclosure; or
- notarization of the deed of dacion en payment in kind (dacion en pago).

The difference between the fair value of the asset acquired and the carrying amount of the asset given up is recognized under ‘Miscellaneous income’ in the statement of comprehensive income under ‘Provision for credit and impairment losses’ account.

Subsequent to initial recognition, investment properties are stated cost less accumulated depreciation and accumulated impairment losses, if any.

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 gains or losses on the retirement or disposal of an investment property are recognized in the statement of comprehensive income in the period of retirement or disposal. Expenditures incurred after the investment properties have been put into operations, such as repairs and maintenance costs, are charged against income in the year in which the costs are incurred.

Depreciation on buildings and improvements is calculated on a straight-line basis over the estimated useful life of three years from the time of acquisition of the investment properties.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by cessation of owner-occupation or of construction or development, or commencement of an operating lease to another party. Transfers are made from investment property 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.

For transfers from investment property to owner-occupied property, the deemed cost of property for subsequent accounting is its depreciated cost at the date of change in use. If the property occupied by the Bank as an owner-occupied property becomes an investment property, the Bank accounts for such property in accordance with the policy stated under ‘Property and equipment’ up to the date of change in use.

<u>Assets Held by Special Purpose Vehicle (SPV)</u>
Assets held by SPV are recognized if the sale of the asset is highly probable, evidenced by the management’s commitment to sell the asset. Assets held by SPV are carried at lower of cost less any impairment in value and net realizable value.

If an asset ceased to be classified as assets held by SPV, it shall be measured at the lower of its carrying amount before the asset was classified as such, adjusted for any depreciation, amortization or revaluations that would have been recognized had it not been classified as such, and its recoverable amount at the date of the subsequent decision not to sell. The Bank shall include any required adjustment to the carrying amount of an asset that ceases to be classified as asset held by SPV in the statement of comprehensive income.

<u>Impairment of Property and Equipment, Investment Properties and Assets Held by SPV</u>
At each reporting date, the Bank assesses whether there is any indication that its property and equipment, investment properties, and assets held by SPV are impaired. When an indicator of impairment exists or when an annual impairment testing for an asset is required, the Bank makes a formal estimate of recoverable amount. Recoverable amount is the higher of an asset’s fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is assessed as part of the cash generating unit to which it belongs. Where the carrying amount of an asset exceeds its recoverable amount, the asset

(or cash generating unit) is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is charged against operations in the year in which it arises.

An assessment is made at each reporting date as to 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. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of comprehensive income. After such a reversal, the depreciation and amortization expense is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

Equity
Common stock represents the aggregate amount of fully paid capital stock which is determined using the nominal or par value of shares that have been issued. Surplus (deficit) represents the cumulative balance of periodic net income or loss, dividend contributions, prior period adjustments, effect of changes in accounting policy and other capital adjustments.

Revenue 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 Bank has assessed that it is acting as a principal (as opposed to as an agent) in all revenue arrangements. The following specific recognition criteria must also be met before the revenue is recognized:

Interest income
For all financial assets measured at amortized cost and interest-bearing instruments, interest income is recorded at the EIR, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options), includes any fees (such as service fees) or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses. The adjusted carrying amount is calculated based on the original EIR. The change in carrying amount is recorded as 'Interest income' in the statement of comprehensive income.

Once the recorded value of a financial asset or group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original EIR used to discount future cash flows.

'Unearned interest income' is recognized as income over the terms of the receivables using the EIR method and shown as deduction from loans.

Loan fees, service fees and penalties
Loan fees are recognized over the term of the credit lines granted to each borrower. Service fees are accrued when earned. Penalties are recognized only upon collection or where there is a reasonable degree of certainty as to their collectability.

Costs and Expenses
Costs and expenses encompass losses as well as those expenses that arise in the course of the ordinary activities of the Bank. Costs and expenses are recognized when incurred.

Retirement Benefits
The Bank's personnel are covered by a noncontributory defined benefit retirement plan.

The retirement cost of the Bank 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 period.

The asset recognized in the statement of financial position, in respect of defined benefit pension plans is the present value of the defined benefit obligation less the fair value of plan assets at the reporting date, together with adjustments for unrecognized actuarial gains or losses, past service costs and unrecognized plan assets determined under the asset ceiling test. The asset ceiling test requires a defined benefit asset to be measured at lower of the amount of the asset and the total of any cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The defined benefit obligation is calculated annually by an independent actuary using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using the interest rate on government bonds with terms to maturity approximating the terms of the related retirement liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged against or credited to income when the net cumulative unrecognized actuarial gains and losses at the end of the previous period exceeded 10.0% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These excess gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

Past service cost is recognized immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, past service costs are amortized on a straight-line basis over the vesting period.

Leases
The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. 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 renewal or extension of the arrangement;
b. A renewal option is exercised or extension granted, unless the 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; or
d. There is a substantial change to the asset.

Where reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment of the 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 asset are classified as operating leases. Operating lease payments are recognized as an expense under 'Occupancy' account in the statement of comprehensive income on a straight-line basis over the lease term.

Income Taxes
Current tax
Current tax assets and liabilities for the current and prior years 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 enacted or substantively enacted as at the reporting date.

Deferred tax
Deferred tax is provided, using the balance sheet liability method, on all temporary differences at the 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 with certain exceptions. Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from excess minimum corporate income tax (MCIT) over regular corporate income tax (RCIT), if any, and unused net operating loss carryover (NOLCO), if any, to the extent that it is probable that taxable income will be available against which the deductible temporary differences and carryforward of unused excess MCIT over RCIT and unused NOLCO can be utilized. Deferred tax, however, is not recognized when it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting income nor taxable income.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced 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 asset to be utilized. Unrecognized deferred tax assets are reassessed as at reporting date and 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 applicable 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 reporting date.

Current tax and deferred tax relating to items recognized directly in equity is also recognized in equity and not in the statement of comprehensive income.

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

Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Bank expects some or all of a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of comprehensive income, net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an 'Interest expense' in the statement of comprehensive income.

Contingent Liabilities and Contingent Assets

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

Events After the Reporting Date

Post-year-end events that provide additional information about the Bank's position at the reporting date (adjusting events), are reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material in the notes to the financial statements.

Future Changes in Accounting Policies

The Bank will adopt the following standards and interpretations when these become effective. Except as otherwise indicated, the Bank does not expect the adoption of these new and amended PAS, PFRS and Philippine Interpretations to have significant impact on its financial statements.

PFRS 7*, Financial instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities* (Amendments)

These amendments require an entity to disclose information about rights of set-off and related arrangements (such as collateral agreements). The new disclosures are required for all recognized financial instruments that are set off in accordance with PAS 32. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or 'similar agreement', irrespective of whether they are set-off in accordance with PAS 32. The amendments require entities to disclose, in a tabular format unless another format is more appropriate, the following minimum quantitative information. This is presented separately for financial assets and financial liabilities recognized at the end of the reporting period:

a) The gross amounts of those recognized financial assets and recognized financial liabilities;
b) The amounts that are set off in accordance with the criteria in PAS 32 when determining the net amounts presented in the statement of financial position;
c) The net amounts presented in the statement of financial position;
d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in (b) above, including:
    i. Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in PAS 32; and
    ii. Amounts related to financial collateral (including cash collateral); and
e) The net amount after deducting the amounts in (d) from the amounts in (c) above.

The amendments to PFRS 7 are to be retrospectively applied and are effective for annual periods beginning on or after January 1, 2013. The amendments affect disclosures only and have no impact on the Bank's financial position or performance.

PFRS 10, *Consolidated Financial Statements*
PFRS 10 replaces the portion of PAS 27, *Consolidated and Separate Financial Statements*, that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC 12, *Consolidation - Special Purpose Entities*. PFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by PFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in PAS 27. The standard becomes effective for annual periods beginning on or after January 1, 2013.

PFRS 11, *Joint Arrangements*
PFRS 11 replaces PAS 31, *Interests in Joint Ventures*, and SIC 13, *Jointly Controlled Entities - Non-Monetary Contributions by Venturers*. PFRS 11 removes the option to account for jointly controlled entities using proportionate consolidation. Instead, jointly controlled entities that meet the definition of a joint venture must be accounted for using the equity method. The standard becomes effective for annual periods beginning on or after January 1, 2013.

PFRS 12, *Disclosure of Interests in Other Entities*
PFRS 12 includes all of the disclosures related to consolidated financial statements that were previously in PAS 27, as well as all the disclosures that were previously included in PAS 31 and PAS 28, *Investments in Associates*. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. The standard becomes effective for annual periods beginning on or after January 1, 2013.

The adoption of PFRS 12 will affect disclosures only and have no impact on the Bank's financial position or performance.

PFRS 13, *Fair Value Measurement*
PFRS 13 establishes a single source of guidance under PFRSs for all fair value measurements. PFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under PFRS when fair value is required or permitted. This standard should be applied prospectively as of the beginning of the annual period in which it is initially applied. Its disclosure requirements need not be applied in comparative information provided for periods before initial application of PFRS 13. The standard becomes effective for annual periods beginning on or after January 1, 2013.

PAS 1, *Presentation of Financial Statements - Presentation of Items of Other Comprehensive Income or OCI* (Amendments)
The amendments to PAS 1 change the grouping of items presented in OCI. Items that can be reclassified (or "recycled") to profit or loss at a future point in time (for example, upon derecognition or settlement) will be presented separately from items that will never be recycled. The amendments affect presentation only and have no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after July 1, 2012. The amendments affect disclosures only and have no impact on the Bank's financial position or performance.

PAS 19, *Employee Benefits* (Revised)
Amendments to PAS 19 range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and rewording. The revised standard also requires new disclosures such as, among others, a sensitivity analysis for each significant actuarial assumption, information on asset-liability matching strategies, duration of the defined benefit obligation, and disaggregation of plan assets by nature and risk. The amendments become effective for annual periods beginning on or after January 1, 2013. Once effective, the Bank has to apply the amendments retroactively to the earliest period presented.

The Bank reviewed its existing employee benefits and determined that the amended standard has significant impact on its accounting for retirement benefits. The Bank performed its computation on the impact to the financial statements upon adoption of the standard.

