CARD MRI Rizal Bank, Inc., A Microfinance-Oriented Rural Bank

Financial Statements
December 31, 2018 and 2017

and

Independent Auditor's Report

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A member firm of Ernst & Young Global Limited

SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City
Philippines

Tel: (632) 891 0307
Fax: (632) 819 0872
ey.com/ph

BOA/PRC Reg. No. 0001,
October 4, 2018, valid until August 24, 2021
SEC Accreditation No. 0012-FR-5 (Group A),
November 6, 2018, valid until November 5, 2021

INDEPENDENT AUDITOR'S REPORT

The Stockholders and the Board of Directors
CARD MRI Rizal Bank, Inc., A Microfinance-Oriented Rural Bank

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of CARD MRI Rizal Bank, Inc., A Microfinance-Oriented Rural Bank (the Bank), which comprise the statements of financial position as at December 31, 2018 and 2017, and the statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards (PFRSs).

Basis for Opinion

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

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

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

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

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

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Auditor's Responsibilities for the Audit of the Financial Statements

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

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

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

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

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

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

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

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

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

Our 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 15-2010 in Note 22 to the financial statements is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such information is the responsibility of the management of CARD MRI Rizal Bank, Inc., A Microfinance-Oriented Rural 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.

Ray Francis C. Balagtas

Ray Francis C. Balagtas
Partner
CPA Certificate No. 108795
SEC Accreditation No. 1510-AR-1 (Group A),
September 18, 2018, valid until September 17, 2021
Tax Identification No. 216-950-288
BIR Accreditation No. 08-001998-107-2018,
February 14, 2018, valid until February 13, 2021
PTR No. 7332523, January 3, 2019, Makati City

April 9, 2019

CARD MRI RIZAL BANK, INC.,
A MICROFINANCE-ORIENTED RURAL BANK
STATEMENTS OF FINANCIAL POSITION

	December 31	
	2018	2017
ASSETS		
Cash and other cash items	**₱7,871,827**	₱2,209,287
Due from Bangko Sentral ng Pilipinas (Notes 6 and 10)	**74,342,915**	47,321,849
Due from other banks (Note 6)	**638,651,481**	395,614,336
Loans and receivables (Note 7)	**3,116,830,742**	2,122,101,566
Investment securities at amortized cost (Note 7)	**41,015,971**	–
Property and equipment (Note 8)	**114,669,678**	90,147,941
Retirement asset (Note 15)	**34,564,180**	30,213,290
Deferred tax assets (Note 18)	**6,729,264**	11,904,261
Other assets (Note 9)	**74,956,094**	24,572,618
	₱4,109,632,151	₱2,724,085,148
LIABILITIES AND EQUITY		
Liabilities		
Deposit liabilities (Notes 10 and 19)		
Regular savings	**₱1,886,068,630**	₱ 1,145,823,829
Special savings	**501,312,932**	380,607,794
	2,387,381,562	1,526,431,623
Bills payable (Note 11)	**775,434,791**	498,023,590
Income tax payable	**45,099,406**	35,986,373
Deposits for future stock subscription (Note 13)	**–**	51,592,800
Other liabilities (Note 11)	**75,805,723**	38,158,584
	3,283,721,482	2,150,192,970
Equity		
Capital stock (Note 13)		
Common stock	**341,249,600**	198,395,400
Preferred stock	**54,000,000**	50,000,000
Surplus free	**394,037,390**	318,552,752
Surplus reserve (Note 7)	**26,695,806**	–
Remeasurement gain on retirement plan (Note 15)	**9,927,873**	6,944,026
	825,910,669	573,892,178
	₱4,109,632,151	₱2,724,085,148

See accompanying Notes to Financial Statements.

CARD MRI RIZAL BANK, INC.,
A MICROFINANCE-ORIENTED RURAL BANK
STATEMENTS OF INCOME

	Years Ended December 31	
	2018	2017
INTEREST INCOME		
Loans and receivables (Note 7)	**₱1,231,160,619**	₱789,109,822
Due from other banks (Note 6)	**9,996,737**	4,988,877
Investment securities at amortized cost (Note 7)	**2,045,361**	–
	1,243,202,717	794,098,699
INTEREST EXPENSE		
Deposit liabilities (Notes 10 and 19)	**44,305,138**	28,561,461
Bills payable (Note 11)	**18,660,368**	12,376,863
	62,965,506	40,938,324
NET INTEREST INCOME	**1,180,237,211**	753,160,375
Miscellaneous	**412,366**	442,895
TOTAL OPERATING INCOME	**1,180,649,577**	753,603,270
OPERATING EXPENSES		
Compensation and benefits (Notes 14, 15 and 19)	**267,592,272**	180,299,412
Transportation and travel	**71,458,928**	47,175,135
Taxes and licenses	**68,701,148**	43,134,700
Rent (Note 16)	**54,515,280**	34,181,777
Stationeries and supplies	**43,184,186**	31,886,702
Information technology	**32,817,765**	8,018,149
Training and development	**31,185,671**	20,612,538
Provision for credit losses (Note 7)	**23,427,828**	11,465,405
Depreciation and amortization (Note 8)	**22,411,502**	14,491,280
Security, messengerial, janitorial services	**19,943,439**	12,661,695
Power, light and water	**8,023,425**	5,007,696
Seminars and meetings	**5,577,105**	3,693,586
Insurance	**3,899,055**	2,931,427
Professional fees	**2,748,090**	1,558,236
Fines, penalties and other charges	**1,986,978**	1,037,933
Miscellaneous (Note 17)	**12,237,816**	8,529,973
	669,710,488	426,685,644
INCOME BEFORE INCOME TAX	**510,939,089**	326,917,626
PROVISION FOR INCOME TAX (Note 18)	**153,481,969**	98,532,653
NET INCOME	**₱357,457,120**	₱228,384,973

See accompanying Notes to Financial Statements.

CARD MRI RIZAL BANK, INC.,
A MICROFINANCE-ORIENTED RURAL BANK

STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31	
	2018	2017
NET INCOME	**₱357,457,120**	₱228,384,973
OTHER COMPREHENSIVE GAIN		
Other comprehensive gain not recycled to profit or loss in subsequent periods:		
Remeasurement gain on retirement plan (Note 15)	**4,262,638**	11,773,445
Income tax effect (Note 18)	**(1,278,791)**	(3,532,034)
	2,983,847	8,241,411
TOTAL COMPREHENSIVE INCOME	**₱360,440,967**	₱236,626,384

See accompanying Notes to Financial Statements.

CARD MRI RIZAL BANK, INC.,
A MICROFINANCE-ORIENTED RURAL BANK

STATEMENTS OF CHANGES IN EQUITY

	Common Stock (Note 13)	Preferred Stock (Note 13)	Surplus		Remeasurement Gain on Retirement Plan (Note 15)	Total
			Free	Reserve (Note 7)		
Balances at January 1, 2018, as previously reported	**₱198,395,400**	**₱50,000,000**	**₱318,552,752**	**₱–**	**₱6,944,026**	**₱573,892,178**
PFRS 9 ECL transition adjustment (Note 2)	–	–	**23,738,324**	–	–	**23,738,324**
Balances at January 1, 2018, as restated	**198,395,400**	**50,000,000**	**342,291,076**	–	**6,944,026**	**597,630,502**
Issuance of shares (Note 13)	**10,907,200**	**4,000,000**	–	–	–	**14,907,200**
Total comprehensive income for the year	–	–	**357,457,120**	–	**2,983,847**	**360,440,967**
Application of DFS subscription to issued shares	**51,592,800**	–	–	–	–	**51,592,800**
Collection of subscription receivable	**1,604,600**	–	–	–	–	**1,604,600**
Declaration of stock dividends (Note 13)	**78,749,600**	–	**(78,749,600)**	–	–	–
Declaration of cash dividends (Note 13)	–	–	**(200,265,400)**	–	–	**(200,265,400)**
Appropriation for valuation allowance (Note 7)	–	–	**(26,695,806)**	**26,695,806**	–	–
Balances at December 31, 2018	**₱341,249,600**	**₱54,000,000**	**₱394,037,390**	**₱26,695,806**	**₱9,927,873**	**₱825,910,669**
Balances at January 1, 2017	₱177,273,200	₱37,003,400	₱220,451,907	₱–	(₱1,297,385)	₱433,431,122
Issuance of shares (Note 13)	21,122,200	12,996,600	–	–	–	34,118,800
Total comprehensive income (loss) for the year	–	–	228,384,973	–	8,241,411	236,626,384
Declaration of dividends (Note 13)	–	–	(130,284,128)	–	–	(130,284,128)
Balances at December 31, 2017	₱198,395,400	₱50,000,000	₱318,552,752	₱–	₱6,944,026	₱573,892,178

See accompanying Notes to Financial Statements.

CARD MRI RIZAL BANK, INC.,
A MICROFINANCE-ORIENTED RURAL BANK
STATEMENTS OF CASH FLOWS

	Years Ended December 31	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	**₱510,939,089**	₱326,917,626
Adjustments for:		
Provision for credit losses (Note 7)	**23,427,828**	11,465,405
Depreciation and amortization (Note 8)	**22,411,502**	14,491,280
Amortization of documentary stamp tax on bills payable (Notes 11 and 20)	**4,045,311**	2,436,550
Amortization of financial assets at amortized cost	**(259,404)**	–
Net change in retirement asset (Note 15)	**(88,252)**	(1,279,872)
Operating income before changes in operating assets and liabilities:	**560,476,074**	354,030,989
Increase in the amounts of:		
Loans and receivables	**(987,387,949)**	(799,991,159)
Other assets	**(50,343,476)**	(6,341,913)
Deposit liabilities	**860,949,939**	552,681,331
Other liabilities	**37,602,615**	20,408,931
Net cash generated from operations	**371,133,140**	120,788,179
Income taxes paid	**(150,646,298)**	(86,334,451)
Net cash provided by operating activities	**220,486,841**	34,453,728
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of property and equipment (Note 8)	**(46,933,239)**	(37,358,336)
Proceeds from maturity of investment securities at amortized cost	**12,510,335**	–
Net cash used in investing activities	**(34,422,906)**	(37,358,336)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from:		
Availment of bills payable (Notes 11 and 20)	**903,365,890**	577,145,480
Issuance of common stock (Note 13)	**10,907,200**	–
Issuance of preferred stock (Note 13)	**4,000,000**	12,996,600
Collection of subscription receivable (Note 13)	**1,604,600**	21,122,200
Deposit for future stock subscription (Notes 13 and 20)	–	47,512,800
Settlements of:		
Bills payable (Notes 11 and 20)	**(630,000,000)**	(520,000,000)
Dividend distribution (Notes 13 and 20)	**(200,220,874)**	(130,270,982)
Net cash provided by financing activities	**89,656,815**	8,506,098
NET INCREASE IN CASH AND CASH EQUIVALENTS	**275,720,751**	5,601,490

(Forward)

	Years Ended December 31	
	2018	2017
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		
Cash and other cash items	**₱2,209,287**	₱5,700,569
Due from Bangko Sentral ng Pilipinas	**47,321,849**	29,888,498
Due from other banks	**395,614,336**	403,954,915
	445,145,472	439,543,982
CASH AND CASH EQUIVALENTS AT END OF YEAR		
Cash and other cash items	**7,871,827**	2,209,287
Due from Bangko Sentral ng Pilipinas	**74,342,915**	47,321,849
Due from other banks	**638,651,481**	395,614,336
	₱720,866,223	₱445,145,472
OPERATIONAL CASH FLOWS FROM INTEREST		
Interest received	**₱1,207,388,121**	₱784,731,408
Interest paid	**52,632,596**	27,055,809

See accompanying Notes to Financial Statements.

CARD MRI RIZAL BANK, INC.,
A MICROFINANCE-ORIENTED RURAL BANK
NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

CARD MRI Rizal Bank, Inc., A Microfinance-Oriented Rural Bank (the Bank) was incorporated under Philippine laws by virtue of Securities and Exchange Commission (SEC) Certificate of Registration No. AS094-11394 dated December 15, 1994. The Bank was granted the authority by the Bangko Sentral ng Pilipinas (BSP) to operate on April 29, 1996. It was established primarily to engage in the business of rural banking as defined and authorized under Republic Act No. 3779, As Amended, such as granting loans to small farmers and to deserving rural enterprises, as well as receiving deposits in accordance with the regulations promulgated by the Monetary Board.

On June 28, 2018, the BSP approved the change in the Bank's corporate name from Rizal Bank, Inc., A Microfinance-Oriented Rural Bank to CARD MRI Rizal Bank, Inc., A Microfinance-Oriented Rural Bank. On October 5, 2018, the SEC approved the change in the corporate name of the Bank.

The Monetary Board, in its Resolution No. 272 dated February 16, 2017, approved the request of the Bank to transfer 10 percent (10%) of the stockholdings of Center for Agriculture and Rural Development, Inc. (CARD, Inc.), transferee-stockholder, to Bank of the Philippine Island (BPI) through sale and purchase of 200,000 common shares of the former by the latter, in accordance with the agreement between CARD, Inc. and BPI, which also includes vesting to BPI the right to appoint one (1) non-independent director in the Board of Directors (BOD) of the Bank.

As of December 31, 2018 and 2017, the Bank's majority stockholder is CARD Bank, Inc.

The principal place of business of the Bank is at P. Guevarra St., Cor. Aguirre St., Brgy. Poblacion 2, Sta. Cruz, Laguna. As at December 31, 2018, the Bank consists of its head office and twenty-four (24) branches.

2. Summary of Significant Accounting Policies

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

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

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

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if there is a currently enforceable legal right to set off the recognized amounts and there is intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The Bank assesses that it has a currently enforceable right of offset if the right is not contingent on a future event, and is legally enforceable in the normal course of business, event of default, and event of insolvency or bankruptcy of the Bank and all of the counterparties.

The Bank has no offsetting arrangements with its counterparties.

Income and expenses are not offset in the statement of income unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Bank.