The effects are detailed below (in thousands):

	As at December 31, 2012	As at January 1, 2012
Increase (decrease) in:		
Statement of financial position		
Net defined benefit asset	₱39,574	₱–
Deferred tax liability	11,872	–
Other comprehensive income	48,202	21,465
Retained earnings	(48,962)	(19,177)

	2012
Income statement	
Net benefit cost	(₱760)
Income tax expense	228
Profit for the year	532
Other comprehensive income	
Remeasurement of defined benefit obligation	₱15,026
Income tax effects	6,440

PAS 27, *Separate Financial Statements* (as revised in 2011)
As a consequence of the issuance of the new PFRS 10, *Consolidated Financial Statements*, and PFRS 12, *Disclosure of Interests in Other Entities*, what remains of PAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in the separate financial statements. The adoption of the amended PAS 27 will not have a significant impact on the financial statements of the Bank. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

PAS 28, *Investments in Associates and Joint Ventures* (as revised in 2011)
As a consequence of the issuance of the new PFRS 11, *Joint Arrangements*, and PFRS 12, *Disclosure of Interests in Other Entities*, PAS 28 has been renamed PAS 28, *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

Philippine Interpretation IFRIC 20, *Stripping Costs in the Production Phase of a Surface Mine*
This interpretation applies to waste removal (stripping) costs incurred in surface mining activity, during the production phase of the mine. The interpretation addresses the accounting for the benefit from the stripping activity. The interpretation is effective for annual periods beginning on or after January 1, 2013. This new interpretation is not relevant to the Bank.

PAS 32, *Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities* (Amendments)
The amendments clarify the meaning of "currently has a legally enforceable right to set-off" and also clarify the application of the PAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendments affect presentation only and have no impact on the Bank's financial position or performance. The amendments to PAS 32 are to be retrospectively applied for annual periods beginning on or after January 1, 2014.

PFRS 9, *Financial Instruments*
PFRS 9, as issued, reflects the first phase on the replacement of PAS 39 and applies to the classification and measurement of financial assets and liabilities as defined in PAS 39, *Financial Instruments: Recognition and Measurement*. Work on impairment of financial instruments and hedge accounting is still ongoing, with a view to replacing PAS 39 in its entirety. PFRS 9 requires all financial assets to be measured at fair value at initial recognition. A debt financial asset may, if the fair value option (FVO) is not invoked, be subsequently measured at amortized cost if it is held within a business model that has the objective to hold the assets to collect the contractual cash flows and its contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding. All other debt instruments are subsequently measured at fair value through profit or loss. All equity financial assets are measured at fair value either through other comprehensive income (OCI) or profit or loss. Equity financial assets held for trading must be measured at fair value through profit or loss. For FVO liabilities, the amount of change in the fair value of a liability that is attributable to changes in credit risk must be presented in OCI. The remainder of the change in fair value is presented in profit or loss, unless presentation of the fair value change in respect of the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. All other PAS 39 classification and measurement requirements for financial liabilities have been carried forward into PFRS 9, including the embedded derivative separation rules and the criteria for using the FVO. The adoption of the first phase of PFRS 9 will have an effect on the classification and measurement of the Bank's financial assets, but will potentially have no impact on the classification and measurement of financial liabilities. The Bank will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture. PFRS 9 is effective for annual periods beginning on or after January 1, 2015.

Philippine Interpretation IFRIC 15, *Agreements for the Construction of Real Estate*
This interpretation covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. The SEC and the Financial Reporting Standards Council (FRSC) have deferred the effectivity of this interpretation until the final Revenue standard is issued by the International Accounting Standards Board (IASB) and an evaluation of the requirements of the final Revenue standard against the practices of the Philippine real estate industry is completed. Adoption of the interpretation when it becomes effective will not have any impact on the financial statements of the Bank.

***Annual Improvements to PFRSs* (2009-2011 cycle)**

The *Annual Improvements to PFRSs* (2009-2011 cycle) contain non-urgent but necessary amendments to PFRSs. The amendments are effective for annual periods beginning on or after January 1, 2013 and are applied retrospectively. Earlier application is permitted.

PFRS 1, *First-time Adoption of PFRS - Borrowing Costs*
The amendment clarifies that, upon adoption of PFRS, an entity that capitalized borrowing costs in accordance with its previous generally accepted accounting principles, may carry forward, without any adjustment, the amount previously capitalized in its opening statement of financial position at the date of transition. Subsequent to the adoption of PFRS, borrowing costs are recognized in accordance with PAS 23, *Borrowing Costs*. The amendment does not apply to the Bank as it is not a first-time adopter of PFRS.

PAS 1, *Presentation of Financial Statements - Clarification of the requirements for comparative information*
The amendments clarify the requirements for comparative information that are disclosed voluntarily and those that are mandatory due to retrospective application of an accounting policy, or retrospective restatement or reclassification of items in the financial statements. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the minimum required comparative period. The additional comparative period does not need to contain a complete set of financial statements. On the other hand, supporting notes for the third balance sheet (mandatory when there is a retrospective application of an accounting policy, or retrospective restatement or reclassification of items in the financial statements) are not required. The amendments will affect disclosures only and have no impact on the Bank's financial position or performance.

PAS 16, Property, Plant and Equipment - Classification of servicing equipment
The amendment clarifies that spare parts, stand-by equipment and servicing equipment should be recognized as property, plant and equipment when they meet the definition of property, plant and equipment and should be recognized as inventory if otherwise. The amendment will not have any significant impact on the Bank's financial position or performance.

PAS 32, Financial Instruments: Presentation - Tax effect of distribution to holders of equity instruments
The amendment clarifies that income taxes relating to distributions to equity holders and to transaction costs of an equity transaction are accounted for in accordance with PAS 12, *Income Taxes*. The Bank expects that this amendment will not have any impact on its financial position or performance.

PAS 34, *Interim Financial Reporting - Interim financial reporting and segment information for total assets and liabilities*
The amendment clarifies that the total assets and liabilities for a particular reportable segment need to be disclosed only when the amounts are regularly provided to the chief operating decision maker and there has been a material change from the amount disclosed in the entity's previous annual financial statements for that reportable segment. The amendment will affect disclosures only and has no impact on the Bank's financial position or performance.

3. Significant Accounting Judgments and Estimates

The preparation of the financial statements in compliance with PFRS requires the Bank to make judgments and estimates that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent assets and contingent liabilities. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the financial statements as they become reasonably determinable.

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

Judgments

(a) *Operating leases - Bank as lessee*
The Bank has entered into commercial property leases with various entities wherein the latter retain all the significant risks and rewards of ownership of those properties leased out under operating leases.

(b) *Classification of HTM investment*
The 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 in certain specific circumstances - for example, selling an insignificant amount close to maturity - it will be required to reclassify the entire portfolio as AFS investments. The investments would therefore be measured at fair value and not at amortized cost. The Bank has assessed that it has the intention and ability to hold these investments until maturity. As at December 31, 2012 and 2011, the carrying value of HTM investments amounted to ₱26.2 million and ₱26.3 million, respectively.

(c) *Fair value of financial instruments*
Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Refer to Note 5 for the fair value measurement of financial assets and liabilities.

(d) *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 the asset is quoted in an active market is the determination on whether the quoted prices are readily and regularly available, and whether those prices represent actual and regularly occurring market transactions on an arm's-length basis.

(e) *Determination of functional currency*
PAS 21, *The Effects of Changes in Foreign Exchange Rates*, requires the Bank to use its judgment to determine its functional currency such that it most faithfully represents the economic effects of the underlying transactions, events and conditions that are relevant to the Bank. In making this judgment, the Bank considers the following:

- 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);
- the currency in which funds from financing activities are generated; and
- the currency in which receipts from operating activities are usually retained.

The Bank has determined that its functional currency is Philippine peso.

(f) *Contingencies*
The amount of probable costs for the resolution of any possible claims against the Bank is to be determined in consultation with outside legal counsel which will handle the Bank's defense in any legal contingencies and will be based upon the analysis of potential results.

(g) *Going Concern*
The Bank's management has made an assessment of the Bank's ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

<u>Estimates</u>
(a) *Credit losses on loans and receivables*
The Bank reviews its loans and receivables at each reporting date to assess whether an allowance for credit losses should be set up. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

The Bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This collective allowance is based on any deterioration in the internal rating of the loan or investment since it was granted or acquired. This collective allowance is based on changes in factors that are indicative of incurred losses, such as deterioration in payment status and underlying property prices, among others.

As at December 31, 2012 and 2011, the carrying values of loans and receivables and related allowance for credit losses are disclosed in Note 8.

(b) *Impairment of AFS investments*
The Bank reviews its debt securities classified as AFS investments at each reporting date to assess whether they are impaired. This requires similar judgment as applied to the individual assessment of loans and receivables.

As at December 31, 2012 and 2011, no impairment losses were provided on AFS investments. The carrying values of AFS investments are disclosed in Note 6.

(c) *Estimated useful lives of property and equipment and investment properties*
The Bank estimates the useful lives of its property and equipment and investment properties based on the period over which the assets are expected to be available for use. The Bank reviews annually the estimated useful lives based on factors that include asset utilization, internal technical evaluation, technological changes, environmental and anticipated use of the assets. A reduction in the estimated useful lives of property and equipment and investment properties would increase the recorded depreciation and amortization and decrease the assets. The estimated lives of property and equipment and investment properties are disclosed in Note 2.

(d) *Impairment of property and equipment, investment properties and assets held by SPV*
The Bank assesses impairment on property and equipment, investment properties and assets held by SPV, whenever events or changes in circumstances indicate that the carrying amount of property and equipment, investment properties and assets held by SPV may not be recoverable. The factors that the Bank considers important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired assets or the strategy for overall business; and
- significant negative industry or economic trends.

The Bank recognizes an impairment loss whenever the carrying amount of its property and equipment, investment properties and assets held by SPV exceeds their recoverable amount.

As at December 31, 2012 and 2011, the carrying values of property and equipment, investment properties and assets held by SPV and their related allowance for impairment losses are disclosed in Notes 9, 10 and 11, respectively.

(e) *Retirement benefits*
The determination of the net retirement asset and retirement recovery and other employee benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among others, discount rates, expected returns on plan assets and salary increase rates. Due to the long term nature of this plan, such estimates are subject to significant uncertainty. In compliance with PFRS, actual results that differ from the Bank's assumptions, subject to the 10.0% corridor test, are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods.

The expected rate of return on plan assets was based on market prices prevailing on the date of valuation, applicable to the period over which the obligation is to be settled. The assumed discount rates were determined using the market yields on Philippine government bonds with terms consistent with the expected employee benefit payout as at the reporting date. Refer to Note 18 for the details of assumptions used in the calculation and the present value of the defined benefit obligation.

(f) Recognition of deferred tax assets
The amount of deferred tax asset recognized by the Bank is based on the estimate of future taxable income. Significant management judgment is required to determine the amount of deferred tax asset that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning.

The Bank reviews the carrying amount of deferred tax asset at each reporting date and reduces this 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 asset to be utilized.

As at December 31, 2012 and 2011, the carrying values of deferred tax assets are disclosed in Note 20.

4. Fair Value Measurement

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

Cash and other cash items, Due from BSP, Due from other banks and microfinance loans and receivables - Carrying amounts approximate fair values due to the relative short-term maturity of these assets and as there is no change in the market interest rates from grant date.

Loans and receivables (other than Microfinance loans and receivables) - Fair values of noncurrent portion of receivables are estimated using the discounted cash flow methodology, based on prevailing market rates for similar financial assets, taking into account the remaining maturities and applicable spreads of the counterparties.

AFS equity investment - The Bank's AFS equity investment comprises of preferred shares of Small Business Corp. (SBC) which are not quoted in an active market. The shares are subject to a three-year holding period which is to lapse on December 9, 2013. After such date, the Bank has an option to dispose of the investment.

Fair value is estimated using the discounted cash flow methodology. For December 31, 2012 and 2011, the following assumptions were used:

(a) The discount rate were determined using the quoted bootstrapped PDS (zero-coupon) rates with terms approximating maturity of the instrument, adjusted for an appropriate credit risk premium.
(b) The expected cash flows include the annual fixed interest at 4.0% and the principal payment at maturity.

Debt securities - Fair values are generally based upon quoted market prices. If the market prices are not readily available, fair values are estimated using the discounted cash flow methodology, using the current market rate on government bonds that have terms to maturity approximating the term of the debt securities, adjusted for any credit risk premium.

Demand deposits, Savings deposits, Bills payable, Accounts payable and Accrued interest payable - Carrying values approximate fair values due to either the demand nature or the relatively short-term maturities of these liabilities.

As at December 31, 2012 and 2011, the carrying values of the Bank's financial instruments, as reflected in the statements of financial position and related notes, approximate their respective fair values except for HTM investment. The fair values of HTM investments amounted to ₱27.9 million and ₱30.54 million as at December 31, 2012 and 2011, respectively.

For financial instruments recorded at fair value, the Bank uses the following three-level fair value hierarchy based on the source of inputs on their valuation:

Level 1: those financial instruments which are quoted in active markets for identical assets or liabilities;
Level 2: those financial instruments involving inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and
Level 3: those financial instruments with inputs for the asset or liability that are not based on observable market data (unobservable inputs).

As at December 31, 2012 and 2011, the fair values of the Bank's AFS investment is derived using inputs other than quoted prices (Level 2). There have been no changes in determining the fair value of financial instruments in 2012 and 2011. As at December 31, 2012 and 2011, there were no transfers between Levels 1 and 2, and transfers into and out of Level 3.

5. Financial Risk Management Objectives and Policies

In the course of the business cycle, the Bank has exposure to the following risks from its use of financial instruments: (a) credit risk; (b) market risk; and (c) liquidity risk.

The Bank adheres to the proactive and prudent approach of managing the business that recognizes and manages risks to continuously provide quality financial services to clients and to protect shareholders' value. Risk management process involves setting of revenue goals, definition of risk philosophy and creating risk culture, determining opportunities that would create risk in the future, identifying and assessing the risk, evaluating and defining risk tolerance, taking actions to mitigate and control the risks through defined roles and responsibilities, close monitoring of the scenarios, reporting of risk taking performance, revalidation of risk methodologies and adjustment of the systems and policies necessary to effectively minimize risk level.

The BOD through its Risk Management Committee (RMC) is responsible for the development and oversight of the Bank's risk management program, identification and evaluation of risk exposures, monitoring the Bank's implementation of risk management policies and procedures, and for reviewing and evaluating the adequacy of risk management framework in relation to the risks faced by the Bank. The RMC regularly reports to the BOD the results of reviews of actual implementation of risk management policies. Risk management of the Bank is strengthened with conjunction of Audit Committee (AC) and Internal Audit (IA) functions. IA undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the AC.

a. <u>Credit risk</u>
Credit risk is the risk of financial loss to the Bank if the counterparty to a financial instrument fails to meet its contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

Management of credit risk
Credit risk is being managed by instilling credit discipline both among the staff and the borrowers. The Bank's staff performs close-monitoring and assessment of account throughout the borrowing period, hence, on-time service delivery motivates the borrowers to fulfill their financial obligation to the highest standards. Borrowers are well-oriented and deeply committed on the credit repayment design they undertake.

For microfinance loans, loan portfolio was diversified in different economic activities or projects. There is geographical diversification to spread the risk brought about by natural calamities. Proper target market selection, rigorous character and background investigation, members' or borrowers' education or training on credit discipline in microfinance and validation of utilization of loan proceeds are applied. Intensive monitoring of all branches is conducted by the Area Manager, Regional Head and Executive Vice President. Staff skills and competencies are regularly updated. Strategies are identified to manage competitors. Development of new client or market-oriented loan or deposit products and enhancement of product design systems and procedures, monitoring of members without loans and motivating qualified members to borrow are regularly done. Cost-cutting measures were planted to achieve improved profitability. Financial ratios and evaluation of compliance with BSP standards are regularly monitored.

Furthermore, the Bank has a preventive delinquency management approach through proper and strict credit delivery. Rebuilding of credit discipline by members through enhancement of awareness of advantages and benefits as members or stockholders; *Lakbay-Aral* program; star awards and quarterly raffle draws are intensified. An intensive follow-up for defaulters and daily monitoring on the number of default members are strictly followed. There is rehabilitation program for worst hit branches. Defaulting borrowers shall be referred to the legal counsel.

In general, borrowers are also perpetual savers. Consequently, their savings balances are pledged and serve as guarantee to their loans, which increase their borrowing capacity. Each business unit has a Unit Manager who reports on all credit-related matters to the local management consisting of the Area Manager, Regional Head and Executive Vice President.

Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolio. Regular audits of business units and credit processes are undertaken by IA.

The Bank adopted a credit scoring system for Small and Medium Enterprise (SME) Loans to help management identify and mitigate credit risk. The risk rating of the borrower will be the basis for the pricing of the loan.

All past due or impaired accounts are reported on a daily, weekly and monthly bases. Consistent monitoring for this group of accounts is established by competent and diligent staff to maximize recovery. Incentives have been established and subjected to review and assessment periodically. These are given to staff to recover from the accounts and to fully instill credit discipline to clients. Restructuring of loan payments are done after full compliance of approved policies and procedures. Writing off bad accounts is approved by the BOD and reported to the BSP in compliance with the Manual of Regulations for Banks.

Maximum exposure to credit risk
Table below provides the analysis of the maximum exposure to credit risk of the Bank's financial instruments, excluding those where the carrying values as reflected in the Statement of financial position and related notes already represent the financial instrument's maximum exposure to credit risk, before and after taking into account collateral held or other credit enhancements.

	2012			
	Maximum Exposure to Credit risk	**Fair value of Collateral and Credit Enhancements**	**Net Exposure to Credit risk**	**Financial effect of Collateral or Credit Enhancement**
Loans and discounts:				
Microfinance loans	**₱427,168,351**	**₱65,629,417**	**₱361,538,934**	**₱65,629,417**
SME loans	**122,673,483**	**19,636,700**	**111,932,389**	**10,741,094**
REM loans	**243,540**	**906,251**	**–**	**243,540**

	2011			
	Maximum Exposure to Credit risk	Fair value of Collateral and Credit Enhancements	Net Exposure to Credit risk	Financial effect of Collateral or Credit Enhancement
Loans and discounts:				
Microfinance loans	₱306,130,913	₱47,679,062	₱258,451,851	47,679,062
SME loans	38,351,652	24,462,680	28,644,844	9,706,808
REM loans	467,042	2,323,178	–	467,042

Credit enhancement for microfinance loans pertains to deposit hold-out from center fund savings equivalent to 15.0% of the outstanding loan to the member as at December 31, 2012 and 2011. The financial effect of deposit hold-out is ₱34.8 million and ₱26.8 million as at December 31, 2012 and 2011, respectively. Credit enhancement for REM and SME loans consists of chattel and real estate mortgages.

The Bank assessed that it has no credit risk exposures relating to off-balance sheet items.

Additionally, the table below shows the distribution of maximum credit exposure by industry sector of the Bank as at December 31, 2012 and 2011:

	2012				
	Loans and Receivables	**Due from BSP and Other Banks**	**AFS Investments**	**HTM Investment**	**Total**
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	**₱311,645,077**	**₱–**	**₱–**	**₱–**	**₱311,645,077**
Manufacturing	**87,580,961**	**–**	**–**	**–**	**87,580,961**
Financial intermediaries	**1,502,017**	**74,480,762**	**–**	**–**	**75,982,779**
Government		**31,379,001**	**8,000,000**	**26,236,233**	**65,615,234**
Other community, social and personal service activities	**54,210,658**	**–**	**–**	**–**	**54,210,658**
Agriculture, hunting and forestry	**45,240,831**	**–**	**–**	**–**	**45,240,831**
Others	**78,534,996**	**–**	**–**	**–**	**78,534,996**
	578,714,540	**105,859,763**	**8,000,000**	**26,236,233**	**718,810,536**
Allowance for credit losses	**(22,443,370)**	**–**	**–**	**–**	**(22,443,370)**
Total	**₱556,271,170**	**₱105,859,763**	**₱8,000,000**	**₱26,236,233**	**₱696,367,166**

	2011				
	Loans and Receivables	Due from BSP and Other Banks	AFS Investments	HTM Investment	Total
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	₱204,093,835	₱–	₱–	₱–	₱204,093,835
Agriculture, hunting and forestry	112,999,262	–	–	–	112,999,262
Financial intermediaries	1,904,574	80,910,070	–	–	82,814,644
Government	–	14,646,774	9,435,558	26,279,591	50,361,923
Other community, social and personal service activities	20,621,123	–	–	–	20,621,123
Manufacturing	10,904,926	–	–	–	10,904,926
Others	31,643,136	–	–	–	31,643,136
	382,166,856	95,556,844	9,435,558	26,279,591	513,438,849
Allowance for credit losses	(16,412,815)	–	–	–	(16,412,815)
Total	₱365,754,041	₱95,556,844	₱9,435,558	₱26,279,591	₱497,026,034

Credit quality

Loans and receivables and AFS investments rated as high and standard grades refer to those accounts that do not have greater than normal risk or have potential weaknesses only.

High grade represents those accounts granted to borrowers which are availed loans intended for microeconomic activities that are current or investments in government securities or debt securities issued by reputable institutions.

Standard grade represents those accounts granted to borrowers which have availed loans intended for financing business capital emergency needs, multi-purpose requirements and housing improvements.