Changes in Accounting Policies
The accounting policies adopted are consistent with those of the previous financial year except for the following new, amendments and improvements to PFRS, Philippine Accounting Standards (PAS) and Philippine Interpretation which became effective as of January 1, 2018. Except as otherwise indicated, these changes in the accounting policies did not have any significant impact on the financial position or performance of the Bank:

- *New and Amended Standards*
  - Amendments to PFRS 2, *Share-based Payment, Classification and Measurement of Share-based Payment Transactions*
  - Amendments to PFRS 4, *Applying PFRS 9 Financial Instruments with PFRS 4 Insurance Contracts*
  - Philippine Interpretation IFRIC-22, *Foreign Currency Transactions and Advance Consideration*

- *Annual Improvements to PFRSs (2014-2017 Cycle)*
  - Amendments to PAS 28, *Investments in Associates and Joint Ventures*, *Measuring an Associate or Joint Venture at Fair Value* (Part of *Annual Improvements to PFRSs* 2014 - 2016 Cycle)
  - Amendments to PAS 40, *Investment Property*, *Transfers of Investment Property*

Standards that have been adopted and that are deemed to have significant impact on the financial statements or performance of the Bank are described below:

PFRS 9, *Financial Instruments*
The Bank adopted PFRS 9 effective January 1, 2018 following the modified retrospective approach. PFRS 9 replaced PAS 39, *Financial Instruments: Recognition and Measurement.* As a result, the Bank changed to the following accounting policies beginning 2018.

Accordingly, the Bank has not restated comparative information for 2017 for financial instruments in the scope of PFRS 9. While impact of adoption is taken to equity balance as of January 1, 2018.

a. Classification and Measurement
   The standard version adopted by the Bank specified how an entity should classify and measure its financial assets. It requires all financial assets to be classified in their entirety on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. Financial assets are measured either at amortized cost or fair value.

As of January 1, 2018, all of the Bank's financial assets were determined to have passed the contractual cash flow test as the cash flows are consistent with basic lending arrangement and asset portfolio are managed based on return of principal and carried at agreed yields.

b. Impairment
The Bank records expected credit losses (ECL) for all loans and other debt financial assets not classified as FVTPL, together with loan commitments and financial guarantee contracts.

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

For non-credit-impaired financial instruments:

- Stage 1 is comprised of all financial instruments which have not experienced a SICR since initial recognition or is considered of low credit risk as of the reporting date. The criteria for determining whether an account should be assessed under Stage 1 are as follows: (i) current; (ii) no significant increase in the probability of default (PD); (iii) unclassified; or (iv) past due up to 30 days. For the microfinance loans, stage 1 criteria (i) and (ii) are considered; while for other loans, stage 1 criteria (i), and (iv) are used. The Bank recognizes a 12-month ECL for Stage 1 financial instruments.
- Stage 2 is comprised of all financial instruments which have experienced a SICR as of reporting date compared to initial recognition. A SICR is generally deemed present in accounts with: (i) more than 30 days up to 90 days past due; (ii) loan especially mentioned or substandard; or (iii) with significant increase in PD. For the other loans, stage 2 criteria (i), (ii), and (iii) are considered. The Bank recognizes a lifetime ECL for Stage 2 financial instruments.

For credit-impaired financial instruments:

- Stage 3 is comprised of all financial assets that have objective evidence of impairment as a result of one or more loss events that have occurred after initial recognition with a negative impact on the estimated future cash flows of a loan or a portfolio of loans. The Bank's criteria for Stage 3 accounts are generally aligned with the definition of "default" which is explained in the next paragraph. The Bank recognizes a lifetime ECL for Stage 3 financial instruments

Definition of "default" and "restored"
The Bank classifies loans and receivables, or any financial asset as in default when it is credit impaired, becomes past due on its contractual payments in case of microfinance loans and for more than 90 days in case of other credit exposures, considered non-performing, under litigation or is classified as doubtful or loss. As part of a qualitative assessment of whether a customer is in default, the Bank considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted. An instrument is considered to be no longer in default (i.e. restored) if there is sufficient evidence to support that full collection is probable and payments are received for all maturing dues.

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

For accounts originated before the transition date, an approximation of the initial PD at origination was utilized. Average PD per portfolio was used as approximated initial PD at origination. Average of the Point-in-Time PDs was used.

Significant increase in credit risk
The assessment of whether there has been a significant increase in credit risk is based on an increase in the probability of a default occurring since initial recognition. The SICR criteria vary by portfolio and include quantitative changes in probabilities of default and qualitative factors, including a backstop based on delinquency. The credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the Bank's internal credit assessment, the borrower or counterparty is determined to require close monitoring or with well- defined credit weaknesses. For exposures without internal credit grades, if contractual payments are one day past due, the credit risk is deemed to have increased significantly since initial recognition. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a SICR since initial recognition, the Bank shall revert to recognizing a 12-month ECL

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

The PD is an estimate of the likelihood of default over a 12-month horizon for Stage 1 or lifetime horizon for Stages 2 and 3. The PD for each individual instrument is modelled based on historic data and is estimated based on current market conditions and reasonable and supportable information about future economic conditions. The Bank segments its credit exposures based on homogenous risk characteristics and developed a corresponding PD methodology for each portfolio. The PD methodology for each relevant portfolio is determined based on the underlying nature or characteristic of the portfolio, behavior of the accounts and materiality of the segment as compared to the total portfolio.

LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from any collateral. It makes use of defaulted accounts that have either been identified as cured, restructured, or liquidated. The Bank segmented its LGD based on homogenous risk characteristics and calculated the corresponding segment-level averages.

EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.*Forward-looking information*

The Bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. A broad range of forward-looking information are considered as economic inputs, such as GDP growth, exchange rate, interest rate, inflation rate and other economic indicators. The inputs and models used for calculating ECL may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

The key forward-looking economic variables used in each of the economic scenarios for the ECL calculations are remittances, retail price index, unemployment rate, and calamity damage.

The following table reconciles the aggregate opening allowances for credit losses under PAS 39 to ECL allowances under PFRS 9 on January 1, 2018:

	Allowance for credit losses under PAS 39 as at December 31, 2017	ECL under PFRS 9 as at January 1, 2018	Remeasure-ment	Deferred tax effect	Effect on equity
	(A)	(B)	(B-A)	(C)	(B - A) - C
Loans and other receivables	**₱44,238,383**	**₱10,326,492**	**(₱33,911,891)**	**(₱10,173,567)**	**₱23,738,324**

The Bank has applied its existing governance framework to ensure that appropriate controls and validations are in place over key processes and judgments in implementing PFRS 9. The Bank is continuously testing and refining the new accounting processes, internal controls and governance framework necessitated by the adoption of PFRS 9.

The amount of ECL recognized for loans and receivables in 2018 is presented in Note 7. For other financial assets such as “Cash and other cash items”, “Due from BSP”, “Due from other banks”, “Financial asset at amortized cost” and “Other assets”, the Bank assessed that the ECL for these items is insignificant to the financial statements.