The table below shows the credit quality per class of financial assets as at December 31, 2012 and 2011:

	2012				
	Neither Past Due Nor Impaired				
	High Grade	**Standard Grade**	**Past Due but not Impaired**	**Individually Impaired**	**Total**
AFS investments	**₱8,000,000**	**₱–**	**₱–**	**₱–**	**₱8,000,000**
HTM investments	**26,236,233**	**–**	**–**	**–**	**26,236,233**
Loans and receivables:					
Due from BSP	**31,379,001**	**–**	**–**	**–**	**31,379,001**
Due from other banks	**74,480,762**	**–**	**–**	**–**	**74,480,762**
Loans and discounts:					
Microfinance	**433,549,818**	**–**	**650,880**	**3,331,750**	**437,532,448**
SME	**74,494,926**	**48,066,728**	**4,421,802**	**5,686,347**	**132,669,803**
REM	**–**	**–**	**246,000**	**1,170,345**	**1,416,345**
Unquoted debt securities	**1,502,017**	**–**	**–**	**–**	**1,502,017**
Other receivables:					
Accrued interest receivable	**4,683,779**	**–**	**–**	**–**	**4,683,779**
Accounts receivable	**–**	**–**	**–**	**910,148**	**910,148**
Total	**₱654,326,536**	**₱48,066,728**	**₱5,318,682**	**₱11,098,590**	**₱718,810,536**

	2011				
	Neither Past Due Nor Impaired				
	High Grade	Standard Grade	Past Due but not Impaired	Individually Impaired	Total
AFS investments	₱9,435,558	₱–	₱–	₱–	₱9,435,558
HTM investments	26,279,591	–	–	–	26,279,591
Loans and receivables:					
Due from BSP	14,646,774	–	–	–	14,646,774
Due from other banks	80,910,070	–	–	–	80,910,070
Loans and discounts:					
Microfinance	315,074,558	–	469,289	2,316,564	317,860,411
SME	–	46,321,820	4,578,089	2,704,901	53,604,810
REM	–	1,233,850	134,000	1,348,422	2,716,272
Unquoted debt securities	1,904,574	–	–	–	1,904,574
Other receivables:					
Accrued interest receivable	5,085,565	–	–	–	5,085,565
Accounts receivable	–	–	–	995,224	995,224
Total	₱453,336,690	₱47,555,670	₱5,181,378	₱7,365,111	₱513,438,849

Aging analysis of past due but not impaired loans and receivables
The following table shows the total aggregate amount of loans and discounts that are contractually past due but not considered as impaired per delinquency bucket as at December 31, 2012 and 2011.

	2012			
	Less than 30 Days	**31 to 60 Days**	**61 to 90 Days**	**Total**
Microfinance	**₱92,837**	**₱286,942**	**₱271,101**	**₱650,880**
SME	**2,944,024**	**738,009**	**739,769**	**4,421,802**
REM	**–**	**–**	**246,000**	**246,000**
	₱3,036,861	**₱1,024,951**	**₱1,256,870**	**₱5,318,682**

	2011			
	Less than 30 Days	31 to 60 Days	61 to 90 Days	Total
Microfinance	₱107,690	₱165,157	₱196,442	₱469,289
SME	638,496	2,802,638	1,136,955	4,578,089
REM	60,000	–	74,000	134,000
	₱806,186	₱2,967,795	₱1,407,397	₱5,181,378

b. <u>Market Risk</u>
Market risk is the risk of loss to future earnings, fair values or future cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates. The Bank is exposed to market risk, although minimal, due to its placement to government debt securities, which are classified as AFS investments.

Interest rate risk
The Bank's nominal interest rate for REM loans and microfinance loans are set at fixed rate of 21.0% and 30.0% per annum, respectively. For SME loans, interest rate charged to a borrower shall depend on the credit risk rating classification, the deposit level of the client as a percentage of the loan, and the internal basic interest rate.

The effect of interest repricing on loans is immaterial to the Bank therefore sensitivity analysis is no longer presented.

The Bank's savings deposit liabilities include compulsory and voluntary savings that earns 2.0% to 2.5% per annum. The bulk of time deposit accounts are concentrated on 30 days to one year maturity with interest rate of less than 5.5%.

In order to manage its interest rate risk, the Bank places its excess funds in high yield investments and other short-term time deposits and treasury notes. It also matches its interest rate and maturity to avoid negative gaps between the sources and applications.

Foreign currency risk
The Bank has no foreign currency denominated transactions, thus it has no exposure to changes in foreign exchange rates.

c. Liquidity Risk
Liquidity risk is generally defined as the current and prospective risk to earnings or capital arising from the Bank's inability to meet its obligations when they come due without incurring unacceptable losses or costs.
The Asset Liability Management Committee is responsible for formulating the Bank's liquidity risk management policies. Liquidity management is among the most important activities conducted within the Bank. The Bank manages its liquidity risk through analyzing net funding requirements under alternative scenarios, diversification of funding sources and contingency planning. The Bank utilizes a diverse range of sources of funds, although short-term deposits made with the Bank's network of domestic branches comprise the majority of such funding.

Liquidity risk is managed by the Bank through holding sufficient liquid assets and appropriate assessment to ensure short-term funding requirements are met and by ensuring the high collection performance at all times. Deposits with banks are made on a short-term basis with almost all being available on demand or within one month.

The Treasury Group uses liquidity forecast models that estimate the Bank's cash flow needs based on the Bank's actual contractual obligations and under normal circumstances and extraordinary circumstances.

Analysis of financial assets and financial liabilities by remaining maturities
The table below shows the maturity profile of the Bank's financial assets and financial liabilities based on contractual undiscounted cash flows as at December 31, 2012 and 2011:

	2012				
	On demand	1 to 6 months	6 to 12 months	Beyond 1 year	Total
Financial Assets					
AFS investments*	₱–	₱–	₱3,518,392	₱5,345,594	₱8,863,986
HTM investment*	–	445,119	679,105	26,751,659	27,875,883
Loans and receivables:					
Due from BSP	31,379,001	–	–	–	31,379,001
Due from other banks*	24,804,464	51,782,761	–	–	76,587,225
Loans and discounts*	43,978,553	225,651,402	322,420,727	29,631,730	621,682,412
Unquoted debt securities	–	1,525,824	–	–	1,525,824
Other receivables:					
Accrued interest receivable	4,332,618	351,161	–	–	4,683,779
Accounts receivable	910,147	–	–	–	910,147
	105,404,783	279,756,267	326,618,224	61,728,983	773,508,257

(Forward)

	2012				
	On demand	1 to 6 months	6 to 12 months	Beyond 1 year	Total
Financial Liabilities					
Deposit liabilities:					
Demand	**730,357**	**–**	**–**	**–**	**730,357**
Savings*	**61,266,718**	**278,773,062**	**65,841,927**	**98,632,794**	**504,514,501**
Bills payable*	**–**	**8,982,579**	**19,043,921**	**–**	**28,026,500**
Accrued expenses	**10,868,399**	**–**	**–**	**–**	**10,868,399**
Accrued interest payable	**2,126,144**	**–**	**–**	**–**	**2,126,144**
Accounts payable	**1,263,784**	**–**	**–**	**–**	**1,263,784**
	76,255,402	**287,755,641**	**84,885,848**	**98,632,794**	**547,529,685**
Net undiscounted financial assets (liabilities)	**₱29,149,381**	**(₱7,999,374)**	**₱241,732,376**	**(₱36,903,811)**	**₱225,978,572**

**Includes future interest*

	2011				
	On demand	1 to 6 months	6 to 12 months	Beyond 1 year	Total
Financial Assets					
AFS investments*	₱–	₱–	₱3,719,285	₱6,580,259	₱10,299,544
HTM investment*	–	100,359	103,207	27,715,675	27,919,241
Loans and receivables:					
Due from BSP*	14,646,774	–	–	–	14,646,774
Due from other banks*	32,069,620	50,960,000	–	–	83,029,620
Loans and discounts*	11,551,265	364,648,250	35,685,059	10,706,212	422,590,786
Unquoted debt securities*	–	1,928,381	–	–	1,928,381
Other receivables:					
Accrued interest receivable	4,734,404	351,161	–	–	5,085,565
Accounts receivable	995,224	–	–	–	995,224
	63,997,287	417,988,151	39,507,551	45,002,146	566,495,135
Financial Liabilities					
Deposit liabilities:					
Demand	733,577	–	–	–	733,577
Savings*	191,626,527	98,122,139	34,224,051	–	323,972,717
Bills payable*	–	52,814,252	18,608,112	–	71,422,364
Accrued interest payable	7,821,678	–	–	–	7,821,678
Accounts payable	5,896,385	–	–	–	5,896,385
Accrued expenses	1,261,714	–	–	–	1,261,714
	207,339,881	150,936,391	52,832,163	–	411,108,435
Net undiscounted financial assets (liabilities)	(₱143,342,594)	₱267,051,760	(₱13,324,612)	₱45,002,146	₱155,386,700

**Includes future interest*

6. Available-for-sale Investments

As at December 31, 2012 and 2011, AFS investments consist of the Bank's investment in 50,000 redeemable preferred shares of Small Business Corporation (SBC) with an annual dividend rate of 4.0% and a minimum holding period of three years starting December 9, 2010, and Microfinance Small and Medium Enterprise (MSME) notes with an annual interest rate of 1.1% and maturity of one year.

Unrealized gain on AFS investments amounted to nil and ₱0.9 million as at December 31, 2012 and 2011, respectively.

7. Held-to-maturity Investments

This account represents investment in government securities bearing annual interest rate of 6.3% to 7.0% in 2012 and 2011.

8. **Loans and Receivables**

This account consists of:

	2012	2011
Loans and discounts:		
Microfinance (Note 14)	**₱437,532,448**	₱317,860,411
SME	**133,498,797**	54,538,466
REM	**1,416,345**	2,716,272
	572,447,590	375,115,149
Unearned interest income	**(828,994)**	(933,656)
	571,618,596	374,181,493
Unquoted debt securities	**1,502,017**	1,904,574
Other receivables:		
Accrued interest receivable	**4,683,779**	5,085,565
Accounts receivable	**910,148**	995,224
	578,714,540	382,166,856
Allowance for credit losses	**(22,443,370)**	(16,412,815)
	₱556,271,170	₱365,754,041

Loans and discounts earn interest ranging from 32.8% to 58.8% in 2012 and 2011.

The following table shows the interest income per class of loans and receivables:

	2012	2011
Loans and discounts:		
Microfinance	**₱185,921,049**	₱132,882,250
SME	**33,654,567**	15,012,605
REM	**642,885**	5,811,052
Unquoted debt securities	**23,515**	36,691
	₱220,242,016	₱153,742,598

Interest income on past due loans and receivables amounted to ₱1.02 million and ₱0.6 million in 2012 and 2011, respectively.

As at December 31, 2012 and 2011, microfinance loans amounting to ₱39.5 million and ₱99.3 million are held as collateral to the Bank's borrowings (Note 14).

BSP Reporting

In accordance with BSP regulations, the Bank considers as part of portfolio-at-risk (PAR) an installment payment that is past due for a day only. As at December 31, 2012 and 2011, the Bank's PAR amounted to ₱15.3 million and ₱11.6 million, respectively. The allowance for credit losses recognized for past due loans amounted to ₱90.0 million and ₱76.5 million as at December 31, 2012 and 2011, respectively.

The following table shows the secured and unsecured portions of loans and discounts as at December 31, 2012 and 2011:

	2012	2011
Secured portion		
Deposit hold-out	**₱65,629,417**	₱47,679,062
REM	**7,372,509**	7,310,640
Chattel mortgage	**4,274,836**	4,719,346
	77,276,762	59,709,048
Unsecured portion	**494,341,834**	314,472,445
	₱571,618,596	₱374,181,493

The Bank also obtains additional security in the form of members' joint guarantees (under memorandum of agreements signed among various member groups) and post-dated checks of members.

The movements in allowance for credit losses follow:

	2012			2011		
	Loans and discounts	**Accounts Receivable**	**Total**	Loans and discounts	Accounts receivable	Total
Balance at beginning of year	**₱16,025,711**	**₱387,104**	**₱16,412,815**	₱11,021,356	₱1,176,840	₱12,198,196
Provisions during the year:						
Individual impairment	**5,367,757**	**591,938**	**5,959,695**	5,024,279	–	5,024,279
Collective impairment	**2,420,924**	**–**	**2,420,924**	2,120,125	–	2,120,125
Write-offs	**(2,281,170)**	**(68,894)**	**(2,350,064)**	(2,140,049)	(789,736)	(2,929,785)
	5,507,511	**523,044**	**6,030,555**	5,004,355	(789,736)	4,214,619
Balance at end of year	**₱21,533,222**	**₱910,148**	**₱22,443,370**	₱16,025,711	₱387,104	₱16,412,815
Gross amounts of loans individually determined to be impaired, before deducting any individually assessed impairment losses	**₱10,188,442**	**₱910,148**	**₱11,098,590**	₱6,369,887	₱995,224	₱7,365,111

As at December 31, 2012 and 2011, allowance provided by the Bank for past due accounts amounted to ₱11.9 million and ₱8.4 million, respectively.

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

	2012		2011	
	Amount	**%**	Amount	%
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	**₱311,645,077**	**53.85**	₱204,093,835	53.40
Manufacturing	**87,580,961**	**15.13**	10,904,926	2.85
Other community, social and personal service activities	**54,210,658**	**9.37**	20,621,123	5.40
Agriculture, hunting and forestry	**45,240,831**	**7.82**	112,999,262	29.57
Financial intermediaries	**1,502,017**	**0.26**	1,904,574	0.50
Others	**78,534,996**	**13.57**	31,643,136	8.28
Total	**578,714,540**	**100%**	₱382,166,856	100%

The BSP considers that loan concentration exists when total loan exposure to a particular industry or economic sector exceeds 30.0% of total loan portfolio. Identified concentrations of credit risks are controlled and managed accordingly. Thrift banks are not covered by the loan concentration limit of 30.0% prescribed by the BSP.

9. Property and Equipment

The composition of and movements in this account follow:

	2012						
	Furniture, Fixtures and Equipment	**Leasehold Improvements**	**Transportation Equipment**	**Building**	**Construction in Progress**	**Land**	**Total**
Cost							
Balance at beginning of year	**₱9,247,074**	**₱3,182,138**	**₱2,250,738**	**₱3,289,871**	**₱484,500**	**₱–**	**₱18,454,321**
Acquisition	**6,105,234**	**4,223,317**	**4,845,501**	**3,283,181**	**–**	**6,903,000**	**25,360,233**
Disposals	**(565,051)**	**–**	**(112,655)**	**–**	**–**	**–**	**(677,706)**
Transfers (Note 10)	**–**	**484,500**	**–**	**–**	**(484,500)**	**3,748,530**	**3,748,530**
Balance at end of year	**14,787,257**	**7,889,955**	**6,983,584**	**6,573,052**	**–**	**10,651,530**	**46,885,378**
Accumulated Depreciation and Amortization							
Balance at beginning of year	**5,863,598**	**1,539,962**	**1,618,081**	**1,296,103**	**–**	**–**	**10,317,744**
Depreciation and amortization	**2,838,679**	**1,306,972**	**1,042,589**	**351,306**	**–**	**–**	**5,539,546**
Disposals	**(565,051)**	**–**	**(112,655)**	**–**	**–**	**–**	**(677,706)**
Balance at end of year	**8,137,226**	**2,846,934**	**2,548,015**	**1,647,409**	**–**	**–**	**15,179,584**
Net Book Value	**₱6,650,031**	**₱5,043,021**	**₱4,435,569**	**₱4,925,643**	**₱–**	**₱10,651,530**	**₱31,705,794**

	2011						
	Furniture, Fixtures and Equipment	Leasehold Improvements	Transportation Equipment	Building	Construction in Progress	Land	Total
Cost							
Balance at beginning of year	₱6,915,021	₱2,093,582	₱2,577,933	₱3,247,344	₱–	₱–	₱14,833,880
Acquisition	2,359,352	1,088,556	123,789	42,527	484,500	–	4,098,724
Disposals	(27,299)	–	(450,984)	–	–	–	(478,283)
Balance at end of year	9,247,074	3,182,138	2,250,738	3,289,871	484,500	–	18,454,321
Accumulated Depreciation and Amortization							
Balance at beginning of year	4,155,040	991,171	1,501,019	1,003,028	–	–	7,650,258
Depreciation and amortization	1,735,857	548,791	486,771	293,075	–	–	3,064,494
Disposals	(27,299)	–	(369,709)	–	–	–	(397,008)
Balance at end of year	5,863,598	1,539,962	1,618,081	1,296,103	–	–	10,317,744
Net Book Value	₱3,383,476	₱1,642,176	₱632,657	₱1,993,768	₱484,500	₱–	₱8,136,577

10. Investment Properties

The composition of and movements in this account follow:

	2012		
	Land	**Building**	**Total**
Cost			
Balance at beginning of year	**₱26,380,042**	**₱4,002,485**	**₱30,382,527**
Foreclosures	**2,285,035**	**–**	**2,285,035**
Disposals	**(2,265,725)**	**(2,471,985)**	**(4,737,710)**
Transfers (Note 9)	**(3,748,530)**	**–**	**(3,748,530)**
Balance at end of year	**22,650,822**	**1,530,500**	**24,181,322**

(Forward)

	2012		
	Land	**Building**	**Total**
Accumulated Depreciation			
Balance at beginning of year	**₱–**	**₱1,278,823**	**₱1,278,823**
Depreciation	**–**	**103,065**	**103,065**
Disposals	**–**	**(820,997)**	**(820,997)**
Balance at end of year	**–**	**560,891**	**560,891**
Allowance for Impairment Losses			
Balance at beginning and end of year	**7,432,213**	**–**	**7,432,213**
Net Book Value	**₱15,218,609**	**₱969,609**	**₱16,188,218**

	2011		
	Land	Building	Total
Cost			
Balance at beginning of year	₱20,802,595	₱4,005,803	₱24,808,398
Foreclosures	8,758,270	1,106,862	9,865,132
Disposals	(3,180,823)	(1,110,180)	(4,291,003)
Balance at end of year	26,380,042	4,002,485	30,382,527
Accumulated Depreciation			
Balance at beginning of year	–	1,334,412	1,334,412
Depreciation	–	433,261	433,261
Disposals	–	(488,850)	(488,850)
Balance at end of year	–	1,278,823	1,278,823
Allowance for Impairment Losses			
Balance at beginning of year	4,088,836	–	4,088,836
Provision for impairment losses	3,343,377	–	3,343,377
Balance at end of year	7,432,213	–	7,432,213
Net Book Value	₱18,947,829	₱2,723,662	₱21,671,491

The investment properties did not generate income in 2012 and 2011, respectively. In 2012 and 2011, direct operating expenses on investment properties, included under 'Miscellaneous expenses' amounted to ₱0.02 million and ₱0.1 million, respectively. Fair value gain on initial recognition of foreclosed properties included under 'Gain on initial recognition of investment properties' amounted to ₱1.7 million and ₱4.9 million in 2012 and 2011, respectively. Investment properties may be disposed through redemption, negotiated sale, lease purchase or donation.

Transferred investment properties to property and equipment pertain to land which the management intended to construct a branch which is expected to be started in 2013 (Note 9).

As at December 31, 2012 and 2011, the fair value of investment properties amounted to ₱20.4 million and ₱24.1 million, respectively.

11. Assets Held by Special Purpose Vehicle

Assets held by SPV represents foreclosed properties (land) which have been specifically identified for sale under a sale and purchase agreement (SPA) with an SPV and is presented net of allowance for impairment losses amounting to ₱2.9 million as at December 31, 2012 and 2011.

Major provisions of the SPA follow:

- The proceeds of the sale shall be paid by the buyer to the Bank on or before the end of ten years following November 20, 2008. The payment shall not be subject to any interest;

- The buyer covenants and undertakes that any and all proceeds from any subsequent sale, disposition or settlement of any asset shall be earmarked for the payment of the purchase price; and
- If on due date and the amount of the net proceeds from the sale is lesser than the purchase price, the difference between the net proceeds and purchase price shall be offset or applied against the unpaid balance such that the SPV has fully paid the obligation.

Under Republic Act No. 9182, *The Special Purpose Vehicle Act of 2002*, the sale of assets to the SPV under the SPA is a true sale, as approved by the BSP. However, under PFRS, the assets sold remain to be recognized by the Bank since the risks and rewards of ownership over the assets are not yet transferred to the SPV.

12. **Other Assets**

This account consists of:

	2012	2011
Stationeries and supplies	**₱3,999,685**	₱1,741,875
Prepaid expenses	**2,649,460**	1,935,854
Miscellaneous	**360,589**	341,084
	₱7,009,734	₱4,018,813

13. **Deposit Liabilities**

Savings deposits earn annual interest rate ranging from 2.0% to 5.5% in 2012 and 2.5% to 5.5% in 2012 and 2011, respectively.

Details of interest expense on deposit liabilities follow:

	2012	2011
Savings deposit	**₱10,618,623**	₱6,023,426
Demand deposit	**6,288,476**	4,153,894
	₱16,907,099	₱10,177,320

In 2011, under existing BSP regulations, deposit liabilities of the Bank are subject to liquidity reserves equivalent to 2.00% and statutory reserves equivalent to 6.0%. In March 2012, BSP issued Circular 753 effective April 6, 2012 unifying the liquidity and statutory reserves requirements to 6.0%, with cash in vault no longer eligible as reserve. Available reserves as at December 31, 2012 and 2011 are as follows:

	2012	2011
Cash and other cash items	**₱–**	₱16,409,109
Due from BSP	**31,379,001**	14,646,774
	₱31,379,001	₱31,055,883

As at December 31, 2012 and 2011, the Bank is compliant with the applicable reserve requirements.

14. Bills Payable

Bills payable represent borrowings from financial institutions, which are subject to certain terms and conditions bearing annual interest rates ranging from 6.0% to 6.5% in 2012 and 6.0% to 9.0% in 2011.

Microfinance loans amounting to ₱39.5 million and ₱99.3 million secure the above borrowings as at December 31, 2012 and 2011, respectively (Note 8).

15. Other Liabilities

This account consists of:

	2012	2011
Financial liabilities:		
Accrued expenses	**₱10,868,399**	₱7,821,678
Accrued interest payable	**2,126,144**	1,261,714
Accounts payable (Note 21)	**1,263,784**	5,896,385
	14,258,327	14,979,777
Nonfinancial liabilities:		
Accrued taxes	**2,040,751**	1,665,171
Others	**631,775**	108,985
	2,672,526	1,774,156
	₱16,930,853	₱16,753,933

Accrued expenses include accruals for vacation leave amounting to ₱4.3 million and ₱3.1 million as at December 31, 2012 and 2011, respectively. Accrued taxes include withholding, gross receipts and documentary stamp tax payable.