The impact of adopting PFRS 9 as of January 1, 2018 follows:

	PAS 39		Remeasurement	PFRS 9	
	Category	Amount	ECL*	Category	Amount
Assets					
Cash and other cash items	Loans and receivables	₱2,209,287	₱–	Amortized cost	₱2,209,287
Due from Bangko Sentral ng Pilipinas	Loans and receivables	47,321,849	–	Amortized cost	47,321,849
Due from other banks	Loans and receivables	395,614,336	–	Amortized cost	395,614,336
Loans and receivables	Loans and receivables	2,122,101,566	23,738,324*	Amortized cost	2,145,839,890
Refundable security rental deposits	Loans and receivables	8,875,290	–	Amortized cost	8,875,290
		₱2,580,991,525	₱23,738,324		₱2,604,729,849

**Net of deferred tax adjustment of 10,173,567*

Equity	Balance at January 1, 2018 (as previously reported)	Transition adjustment	Balance at January 1, 2018 (as restated)
Surplus free	₱318,552,752	₱23,738,324*	₱342,291,076

**Net of deferred tax adjustment of 10,173,567*

PFRS 15, *Revenue from Contracts with Customers*
PFRS 15 supersedes PAS 11, *Construction Contracts*, PAS 18, *Revenue* and related Interpretations and it applies, with limited exceptions, to all revenue arising from contracts with customers. PFRS 15 establishes a five-step model to account for revenue arising from contracts with customers and requires that revenue be recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

PFRS 15 requires entities to exercise judgment, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. In addition, the standard requires extensive disclosures.

The Bank adopted PFRS 15 using the modified retrospective method of adoption with the date of initial application of January 1, 2018. Under this method, the standard can be applied either to all contracts at the date of initial application or only to contracts that are not completed at this date. The Bank elected to apply the standard to all contracts as at January 1, 2018.

The adoption of PFRS 15 has no significant impact to the Bank, since it's revenue, primarily interest income from loans and receivables, are outside the scope of such standard.

Summary of Significant Accounting Policies

Fair Value Measurement
The Bank initially measures its financial instruments at fair value. Fair values of financial instruments measured at amortized cost are disclosed in Note 4.

Fair value is the estimated price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

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

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

If an asset or a liability measured at fair value has a bid price and an ask price (e.g., an input from a dealer market), the price between the bid-ask price spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where the input is categorized within the fair value hierarchy.

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

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

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

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

For assets and liabilities that are carried in the financial statements at fair value on a recurring basis, the Bank determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at every reporting date (See Note 4).

For purposes of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and fair value hierarchy as explained above.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, and amounts due from BSP and other banks 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.

Due from BSP includes the statutory reserves required by the BSP which the Bank considers as cash equivalents as withdrawals can be made to meet the Bank's cash requirements as allowed by the BSP. The components of cash and cash equivalents are shown in the statement of cash flows. Cash and cash equivalents are carried at amortized cost in the statement of financial position.

Financial Instruments - Initial Recognition and Subsequent Measurement

Date of recognition

Regular way purchases and sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market, except for derivatives, are recognized on the settlement date. Settlement date is the date on which the transaction is settled by delivery of the assets that are the subject of the agreement. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the Bank, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the Bank.

'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 income unless it qualifies for recognition as some other type of asset.

In cases when the fair value is determined using data which are not observable, the difference between the transaction price and model value is only recognized in the statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Bank determines the appropriate method of recognizing the ‘Day 1’ difference amount.

Policies applicable beginning January 1, 2018

Classification and measurement
Under PFRS 9, the classification and measurement of financial assets is driven by the entity’s contractual cash flow characteristics of the financial assets and business model for managing the financial assets.

As part of its classification process, the Bank assesses the contractual terms of financial assets to identify whether they meet the ‘solely payments of principal and interest’ (SPPI) test. ‘Principal’ for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (e.g., if there are repayments of principal or amortization of the premium or discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgment and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set. In contrast, contractual terms that introduce a more than de minimis exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Business model assessment
The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:
- how the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- the expected frequency, value and timing of sales are also important aspects of the Bank’s assessment

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case’ scenarios into account. If cash flows after initial recognition are realized in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The Bank's measurement categories are described below:

Investment securities at amortized cost
Debt financial assets are measured at amortized cost if both of the following conditions are met:

- the asset is held within the Bank's business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the instrument give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Debt financial assets meeting these criteria are measured initially at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method less any impairment in value, with the interest calculated recognized as 'Interest income' in the statement of income. The Bank classified 'Cash and other cash items', 'Due from BSP', 'Due from other banks', 'Investment securities at amortized cost', 'Loans and receivables', and security deposits (included under 'Other assets') as financial assets at amortized cost.

The Bank may irrevocably elect at initial recognition to classify a financial asset that meets the amortized cost criteria above as at FVTPL if that designation eliminates or significantly reduces an accounting mismatch had the debt financial asset been measured at amortized cost.

As of December 31, 2018, the Bank has not made such designation.

<u>*Policies applicable prior to January 1, 2018*</u>

Loans and receivables
This accounting policy relates to the statement of financial position captions 'Loans and receivables', 'Due from BSP', 'Due from other banks' and refundable rental deposits under 'Other assets'. These are non-derivative financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market, other than:

- those that the Bank intends to sell immediately or in the near term and those that the Bank upon initial recognition designates as at FVPL;
- those that the Bank, upon initial recognition, designates as AFS investments; or
- those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration.

After initial measurement, loans and receivables are subsequently measured at amortized cost using the effective interest method, less any allowance for credit losses. 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 effective interest rate (EIR). The amortization is included in 'Interest income' in the statement of income. The losses arising from impairment are recognized in 'Provision for credit and impairment losses' in the statement of income.

Financial liabilities
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 financial liabilities at amortized cost are classified under the statement of the financial position captions 'Deposit liabilities' and 'Bills payable', and financial liabilities presented under 'Other liabilities'. 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.

After initial measurement, financial liabilities are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are integral part of the EIR.

This accounting policy relates to the balance sheet captions 'Deposit liabilities', 'Bills payable' and financial liabilities presented under 'Other liabilities'.

Policies applicable beginning January 1, 2018 for impairment of financial asset

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

For non-credit-impaired financial instruments:

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

For credit-impaired financial instruments:

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

The Bank recognizes lifetime ECL on all of its non-impaired financial instruments since the Bank assessed that the expected life of its financial assets does not exceed 12 months. As a result, the Bank considers these instruments under Stage 1, regardless whether SICR already exists since initial recognition.

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

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

ECL is a function of the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD), with the timing of the loss also considered, and is estimated by incorporating forward-looking economic information and through the use of experienced credit judgment.

The PD represents the likelihood that a credit exposure will not be repaid and will go into default. EAD represents an estimate of the outstanding amount of credit exposure at the time a default may occur. For off-balance sheet and undrawn amounts, EAD includes an estimate of any further amounts to be drawn at the time of default. LGD is the amount that may not be recovered in the event of default. LGD takes into consideration the amount and quality of any collateral held.

Policies applicable prior to January 1, 2018

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 asset carried at amortized cost
For financial assets carried at amortized cost, which includes 'Loans and receivables', 'Due from BSP', 'Due from other banks', and refundable rental deposits under 'Other assets', 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 income. Financial assets, 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, subsequently, 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 write-off is later recovered, any amounts formerly charged are credited to 'Miscellaneous' in the statement of income.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of such credit risk characteristics as days past-due 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 in 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 as changes in unemployment rates, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

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

<u>Derecognition of Financial Assets and Financial 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:

a. the rights to receive cash flows from the asset have expired; or
b. the Bank retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or
c. the Bank has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained the risks and rewards of the asset but has transferred 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. In that case, the Bank also recognizes an associated liability. The transferred asset and associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

The transfer of risks and rewards is evaluated by comparing the Bank's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. The Bank has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (e.g., because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sole price plus a lender's return).