16. Maturity Analysis of Assets and Liabilities

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

	2012			2011		
	Less than Twelve Months	**Over Twelve Months**	**Total**	Less than Twelve Months	Over Twelve Months	Total
Financial Assets						
Cash and other cash items	**₱2,903,536**	**₱–**	**2,903,536**	₱16,409,109	₱–	₱16,409,109
Due from BSP	**31,379,001**	**–**	**31,379,001**	14,646,774	–	14,646,774
Due from other banks	**74,480,762**	**–**	**74,480,762**	80,910,070	–	80,910,070
AFS investments	**3,000,000**	**5,000,000**	**8,000,000**	3,199,770	6,235,788	9,435,558
HTM investment	**–**	**26,236,233**	**26,236,233**	–	26,279,591	26,279,591
Loans and receivables - at gross	**552,331,804**	**27,211,730**	**579,543,534**	374,395,975	8,704,537	383,100,512
	664,095,103	**58,447,963**	**722,543,066**	489,561,698	41,219,916	530,781,614
Nonfinancial Assets						
Property and equipment - gross	**–**	**46,885,378**	**46,885,378**	–	18,454,321	18,454,321
Investment properties - gross	**–**	**24,181,322**	**24,181,322**	–	30,382,527	30,382,527
Assets held by SPV - gross	**–**	**8,788,674**	**8,788,674**	–	8,788,674	8,788,674
Deferred tax asset	**–**	**10,178,288**	**10,178,288**	–	2,159,609	2,159,609
Retirement Asset	**–**	**1,450,585**	**1,450,585**			
Other assets	**7,009,734**	**–**	**7,009,734**	4,018,813	–	4,018,813
	₱7,009,734	**₱91,484,246**	**98,493,981**	₱4,018,813	₱59,785,131	63,803,944
Less: Allowance for credit and impairment losses			**(32,781,703)**			(26,751,148)
Unearned interest			**(828,994)**			(933,656)
Accumulated depreciation and amortization			**(15,740,475)**			(11,596,567)
			₱771,685,875			₱555,304,187
Financial Liabilities						
Deposit liabilities						
Demand	**₱730,357**	**₱–**	**₱730,357**	₱733,577	₱–	₱733,577
Savings	**403,629,254**	**98,069,681**	**501,698,935**	321,157,151	–	321,157,151
Bills payable	**26,476,877**	**–**	**26,476,877**	65,389,307	–	65,389,307
Accrued expenses	**10,868,399**	**–**	**10,868,399**	7,821,678	–	7,821,678
Accrued interest payable	**2,126,144**	**–**	**2,126,144**	1,261,714	–	1,261,714
Accounts payable	**1,263,784**	**–**	**1,263,784**	5,896,385	–	5,896,385
	445,094,815	**98,069,681**	**543,164,496**	402,259,812	–	402,259,812
Nonfinancial Liabilities						
Income tax payable	**4,577,903**	**–**	**4,577,903**	4,844,812	–	4,844,812
Accrued taxes	**2,040,751**	**–**	**2,040,751**	1,665,171	–	1,665,171
Other liabilities	**631,775**	**–**	**631,775**	108,985	–	108,985
Retirement Liability	**–**	**–**	**–**	–	4,048,729	4,048,729
	7,250,429	**–**	**7,250,429**	6,618,968	4,048,729	10,667,697
	₱452,345,244	**₱98,069,681**	**₱550,414,925**	₱408,878,780	₱4,048,729	₱412,927,509

17. Equity

Capital Stock

As at December 31, 2012 and 2011, the Bank's capital stock consists of:

	2012		2011	
	Shares	**Amount**	Shares	Amount
Common stock – ₱100 par value, 5,000,000 authorized shares				
Issued and outstanding	**1,500,897**	**150,089,700**	1,470,031	₱147,003,100
Subscribed	**3,499,103**	**349,910,300**	3,529,969	352,996,900
Subscription receivable		**(284,486,175)**		(338,991,600)
		₱215,513,825		₱161,008,400

Capital Management
The Bank's capital management aims to ensure that it complies with regulatory capital requirements and it maintains strong credit ratings and healthy capital ratios in order to support and sustain its business growth towards maximizing the shareholders' value.

The Bank manages its capital structure and appropriately effect adjustment according to the changes in economic conditions and the risk level it recognizes at every point of time in the course of its business operations. In order to maintain or adjust for good capital structure, the Bank carefully measures the amount of dividend payment to shareholders, call payment due from the capital subscribers or issue capital securities as necessary. No changes were made in the objectives, policies and processes from the previous years.

Regulatory Qualifying Capital
The determination of the Bank's compliance with the regulatory requirements and ratios is based on the amount of the Bank's unimpaired capital (regulatory net worth) reported to the BSP, determined on the basis of regulatory accounting policies which differ from PFRS in some respects.

In addition, the CAR of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, should not be less than 10.0%. Qualifying capital and risk-weighted assets are computed based on BSP regulations. Risk-weighted assets consist of total assets less cash on hand, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits and other non-risk items determined by the MB of the BSP.

Under BSP Circular No. 360, effective July 1, 2003, the CAR is to be inclusive of a market risk charge. As at December 31, 2012 and 2011, the Bank's CAR is in compliance with the regulatory requirement. The CAR of the Bank as at December 31, 2012 and 2011, as reported to the BSP, is shown in the table below (amounts in thousands):

	2012	2011
Tier 1	**₱197,354**	₱135,001
Tier 2	**5,724**	3,755
Gross qualifying capital	**203,078**	138,756
Less: required deductions	–	–
Total qualifying capital	**₱203,078**	₱138,756
Risk-weighted assets	**₱609,567**	₱378,921
Tier 1 capital ratio	**32.4%**	35.6%
Tier 2 capital ratio	**0.9%**	1.0%
CAR	**33.3%**	36.6%

On March 4, 2011, the BSP issued BSP Circular No. 715 which amends the provisions of the Manual of Regulations for Banks on the minimum capitalization of banks and on the prerequisites for the grant of authority to establish a branch. Under the circular, for a thrift bank with head office located in areas other than Metro Manila and cities of Cebu and Davao, the required minimum capitalization (a) upon establishment of a new bank, (b) upon conversion of an existing bank from a lower to a higher category and vice versa, and (c) upon relocation of its head office in an area of higher classification, shall be ₱250.0 million from ₱52.0 million.

Financial Performance
The following basic ratios measure the financial performance of the Bank:

	2012	2011
Return on average equity	**12.4%**	9.1%
Return on average assets	**3.4**	2.5
Net interest margin	**34.9**	31.7

18. **Retirement Benefits**

The Bank, CARD MRI Development Institute, Inc. (CMDI), CARD Mutual Benefit Association (MBA), Inc., CARD Bank, Inc., CARD MRI Insurance Agency (CAMIA), Inc., CARD Business Development Service Foundation (BDSF), Inc., CARD MRI Information Technology, Inc. (CMIT), BotiCARD, Inc., and CARD, Inc. maintain a funded and formal noncontributory defined benefit retirement plan - the CARD MRI Multi-Employer Retirement Plan (MERP) - covering all of their regular employees. MERP has a projected unit cost format and is financed solely by the Bank and its related parties. MERP complies with the requirement of Republic Act No. 7641 (Retirement Law). MERP provided lump sum benefits equivalent to at least one half (1/2) month salary for every year of service, a fraction of at least six months being considered as one whole year upon retirement, death, total and permanent disability, or early retirement after completion of at least ten (10) years of service with the participating companies. However, starting 2011, MERP provides lump sum benefits equivalent to 120.0% of final salary for every year of credited service, a fraction of at least six (6) months being considered as one whole year upon retirement, death, total and permanent disability, or early retirement after completion of at least one year of service with the participating companies.

The following table shows the actuarial assumptions as at January 1, 2012 and 2011 used in determining the retirement benefit obligation of the Bank:

	2012	2011
Discount rate	**6.2%**	9.4%
Expected rate of return on plan assets	**5.0**	5.0
Salary rate increase	**12.0**	12.0
Estimated working lives	**22 years**	22 years

The amount of retirement asset (liability) recognized in the statements of financial position follows:

	2012	2011
Fair value of plan assets	**₱32,847,197**	₱14,486,105
Present value of defined benefit obligation	**(78,838,200)**	(40,847,700)
Deficit	**(45,991,003)**	(26,361,595)
Unamortized past service cost	**819,200**	847,400
Unrecognized actuarial loss	**46,622,388**	21,465,466
	₱1,450,585	(₱4,048,729)

The movements in retirement asset (liability) follow:

	2012	2011
Balance at beginning of year	**(₱4,048,729)**	₱975,666
Retirement expense	**(10,806,128)**	(6,795,000)
Actual contributions	**16,305,442**	1,770,605
Balance at end of year	**₱1,450,585**	(₱4,048,729)

The movements in the fair value of plan assets follow:

	2012	2011
Balance at beginning of year	**₱14,486,105**	₱10,358,200
Actual contributions	**16,305,442**	1,770,605
Transfer to the plan	**2,489,970**	1,719,900
Expected return on plan assets	**709,075**	517,900
Actuarial gain (loss)	**(1,143,395)**	119,500
Balance at end of year	**₱32,847,197**	₱14,486,105

Transfer to the plan represents the re-allocation of plan assets attributable to the employees transferred to the Bank from its affiliate.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	2012	2011
Time deposits and special savings accounts	**60.3%**	70.2%
Government bonds	**39.7**	29.8
	100.0%	100.0%

The overall expected rate of return on plan assets is determined based on the market prices prevailing on that date applicable to the period over which the obligation is to be settled. Actuarial valuation of the Bank is made every year.

Actual return on plan assets in 2012 and 2011 amounted to ₱0.4 million and ₱0.6 million, respectively.

The Bank intends to contribute ₱13.0 million to the retirement fund in 2013.

The movements in the present value of defined benefit obligation follow:

	2012	2011
Balance at beginning of year	**₱40,847,700**	₱15,790,400
Actuarial loss	**24,803,559**	15,396,600
Past service cost	**–**	3,434,000
Current service cost	**7,804,954**	3,016,200
Interest cost	**2,892,017**	1,490,600
Transfer to the plan	**2,489,970**	1,719,900
Balance at end of year	**₱78,838,200**	₱40,847,700

The components of retirement expense recognized under 'Compensation and fringe benefits' in the statements of comprehensive income follow:

	2012	2011
Current service cost	**₱7,804,954**	₱3,016,200
Amortization of vested past service cost	–	2,558,400
Interest cost	**2,892,017**	1,490,600
Expected return on plan assets	**(709,075)**	(517,900)
Amortization of actuarial loss	**790,032**	219,500
Amortization of non-vested past service cost	**28,200**	28,200
Balance at end of year	**₱10,806,128**	₱6,795,000

Actuarial loss (gain) in excess of corridor is amortized over the average expected future service years.