The Bank has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g., because the entity has sold a financial asset subject only to an option to buy it back at its fair value at the time of repurchase or has transferred fully proportionate share of the cash flows from a larger financial asset in an agreement).

Whether the Bank has retained control of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control.

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 income.

Prepayments
Prepayments are expenses paid in advance and recorded as asset before they are utilized. This account consists of prepaid rentals and prepaid expenses under 'Other assets' in the statement of financial position. Prepayments are apportioned over the period covered by the payments and charged to the appropriate accounts in the statements of income when incurred.

Property and Equipment
Depreciable property and equipment, which include building, furniture, fixtures and equipment, information technology equipment, transportation equipment and leasehold improvements, are stated at cost less accumulated depreciation and amortization, and any impairment in value. Land is stated at cost less any impairment in value.

The initial cost of property and equipment comprises its purchase price and any directly attributable costs of bringing the property and equipment to its working condition and location for its intended use. Expenditures incurred after the property and equipment have been put into operation, such as repairs and maintenance, are normally charged against operations in the year 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 of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as additional costs of property and equipment.

The initial cost is comprised of construction costs and any other directly attributable costs of bringing the asset to its working condition and location for its intended use. Construction-in-progress is not depreciated and is transferred to the related property and equipment account when the construction or installation and related activities necessary to prepare the property and equipment for their intended use are completed, and the property and equipment are ready for use.

Depreciation is calculated on the straight-line method over the estimated useful lives (EUL) of the depreciable assets. The EULs of the depreciable assets follow:

Building	10 years
Furniture, fixtures and equipment	3 years
Information technology equipment	3 years
Transportation equipment	3 years
Leasehold and improvements	5 years or the terms of the related leases, whichever is shorter

The EULs, residual value 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.

The carrying values of 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, the assets are written down to their recoverable amounts.

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected from its use. 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 income in the year the asset is derecognized.

Fully depreciated assets are retained in the accounts until they are no longer in use and no further depreciation is credited against statement of income.

Impairment of Non-financial Assets

At each reporting date, the Bank assesses whether there is any indication that its non-financial assets may be 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 (CGU) to which it belongs. Where the carrying amount of an asset exceeds its recoverable amount, the asset 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 to the statement of income in the year in which it arises.

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 income. After such a reversal, the depreciation 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.

Deposit for Future Stock Subscription (DFS)
DFS represents payments made on subscription of shares which cannot be directly credited to 'Preferred stock' or 'Common stock' pending registration with the SEC of the amendment to the Articles of Incorporation increasing capital stock.

Under SEC Financial Reporting Bulletin No. 006 issued in 2012 and amended in 2013, an entity should not consider a DFS as an equity instrument unless all of the following elements are present.

1. The unissued authorized capital stock of the Bank is insufficient to cover the amount of shares classified as deposits for future shares subscriptions;
2. The entity's BOD and shareholders have approved an increase in capital stock to cover the shares corresponding to the amount of the deposit; and
3. An application for the approval of the increase in capital stock has been filed with the SEC and BSP.

If any or all of the foregoing elements above are not present, the DFS should be recognized as a financial liability.

As of December 31, 2017, the Bank has DFS recorded under liabilities amounting to ₱51.59 million (Note 13). As of December 31, 2018, the Bank's DFS met the foregoing provisions and is reclassified to capital stock under equity.

Equity
Capital stock is measured at par value for all shares issued and outstanding. When the Bank issues more than one class of stock, a separate account is maintained for each class of stock and the number of shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown in equity as deduction from proceeds, net of tax. Capital stock consists of common and preferred. Preferred stocks are: (a) cumulative, (b) non-voting, and (c) non-redeemable.

Common stock is recognized at subscribed amount net of any subscription receivable. This will be credited upon full payment of the subscription and issuance of the shares of stock.

Surplus 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.

Cash dividends are recognized as liability and deducted from the equity when approved by the BOD while stock dividends are deducted from equity when approved by BOD and ratified by stockholders. Dividends for the year that are approved after the reporting date are dealt with as subsequent events. Stock issuance costs are accounted for as deduction from equity.

Retirement Benefits
The Bank operates a defined benefit retirement plan and a defined contribution plan, which require contributions to be made to a separately administered fund.

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

The cost of providing benefits under the defined benefit plans is actuarially determined using the projected unit credit method.

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

Service costs which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expenses in the statement of income. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuaries.

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

Remeasurements comprising actuarial gains and losses, return on plan assets and any change in the effect of the asset ceiling (excluding net interest on defined benefit liability) are recognized immediately in the statement of financial position with a corresponding debit or credit to 'Remeasurement gains (losses) on retirement liabilities' under OCI in the period in which they arise. Remeasurements are not reclassified to the statement of income in subsequent periods.

Plan assets are assets that are held by a long-term employee benefit fund. Plan assets are not available to the creditors of the Bank, nor can they be paid directly to the Bank. Fair value of plan assets is based on market price information. When no market price is available, the fair value of plan assets is estimated by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations). If the fair value of the plan assets is higher than the present value of the defined benefit obligation, the measurement of the resulting defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The Bank also operates defined contribution plan referred to as "Hybrid Plan" which provides a retirement benefit equal to 100% of the member's employer accumulated value, if any, provided that in no case shall 100% of the employee accumulated value in Fund A be less than 100% of plan salary for every year of credited service. As of December 2018 and 2017, the Bank does not value its defined benefit assets (liability) for the contributions made to the Hybrid Plan.

<u>Leases</u>
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 a renewal or extension of the arrangement;
b. a renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;
c. there is a change in the determination of whether fulfillment is dependent on a specified asset; or
d. there is a substantial change to the asset.

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

Bank as a lessee
Leases where the lessor retains substantially all the risks and rewards of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the statement of income on a straight-line basis over the lease term.

Revenue Recognition
Prior to January 1, 2018, under PAS 18, *Revenue,* revenue is recognized to the extent that it is probable that economic benefits will flow to the Bank and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received. Upon adoption of PFRS 15, beginning January 1, 2018, revenue from contracts with customers is recognized upon transfer of services to the customer at an amount that reflects the consideration to which the Bank expects to be entitled in exchange for those services. The adoption of PFRS 15 did not have significant impact to the Bank as the main source of revenue is from interest income earned from loans and receivables.

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

Interest income
For all financial assets measured at amortized cost, interest income is recorded at 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 including any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses.

Under PFRS 9, when a financial asset becomes credit-impaired, the Bank calculates interest income by applying the EIR to the net amortized cost of the financial asset. If the financial asset cures and is no longer credit-impaired, the Bank reverts to calculating interest income on a gross basis. Under PAS 39, once the recorded value of a financial asset or group of similar financial assets carried at amortized cost has been reduced due to an impairment loss, interest income continues to be recognized using the original EIR applied to the new carrying amount.

Expense Recognition
Expenses are recognized when it is probable that decrease in the future economic benefits related to decrease in asset or an increase in liability has occurred and that the decrease in economic benefits can be measured reliably. Expenses are recognized as incurred.

Interest expense
Interest expense for financial liabilities is recognized in 'Interest expense' in the statement income using the EIR of the financial liabilities to which they relate.