	2012	2011
Balance at beginning of year	**₱21,465,466**	₱6,407,866
Actuarial loss - obligation	**24,803,559**	15,396,600
Actuarial gain - plan assets	**1,143,395**	(119,500)
Amortization of actuarial loss for the year	**(790,032)**	(219,500)
Balance at end of year	**₱46,622,388**	₱21,465,466

Information on the Bank's retirement plan for the current and previous annual periods are as follows:

	2012	2011	2010	2009
Fair value of plan assets	**₱32,847,197**	₱14,486,105	₱10,358,200	₱6,938,100
Present value of funded obligations	**(78,838,200)**	(40,847,700)	(15,790,400)	(4,251,400)
Excess (deficit)	**(45,991,003)**	(26,361,595)	(5,432,200)	2,686,700
Experience adjustment on plan assets	**(1,143,395)**	119,500	(62,600)	(813,262)
Experience adjustment on plan liabilities	**12,913,859**	(2,181,300)	(156,000)	3,163,236

19. Miscellaneous Income and Expenses

Miscellaneous income consists of the following:

	2012	2011
Gain on sale of assets held in SPV	**₱–**	₱1,053,342
Gain (loss) on sale of investment properties	**121,489**	(302,153)
Others	**1,854,319**	2,254,163
	₱1,975,808	₱3,005,352

Others pertain mainly to service fees and commission.

Miscellaneous expenses consist of the following:

	2012	2011
Entertainment, amusement and recreation (EAR) (Note 20)	**₱2,181,218**	₱1,128,268
Others	**2,971,278**	1,902,746
	₱5,152,496	₱3,031,014

Others include advertising and publicity, charitable contributions, litigation and other expenses.

20. Income Taxes

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

Income taxes include final income tax which is paid at the rate of 20.0%. This is generally withheld on gross interest income from government securities and other deposit substitutes.

RA No. 9337, *An Act Amending National Internal Revenue Code* provides that the RCIT rate shall be 30.0%. Interest allowed as a deductible expense shall be reduced by 33.0% of interest income subject to final tax.

The law also provides for MCIT of 2.0% on modified gross income which is paid if determined to be higher than RCIT. The excess of the MCIT over the RCIT can be carried-over and applied against the RCIT liability for the next three years.

NOLCO is allowed as a deduction against the taxable income for RCIT purposes for a three-year period from the year of inception.

Current tax regulations also provide for the ceiling on the amount of 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 1.0% of net revenue. EAR expenses of the Bank amounted to ₱2.2 million and ₱1.1 million in 2012 and 2011, respectively. EAR expenses are included under 'Miscellaneous expense' in the statement of comprehensive income (Note 19).

Provision for income tax consists of:

	2012	2011
RCIT	**₱10,033,679**	₱6,575,494
Final tax	**1,536,310**	1,019,955
	11,569,989	7,595,449
Deferred	**(8,018,679)**	(1,544,740)
	₱3,551,310	₱6,050,709

Components of deferred tax are as follows:

	2012	2011
Deferred tax asset on:		
Allowance for credit and impairment losses	**₱9,834,511**	₱4,923,845
Accumulated vacation leave	**1,279,798**	942,243
Unamortized past service cost	**2,442,573**	–
Accumulated depreciation - investment properties	**168,267**	–
Retirement liability	**–**	1,214,619
	13,725,149	7,080,707
Deferred tax liability on:		
Fair value adjustment on investment properties	**3,111,685**	4,539,391
Unrealized gain on AFS	**–**	381,707
Retirement asset	**435,176**	–
	3,546,861	4,921,098
	₱10,178,288	₱2,159,609

The Bank did not recognize deferred tax assets on the following temporary differences:

	2012	2011
Allowance for credit and impairment losses	**₱–**	₱10,338,333
Accumulated depreciation - investment properties	**–**	1,278,823
	₱–	₱11,617,156

The reconciliation between the statutory income tax and effective income tax follow:

	2012	2011
Statutory income tax	**₱8,649,242**	₱4,424,098
Income tax effects of:		
Change in unrecognized deferred tax assets	**(4,418,090)**	1,773,979
Nondeductible operating expenses	**84,662**	362,609
Interest income subject to final tax and nontaxable income	**(704,504)**	(509,977)
Nontaxable income	**(60,000)**	–
Provision for income tax	**₱3,551,310**	₱6,050,709

21. **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. The Bank's related parties include:

- key management personnel, close family members of key management personnel and entities which are controlled, significantly influenced by or for which significant voting power is held by key management personnel or their close family members,
- post-employment benefit plans for the benefit of the Bank's employees, and
- entities under common significant influence (CARD MRI entities).

The Bank has several business relationships with related parties. Transactions with such parties are made in the ordinary course of business and on substantially same terms, including interest and collateral, as those prevailing at the time for comparable transactions with other parties. These transactions also did not involve more than the normal risk of collectability or present other unfavorable conditions.

<u>Transactions with retirement plans</u>
Under PFRS, certain post-employment benefit plans are considered as related parties. CARD MERP is managed by the CARD Employee EMPC. The plan assets are invested in time deposits and special savings accounts and government bonds (Note 18). As at December 31, 2012 and 2011, the retirement funds do not hold or trade the Bank's shares.

<u>Remunerations of Directors and other Key Management Personnel</u>
Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly. The Bank considers the members of the board of directors and senior management to constitute key management personnel for purposes of PAS 24.

The compensation of key management personnel included under 'Compensation and fringe benefits' in the statement of comprehensive income follows (in millions):

	2012	2011
Short-term employee benefits	**₱5.9**	₱3.7
Post employment benefits	**3.2**	2.6
	₱9.1	₱6.3

Short-term employee benefits include salaries and other non-monetary benefits. Non-monetary benefits include ₱3.7 million accrued compensation granted in 2011 to members of Executive and Management Committees and which will be used as payment of their outstanding common stock subscription with the Bank. In addition, the Bank accrued ₱1.7 million in 2011 as additional contribution of the members to CARD EMPC. This additional compensation is not part of regular monthly salaries of such officers.

The Bank also provides banking services to directors and other key management personnel and persons connected to them.

<u>Other related party transactions</u>
Transactions between the Bank and its key management personnel meet the definition of related party transactions. Transactions between the Bank and its affiliates within the CARD MRI, also qualify as related party transactions.

Loans receivables
As at December 31, 2012 and 2011, the Bank has no loan outstanding that was granted to related parties.

Deposit liabilities, accounts receivable and accounts payable
The table below shows the deposit liabilities held by the Bank for key management personnel and affiliates as at December 31, 2012 and 2011 follow:

	December 31, 2012		
Category	**Amount / Volume**	**Outstanding Balance**	**Nature, Terms and Conditions**
Key Management Personnel			
Deposit liabilities		**₱651**	These are savings accounts with annual interest rates ranging from 2.0% to 3.0%.
Deposits	**₱1,861**		
Withdrawals	**(1,379)**		
CARD, Inc. (shareholder)			
Deposit liabilities		**37,023**	These are savings accounts with annual interest rates ranging from 2.0% to 4.5%.
Deposits	**155,781**		
Withdrawals	**(149,439)**		
Accounts receivables		**–**	The amount represents the CARD, Inc.' share of expenses still payable to the Bank.
Share of expenses	**574,640**		
Collections	**(574,640)**		
Accounts payable:		**250,311**	This represents payment of loans from members under CARD Inc.
Share of expenses	**523,062**		
Remittances	**(277,514)**		
CMDI (other related party)			
Deposit liabilities		**14,548**	These are savings accounts with annual interest rates ranging from 2.0% to 4.0%.
Deposits	**13,556**		
Withdrawals	**(1,213)**		
Accounts receivables		**–**	The amount represents the CMDI's share of expenses still payable to the Bank.
Charges	**9,168**		
Remittances	**(9,168)**		
Accounts payable:		**1,275**	The amount represents the Bank's share of expenses still payable to CMDI.
Charges	**614,248**		
Payments	**(771,664)**		
CARD MBA (other related party)			
Deposit liabilities		**6,693**	These are savings accounts with annual interest rates ranging from 2.0% to 5.5%.
Deposits	**169,875**		
Withdrawals	**(163,566)**		
Accounts receivables		**282,092**	The amount represents the CARD MBA's share of expenses payable to the Bank.
Charges	**364,000**		
Collections	**(81,908)**		
Accounts payable		**–**	These are savings accounts with annual interest rates ranging from 2.0% to 4.0%.
Premium collections	**123,883,860**		
Remittances	**(127,924,629)**		
CAMIA (other related party)			
Deposit liabilities		**3,000**	These are savings account with annual interest rates ranging from 2.0% to 3.8%.
Deposits	**3,000**		
Withdrawals	**–**		
Accounts payable		**–**	This pertains to insurance for the employees of the Bank.
Charges	**1,753,983**		
Payments	**(1,754,983)**		
CARD BDSF (other related party)			
Deposit liabilities		**6,079**	These are savings accounts with annual interest rates ranging from 2.0% to 4.5%.
Deposits	**13,114**		
Withdrawals	**(8,138)**		
Accounts receivable		**–**	The amount represents the CARD BDSF's share of expenses payable to the Bank.
Charges	**1,941**		
Payments	**(1,941)**		
Accounts payable		**84,000**	The amount represents the Bank's share of expenses still payable to CARD BDSF
Charges	**462,377**		
Payments	**(558,815)**		

(Forward)

Category	Amount / Volume	Outstanding Balance	Nature, Terms and Conditions
	December 31, 2012		
CARD MERP (retirement plan)			
Deposit liabilities		**₱96,266**	These are savings accounts with annual interest rates ranging from 2.0% to 5.5%.
Deposits	**₱84,323**		
Withdrawals	**(36,149)**		
Accounts payable		–	These amount is payment for retirement of employees
Charges	**10,806,128**		
Payments	**(10,806,128)**		
CMIT (other related party)			
Deposit liabilities		**26,076**	These are savings accounts with annual interest rates ranging from 2.0% to 4.5%.
Deposits	**5,710**		
Withdrawals	**(6,379)**		
Accounts payable		–	These payment is for system maintenance and enhancement of system
Premium collections	**6,571,913**		
Remittances	**(6,571,913)**		
BotiCARD (other related party)			
Deposit liabilities		**327,000**	These are savings accounts with annual interest rates ranging from 2.0% to 2.5%.
Deposits	**827,000**		
Withdrawals	**(500,000)**		
CARD EMPC (shareholder)			
Deposit liabilities		**6,354,000**	These are savings accounts with annual interest rates ranging from 2.5% to 3.8%.
Deposits	**6,392,000**		
Withdrawals	**(38,000)**		