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

Employee leave entitlement
Employee entitlements to annual leave are recognized as a liability when they are accrued to the employees. The undiscounted liability for leave expected to be settled after the end of the annual reporting period is recognized for services rendered by employees up to the end of the reporting period. For leave entitlements expected to be settled for more than twelve months after the reporting date, the estimated liability is reported under 'Accrued other expenses' in the statement of financial position.

Income Taxes

Current tax

Current tax assets and current tax liabilities for the current period 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 at the reporting date.

Deferred tax

Deferred tax is provided, using the statement of financial position 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 exceptions. Deferred tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits from excess minimum corporate income tax (MCIT) over regular corporate income tax (RCIT) and unused net operating loss carryover (NOLCO), to the extent that it is probable that future taxable income will be available against which the deductible temporary differences and carry forward 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 or loss.

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 future taxable income will be available to allow all or part of the deferred tax asset to be utilized.

Deferred tax assets and deferred tax 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.

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

Current income tax and deferred income tax relating to items recognized directly in equity is recognized in OCI, and not in profit or loss.

Provisions and Contingencies

Provisions are recognized when the Bank has a present obligation (legal or constructive) where, as a result of a past event, 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. When 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 time value of money is recognized as 'Interest expense' in the statement of comprehensive income.

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

Events After the Reporting Date
Post-year-end events up to the date of approval of the financial statements 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 in the notes when material to the financial statements.

Standards Issued but not yet Effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are listed below. The Bank intends to adopt these standards when they become effective. Unless otherwise stated, adoption of these standards and interpretations are not expected to have any significant impact on the financial statements of the Bank.

Effective beginning on or after January 1, 2019:

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

- PFRS 16, *Leases*. This new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under PAS 17, *Leases.* The standard includes two recognition exemptions for lessees - leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less).

  At the commencement date of a lease, a lessee will recognize a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognize the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

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

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

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

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

The Bank is currently assessing the impact of this new standard in the financial statements.

- PAS 19 (Amendments), *Employee Benefits, Plan Amendment, Curtailment or Settlement.* The amendments to PAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to:

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

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

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

  Early application is permitted.

- PAS 28 (Amendments), *Long-term Interests in Associates and Joint Ventures.* The amendments clarify that an entity applies PFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied but that, in substance, form part of the net investment in the associate or joint venture (long-term interests). This clarification is relevant because it implies that the expected credit loss model in PFRS 9 applies to such long-term interests.

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

  The amendments should be applied retrospectively, with early application permitted.

- IFRIC 23, *Uncertainty over Income Tax Treatments*. The interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of PAS 12, *Income Taxes*, and does not apply to taxes or levies outside the scope of PAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

The interpretation specifically addresses the following:

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

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

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

Annual Improvements to PFRS 2015-2017 Cycle

- Amendments to PFRS 3, *Business Combinations, and PFRS 11, Joint Arrangements, Previously Held Interest in a Joint Operation*. The amendments clarify that, when an entity obtains control of a business that is a joint operation, it applies the requirements for a business combination achieved in stages, including remeasuring previously held interests in the assets and liabilities of the joint operation at fair value. In doing so, the acquirer remeasures its entire previously held interest in the joint operation.

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

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

- Amendments to PAS 12, *Income Tax Consequences of Payments on Financial Instruments Classified as Equity.* The amendments clarify that the income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity recognizes the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events.

- Amendments to PAS 23, *Borrowing Costs, Borrowing Costs Eligible for Capitalization*. The amendments clarify that an entity treats as part of general borrowings any borrowing originally made to develop a qualifying asset when substantially all of the activities necessary to prepare that asset for its intended use or sale are complete.

  An entity applies those amendments to borrowing costs incurred on or after the beginning of the annual reporting period in which the entity first applies those amendments. Early application is permitted.

Effective beginning on or after January 1, 2020

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

  Earlier application is permitted.

- Amendments to PAS 1, *Presentation of Financial Statements, and PAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, Definition of Material*. The amendments refine the definition of material in PAS 1 and align the definitions used across PFRSs and other pronouncements. They are intended to improve the understanding of the existing requirements rather than to significantly impact an entity's materiality judgments.

  Earlier application is permitted.

Effective beginning on or after January 1, 2021

- PFRS 17, *Insurance Contracts*. The standard is a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, PFRS 17 will replace PFRS 4, *Insurance Contracts*. This new standard on insurance contracts applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply.

  The overall objective of PFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in PFRS 4, which are largely based on grandfathering previous local accounting policies, PFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of PFRS 17 is the general model, supplemented by:

  - A specific adaptation for contracts with direct participation features (the variable fee approach)
  - A simplified approach (the premium allocation approach) mainly for short-duration contracts

  Early application is permitted. This standard has no impact on the Bank as it has no insurance operations.

Deferred effectivity

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

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

3. Significant Accounting Judgments and Estimates

The preparation of the Bank's financial statements in accordance with PFRS requires the management to make judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses and disclosure of contingent assets and contingent liabilities, if any. Future events may occur which will cause the judgments 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.

<u>Judgments</u>

(a) Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recognized or disclosed in the statements of financial position cannot be derived from active markets, these are determined using internal valuation techniques using generally accepted market valuation models.

The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. These judgments may include considerations of liquidity and model inputs such as correlation and volatility for longer dated derivatives.

<u>Estimates</u>

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, which have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next period, are described below. The Bank based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances beyond the control of the Bank. Such changes are reflected in the assumptions when they occur.

(a) Credit losses on loans and receivables (prior to adoption of PFRS 9)

The Bank reviews its loans and receivables to assess impairment annually. In determining whether an impairment loss should be recorded in the statement of income, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of receivables before the decrease can be identified with an individual receivable in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of customers or national or local economic conditions that correlate with defaults on the loans and receivables. Past-due accounts and loans wherein the borrower requested moratorium but no subsequent collection is made after the moratorium ends at year-end, fall under specific loan loss provision. In addition, the Bank makes a collective impairment assessment 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 changes in factors that are indicative of incurred losses, such as deterioration in payment status among others. As at December 31, 2017, the carrying value of loans and receivables and related allowance for credit losses are disclosed in Note 7.

(b) *Expected credit losses on financial assets (PFRS 9)*
The Bank reviews its financial assets and commitments at each reporting date to determine the amount of expected credit losses to be recognized in the balance sheet and any changes thereto in the statement of income. In particular, judgments and estimates by management are required in determining the following:

- whether a financial asset has had a significant increase in credit risk since initial recognition;
- whether default has taken place and what comprises a default;
- macro-economic factors that are relevant in measuring a financial asset's probability of default as well as the Bank's forecast of these macro-economic factors;
- probability weights applied over a range of possible outcomes;
- sufficiency and appropriateness of data used and relationships assumed in building the components of the Bank's expected credit loss models;
- measuring the exposure at default for unused commitments on which an expected credit loss should be recognized and the applicable loss rate

The related allowance for credit losses of financial assets are disclosed in Note 7.

(c) *Recognition of deferred tax assets*
The amount of deferred tax assets 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. The recognized and unrecognized deferred tax assets for the Bank are disclosed in Note 18.

(d) *Present value of defined benefit obligation*
The cost of defined benefit retirement plan and other post-employment benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, future salary increases, and mortality rates. Due to the complexity of the valuation, the underlying assumptions and long-term nature of these plans, such estimates are subject to significant uncertainty. All assumptions are reviewed at each reporting date.