Category	Amount / Volume	Outstanding Balance	Nature, Terms and Conditions
	December 31, 2011		
Key Management Personnel			
Deposit liabilities		₱169	These are savings accounts with annual interest rates ranging from 2.0% to 2.5%.
Deposits	₱289		
Withdrawals	(120)		
CARD, Inc. (shareholder)			
Deposit liabilities		30,681	These are savings accounts with annual interest rates ranging from 2.5% to 5.5%.
Deposits	54,703		
Withdrawals	(29,026)		
Accounts receivables		–	The amount represents the CARD BDSF's share of expenses payable to the Bank.
Charges	(251,410)		
Remittances	251,410		
Accounts payable:		4,783	The amount represents the Bank's share of expenses still payable to CARD Inc.
Charges	(120,230)		
Payments	115,447		
CMDI (other related party)			
Deposit liabilities		2,205	These are savings accounts with annual interest rates ranging from 2.5% to 4.3%.
Deposits	(1,141)		
Withdrawals	2,103		
Accounts payable:		158,671	The amount represents the Bank's share of expenses still payable to CMDI.
Charges	454,675		
Payments	(296,004)		
CARD MBA (other related party)			
Deposit liabilities		384	These are savings accounts with annual interest rates ranging from 2.5% to 5.5%.
Deposits	23,847		
Withdrawals	(50,393)		
Accounts payable		4,040,769	These are savings accounts with annual interest rates ranging from 2.0% to 4.0%.
Premium collections	60,776,314		
Remittances	(56,735,545)		
CAMIA (other related party)			
Deposit liabilities		–	These are savings accounts with annual interest rates ranging from 2.0% to 2.5%.
Deposits	799		
Withdrawals	(1,108)		
Accounts payable		1,000	This pertains to insurance for the employees of the Bank.
Charges	30,851		
Payments	(29,851)		
CARD BDSF (other related party)			
Deposit liabilities		1,103	These are savings accounts with annual interest rates ranging from 2.5% to 4.3%.
Deposits	5,398		
Withdrawals	(4,472)		

(Forward)

Category	Amount / Volume	Outstanding Balance	Nature, Terms and Conditions
	December 31, 2011		
Accounts payable		₱180,438	The amount represents the Bank's share of expenses still payable to CARD BDSF
Charges	₱1,403,033		
Payments	(1,222,595)		
CARD MERP (shareholder)			
Deposit liabilities		48,092	These are savings accounts with annual interest rates ranging from 2.5% to 5.5%.
Deposits	48,109		
Withdrawals	(17)		
Accounts payable		–	The amount represents the Bank's share of expenses still payable to CARD EMPC
Charges	6,795,000		
Payments	6,795,000		
CMIT (other related party)			
Deposit liabilities		26,745	These are savings accounts with annual interest rates ranging from 2.5% to 4.5%.
Deposits	33,966		
Withdrawals	7,221		
Accounts payable		–	The amount represents the Bank's system maintenance expenses still payable to CMIT
Charges	7,542,117		
Payments	7,542,117		

Others

Other related party transactions of the Bank are as follows:

	2012	2011	**Nature, Terms and Conditions**
Statement of Comprehensive Income (in volume)			
CARD, Inc. (shareholder)			
Occupancy	**₱60,000**	₱60,000	An establishment owned by CARD, Inc. is being leased to the Bank. Lease contract is renewable annually
Interest expense	**2,381**	1,906	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 4.5%
CMDI (other related party)			
Seminars and trainings expense	**18,724,951**	9,245,250	The Bank engaged CMDI for training and development of its members and employees (shown as part of 'Employee trainings') in the statement of comprehensive income).
Interest expense	**2,380**	1,906	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 4.5%
CARD MBA (other related party)			
Interest expense	**1,514**	1,834	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 5.0%.
CAMIA (other related party)			
Interest expense	**18**	23	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 3.8%.
CARD BDSF (other related party)			
Transportation and travel expense	–	6,135,209	Relates to the lease of motorcycles with a term of three years. All contracts were pre-terminated in the beginning of 2012.
Interest expense	**309,800**	122,200	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 4.0%.
CARD MERP (retirement plan)			
Retirement expense	**72,353,121**	34,270,907	This pertains to the funded and formal noncontributory defined benefit retirement plan of the Bank that is handled by CARD MERP (Note 17).
CMIT (other related party)			
Information technology	**3,680,300**	12,400,000	This pertains to the CMIT's rendered services in relation to upgrade of the Bank's core banking system (CBS).
System maintenance services	**6,571,913**	7,542,117	This represents information technology-related support services to the Bank including software maintenance of the Bank's CARD e-System, hardware maintenance, set-up of network and centers and technical support, among others

(Forward)

	2012	2011	Nature, Terms and Conditions
Statement of Comprehensive Income (in volume)			
Interest expense	**₱2,810**	₱111	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 6.0%.
BotiCARD (other related party)			
Interest expense	**155,502**	–	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 3.5%.
CARD EMPC (shareholder)			
Interest expense	**198**	–	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 3.5%.
CARD MERP (other related party)			
Benefit expense	**10,806,128**	6,795,000	This pertains to the funded and formal noncontributory defined benefit retirement plan of the Bank that is handled by CARD MERP (Note 18).
Interest expense	**2,810**	112	Pertains to interest on savings accounts with annual rates ranging from 2.0% to 6.0%.

Evaluated accounts from CARD, Inc. to the Bank were 20 units and 1 unit in 2012 and 2011, respectively. The BOD passed a resolution for the evaluation of accounts from CARD, Inc. after receipt of approval from the BSP to establish additional MBOs on October 15, 2012 for 2012 additional branches and September 29, 2011 for 2011 additional branches.

Regulatory Reporting

As required by BSP, the Bank discloses loan transactions with investees and with certain directors, officers, stockholders and related interests (DOSRI). Existing banking regulations limit the amount of individual loans to DOSRI, 70.00% of which must be secured, to the total of their respective deposits and book value of their respective investments in the lending company within the Bank.

In the aggregate, loans to DOSRI generally should not exceed total equity or 15.00% of total loan portfolio, whichever is lower. As at December 31, 2012 and 2011, the Bank is in compliance with the regulatory requirements.

BSP Circular No. 423 dated March 15, 2004 amended the definition of DOSRI accounts. On October 8, 2010, BSP Circular No. 695 is issued to provide guidance on the definition of Related Interest.

As at December 31, 2012 and 2011, there were no loans, other credit accommodations and guarantees classified as DOSRI accounts under the existing regulations as shown in the table below:

	2012	2011
Total outstanding DOSRI accounts	**₱–**	₱–
Percent of DOSRI accounts granted prior to effectivity of BSP Circular No. 423 to total loans	**0.00%**	0.00%
Percent of DOSRI accounts granted after effectivity of BSP Circular No. 423 to total loans	**0.00%**	0.00%
Percent of DOSRI accounts to total loans	**0.00%**	0.00%
Percent of unsecured DOSRI accounts to total DOSRI accounts	**0.00%**	0.00%
Percent of past due DOSRI accounts to total DOSRI accounts	**0.00%**	0.00%
Percent of nonaccruing DOSRI accounts to total DOSRI accounts	**0.00%**	0.00%

22. Lease Contracts

As Lessee

The Bank leases the premises occupied by some of its branches in which lease payments are subjected to escalation clauses ranges from 3.0% to 5.0%. The lease contracts are for the periods ranging from one to ten years and are renewable upon mutual agreement between the Bank and the lessors such as CARD, Inc., employees and third-party lessors.

The future aggregate minimum lease payments under non-cancelable operating leases follow:

	2012	2011
Within one year	**₱1,839,500**	₱744,020
Beyond one year but not more than five years	**5,085,706**	–
	₱6,925,206	₱744,020

23. Commitments and Contingencies

There are commitments and contingent liabilities that arise in the normal course of the Bank's operations which are not reflected in the accompanying financial statements. As at December 31, 2012 and 2011, management is of the opinion that losses, if any, from these commitments and contingencies will not have a material effect on the Bank's financial statements.

24. Notes to Statements of Cash Flows

Noncash activities of the Bank consist of the following:

	2012	2011
Noncash investing activities:		
Foreclosure of investment properties	**₱585,000**	₱4,991,463
Transfer from investment properties to property and equipment	**(3,748,530)**	–

25. Approval for the Release of Financial Statements

The accompanying financial statements were approved and authorized for issue by the BOD on March 9, 2013

26. Supplementary Information Under Revenue Regulations 19-2011

In addition to the required supplementary information under RR No. 15-2010, on December 9, 2011, the BIR issued RR No. 19-2011 which prescribes the new annual income tax forms that will be used for filing effective taxable year 2011. Specifically, companies are required to disclose certain tax information in their respective notes to financial statements.

For the taxable year December 31, 2012, the Bank reported the following revenues and expenses for income tax purposes:

Schedule of Sales/Revenues/Receipts

	Taxable Amount
Sale of services	₱220,242,016

Schedule of Cost of Services

Direct charges - salaries, wages and benefits	₱76,794,100
Direct charges - interest expense	17,172,678
	₱93,966,778

Schedule of Non-operating and Taxable Other Income

Nature of Income	Taxable Amount
Fees and commissions	₱41,435
Others	3,985,225
	₱4,026,660

Computation of Itemized Deductions

	Regular Rate
Transportation and travel	₱13,651,929
Taxes and licenses	13,224,238
Seminars and meeting	9,730,430
Employee trainings	8,977,838
Office supplies	8,712,744
Rental	7,631,742
Information technology	6,566,057
Depreciation	5,534,610
Security services	3,960,082
Insurance	3,913,841
Losses	2,347,970
Repairs and maintenance	2,280,773
Representation and entertainment	2,179,275
Communication, light and water	2,033,512
Postage, telephone and cable	1,529,021
Professional fees	967,877
Program monitoring and evaluation	645,732
Miscellaneous	2,968,630
Total	₱96,856,301

27. Supplementary Information Required under Revenue Regulations 15-2010

On November 25, 2010, the BIR issued RR 15-2010 prescribing the manner of compliance in connection with the preparation and submission of financial statements accompanying the tax returns. It includes provisions for additional disclosure requirements in the notes to the financial statements, particularly on taxes, duties and licenses paid or accrued during the year.

The components of ‘Taxes and licenses’ in 2012 follow:

Gross receipt tax	₱11,314,583
Business permits and licenses	885,785
Documentary stamp tax (DST)	153,838
Real property tax	65,091
Others	816,734
	₱13,236,031

In 2012, withholding taxes lodged under ‘Accrued taxes’ account are categorized into:

Paid:	
Withholding taxes on compensation and benefits	₱2,892,956
Final withholding tax on interest expense	2,086,875
Expanded withholding tax	359,335
	₱5,339,166
Accrued:	
Withholding taxes on compensation and benefits	₱590,689
Final withholding tax on interest expense	505,418
Expanded withholding tax	47,516
	₱1,143,623