In determining the appropriate discount rate, management considers the market yields on Philippine government bonds with terms consistent with the expected employee benefit payout at reporting date, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation. Future salary increases are based on expected future inflation rates for the specific country. The mortality rate is based on publicly available mortality tables for the specific country and is modified accordingly with estimates of mortality improvements. The present value of the retirement liability and fair value of plan assets are disclosed in Note 15.

4. Fair Value Measurement

The fair values of cash and cash equivalents, loans and receivables, deposit liabilities and other financial liabilities except for financial assets at amortized cost approximate their carrying values in view of the relatively short-term maturities of these instruments.

The fair value of unquoted debt securities classified as loans (UDSCL), investment securities at amortized cost, refundable rental deposits and bills payable is estimated based on the discounted cash flow methodology, using current incremental lending rates for similar type of loans or instruments ranging from 3.25% to 7.25% in 2018 and 2.29% to 6.15% in 2017.

The following tables summarize the carrying amounts and the fair values by level of the fair value hierarchy of the Bank's financial assets and liabilities as at December 31, 2018 and 2017:

	2018				
	Carrying Value	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value**
Assets and liability for which fair values are disclosed:					
Financial assets					
investment securities at amortized cost	**₱41,015,971**	**₱–**	**₱–**	**₱40,888,653**	**₱40,888,653**
Other assets					
Refundable rental deposits	**13,744,487**	–	–	**12,525,379**	**12,525,379**
Financial liability					
Bills payable	**775,434,791**	–	–	**762,558,194**	**762,558,194**

	2017				
	Carrying Value	Level 1	Level 2	Level 3	Total Fair Value
Assets and liability for which fair values are disclosed:					
Financial assets					
Unquoted debt securities classified as loans (UDSCL)	₱53,266,902	₱–	₱–	₱52,927,232	₱52,927,232
Refundable rental deposits	8,875,290	–	–	8,624,775	8,624,775
Financial liability					
Bills payable	498,023,590	–	–	491,333,128	491,333,128

There were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements in 2018 and 2017.

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:
- Credit risk
- Market risk
- Liquidity risk

The Bank has instituted the Risk Management Committee (RMC), composed of Independent director as chairman and majority of the members are independent directors , which is responsible for the comprehensive development of financial risk strategies, principles, frameworks, policies and limits purposely to eliminate or at least reduce the risk the Bank faces in banking activities and thus optimize returns on the capital or equity.

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 identifying and assessing the risk, taking actions to mitigate the risks through defined roles and responsibilities, close monitoring of the scenarios, and adjustment of the systems and policies necessary to effectively minimize risk level.

The BOD through its RMC is responsible for monitoring the Bank's implementation of risk management policies and procedures, and for reviewing 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. Internal Audit (IA) undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee (AC).

Credit Risk
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
The Bank faces potential credit risks every time it extends funds to borrowers, commits funds to counterparties or invests funds to issuers (e.g., investment securities issued by either sovereign or corporate entities).

The Bank manages credit risks by instilling credit discipline both among the staff and the borrowers. Close-monitoring and assessment of account throughout the borrowing period is being done. Moreover, on-time and quality service delivery increase motivation of the borrowers to fulfill their financial obligation. Instilling good credit discipline and commitment are always considered through regular orientation and training. Consequently, their savings balances are pledged and serve as guarantee to their loans, which increase their borrowing capacity. Each business unit has a designated Unit Manager, who reports on all credit-related matters to Area Manager and Regional Director. Each business unit is responsible for the quality and performance of its credit portfolio and monitoring and controlling risks associated with it. Regular audits of business units and credit processes are undertaken by IA. In addition, Executive Committee and Management Committee members of the Bank regularly conduct monitoring based on their respective target per month. This strategy further ensures that business unit's implementation is within the credit policy and regulation of the Bank. Regular capacity building program through provisions of banking-related trainings such as but not limited to credit risk management, managing business, and delinquency management are regularly run. Availability of operations manual as reference, assist personnel in handling daily transaction. The manual is customized for microfinance clients and is being updated as often as new policies and procedures are finalized and approved by the BOD, based on client and staff satisfaction surveys, staff and management program review and planning meetings and workshops. A codified signing authority is in place for every level of loan processing and approval.

All past due accounts are reported on daily, weekly and monthly bases. Consistent monitoring for this group of accounts is established by competent and diligent staff to maximize recovery. Writing off bad accounts are approved by the BOD and reported to the BSP in compliance with the rules and regulations for banks.

The RMC closely monitors the over-all credit operations. Identified existing and potential risks are acted upon appropriately and are reported during monthly meetings of the BOD.

Maximum exposure to credit risk
An analysis of the maximum exposure to credit risk after taking into account any collateral held or other credit enhancements is shown below as at December 31, 2018 and 2017:

	2018			
	Maximum Exposure*	**Fair Value of Collateral**	**Financial Effect of Collateral**	**Net Exposure**
Loans and receivables	**₱3,116,830,742**	**₱739,094,819**	**₱731,316,104**	**₱2,385,514,638**

**Net of allowance for credit losses*

	2017			
	Maximum Exposure*	Fair Value of Collateral	Financial Effect of Collateral	Net Exposure
Loans and receivables	₱2,122,101,566	₱495,146,778	₱484,561,122	₱1,637,540,444

**Net of allowance for credit losses*

As at December 31, 2018 and 2017, the Bank does not hold any collateral or other credit enhancements to cover the credit risks associated with its due from BSP and other banks, other receivables and other financial assets. Hence, the carrying values of those financial assets best represent the maximum exposure to credit risk.

Credit enhancement for receivable from customers pertains to deposit hold-out from pledge savings equivalent to 15.00% of the original amount of the loan to the member as at December 31, 2018 and 2017.

The Bank has no financial instruments with rights of set-off in accordance to PAS 32 as at December 31, 2018 and 2017. There are also no financial instruments that are subject to an enforceable master netting arrangements or similar agreements which require disclosure in the financial statements in accordance with amendments to PFRS 7.

Additionally, the tables below show the distribution of maximum credit exposure by industry sector of the Bank as at December 31, 2018 and 2017:

	2018				
	Loans and Receivables	**Due from BSP and Other Banks**	**Financial assets at Amortized Cost**	**Other Assets***	**Total**
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	**₱1,411,665,121**	**₱–**	**₱–**	**₱–**	**₱1,411,665,121**
Financial institutions	–	**600,097,861**	**6,000,000**	–	**606,097,861**
Agriculture, hunting and forestry	**541,428,486**	–	–	–	**541,428,486**
Real estate activities	**365,422,357**	–	–	–	**365,422,357**
Accommodation and food service activities	**271,013,232**	–	–	–	**271,013,232**
Government	–	**112,896,535**	**35,015,971**	–	**147,912,505**
Education	**129,064,734**	–	–	–	**129,064,734**
Manufacturing	**127,732,642**	–	–	–	**127,732,642**
Fishing	**101,885,153**	–	–	–	**101,885,153**
Transportation and storage	**51,513,780**	–	–	–	**51,513,780**
Human health and social work activities	**42,085,137**	–	–	–	**42,085,137**
Information and communication	**33,827,147**	–	–	–	**33,827,147**
Construction	**18,961,219**	–	–	–	**18,961,219**
Administrative and support service activities	**17,222,095**	–	–	–	**17,222,095**
Water supply, sewerage, waste management, and remediation activities	**15,098,058**	–	–	–	**15,098,058**
Other community, social and personal service activities	–	–	–	**13,744,487**	**13,744,487**
Arts, entertainment and recreation	**12,672,481**	–	–	–	**12,672,481**
Professional, scientific and technical services	**6,239,053**	–	–	–	**6,239,053**
Electricity, gas and water supply	**3,710,271**	–	–	–	**3,710,271**
Mining and quarrying	**186,932**	–	–	–	**186,932**
	3,149,727,898	**712,994,396**	**41,015,971**	**13,744,487**	**3,917,482,752**
Less allowance for credit losses	**32,897,156**	–	–	–	**32,897,156**
Total	**₱3,116,830,742**	**₱712,994,396**	**₱41,015,971**	**₱ 13,744,487**	**₱3,884,585,596**

**Pertains to refundable rental deposits*

	2017			
	Loans and Receivables	Due from BSP and Other Banks	Other Assets*	Total
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	₱833,698,956	₱–	₱–	₱833,698,956
Agriculture, hunting and forestry	361,255,088	–	–	361,255,088
Real estate activities	277,834,705	–	–	277,834,705
Government	40,370,329	221,282,069	–	261,652,398
Financial institutions	13,324,940	221,654,116	–	234,979,056
Manufacturing	151,063,513	–	–	151,063,513
Accommodation and food service activities	126,533,647	–	–	126,533,647
Education	99,775,637	–	–	99,775,637
Fishing	85,805,525	–	–	85,805,525
Transportation and storage	58,969,570	–	–	58,969,570
Information and communication	34,874,643	–	–	34,874,643
Human health and social work activities	27,706,342	–	–	27,706,342
Water supply, sewerage, waste management, and remediation activities	16,008,077	–	–	16,008,077
Administrative and support service activities	14,911,818	–	–	14,911,818
Other community, social and personal service activities	–	–	8,875,290	8,875,290
Professional, scientific and technical services	5,950,537	–	–	5,950,537
Arts, entertainment and recreation	4,671,987	–	–	4,671,987
Construction	3,051,136	–	–	3,051,136
Mining and quarrying	88,508	–	–	88,508
Electricity, gas and water supply	35,645	–	–	35,645
Other service activities	10,409,346	–	–	10,409,346
	2,166,339,949	442,936,185	8,875,290	2,618,151,424
Less allowance for credit losses	44,238,383	–	–	44,238,383
Total	₱2,122,101,566	₱442,936,185	₱8,875,290	₱2,573,913,041

**Pertains to refundable rental deposits*

Credit quality per class of financial assets
In 2017, the description of the financial assets grading used by the Bank is as follows:

- *High grade* - These are financial assets which have a high probability of collection or are invested or deposited with reputable financial institutions. The counterparty has the apparent ability to satisfy its obligation and the securities on the receivables are readily enforceable.

- *Standard grade* - These are financial assets where collections are probable due to the reputation and the financial ability of the counterparty to pay but with experience of default.

In 2018, the financial assets are grouped according to stage whose description is explained as follows:

Stage 1 - those that are considered current and up to 30 days past due, and based on change in rating, delinquencies and payment history, do not demonstrate significant increase in credit risk.

Stage 2 - those that, based on change in rating, delinquencies and payment history, demonstrate significant increase in credit risk, and/or are considered more than 30 days past due but does not demonstrate objective evidence of impairment as of reporting date.

Stage 3 - those that are considered in default or demonstrate objective evidence of impairment as of reporting date.

The tables below show the credit quality per class of financial assets (gross of allowance for credit and impairment losses) as at December 31, 2018 and 2017:

	2018		
	Stage 1	**Stage 3**	**Total**
Due from BSP	**₱74,342,915**	**₱–**	**₱74,342,915**
Due from other banks	**638,651,481**	–	**638,651,481**
Receivable from customers:			
Microfinance loans	**2,703,573,244**	**42,109,680**	**2,745,682,924**
Other loans	**332,887,740**	**5,398,263**	**338,286,003**
Other receivables:			
Accrued interest receivable	**62,888,938**	–	**62,888,938**
Accounts receivable	**2,870,033**	–	**2,870,033**
Investment securities at amortized cost	**41,015,971**	–	**41,015,971**
Other assets:			
Refundable rental deposits	**13,744,487**	–	**13,744,487**
	₱3,869,974,809	**₱47,507,943**	**₱3,917,482,752**

	2017				
	High grade	Standard Grade	Past due but not impaired	Impaired	Total
Due from BSP	₱47,321,849	₱–	₱–	₱–	₱47,321,849
Due from other banks	395,614,336	–	–	–	395,614,336
Receivable from customers:					
Microfinance loans	–	1,840,062,996	3,458,360	19,919,250	1,863,440,606
Other loans	–	219,049,141	544,628	2,515,219	222,108,988
Other receivables:					
Accrued interest receivable	–	27,333,746	–	–	27,333,746
Accounts receivable	–	189,707	–	–	189,707
UDSCL	–	53,266,902	–	–	53,266,902
Other assets:					
Refundable rental deposits	–	8,875,290	–	–	8,875,290
	₱442,936,185	₱2,148,777,782	₱4,002,988	₱22,434,469	₱2,618,151,424

As at December 31, 2018 and 2017, the Bank's microfinance loans that are past due for more than 90 days are considered impaired.

Aging analysis of past due but not impaired loans and receivables
The following tables show the total aggregate amount of loans and receivables that are contractually past due but not considered as impaired per delinquency bucket as at December 31, 2018 and 2017:

	2018			
	Less than 30 Days	**31 to 60 Days**	**61 to 90 Days**	**Total**
Microfinance loans	**₱990,221**	**₱3,640,197**	**₱3,130,973**	**₱7,761,391**
Other loans	**141,447**	**282,663**	**666,922**	**1,091,032**
	₱1,131,668	**₱3,922,860**	**₱3,797,895**	**₱8,852,423**

	2017			
	Less than 30 Days	31 to 60 Days	61 to 90 Days	Total
Microfinance loans	₱717,780	₱1,382,831	₱1,357,749	₱3,458,360
Other loans	91,860	218,336	234,432	544,628
	₱809,640	₱1,601,167	₱1,592,181	₱4,002,988

Carrying amount per class of loans and receivables which terms have been renegotiated
Restructured receivables have principal terms and conditions that have been modified in accordance with an agreement setting forth a new plan of payment or a schedule of payment on a periodic basis. When the receivable account becomes past due and is being restructured or extended, the approval of the BOD is required before loan booking and is always governed by the BSP rules on restructuring. No loans were restructured as at December 31, 2018 and 2017.

Market Risk
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 financial instruments of the Bank have fixed interest rates, and are therefore not subject to any interest rate risk.

Interest rate risk
The Bank has floating or variable interest rates from Held-to-maturity investments, however, management assessed that the Bank's exposure to changes in interest rate risk is immaterial.

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 Bank's ALCO 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. Core deposits composed mainly of pledge savings.

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 Bank 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.

The tables below summarize the maturity profile of the financial instruments of the Bank based on contractual undiscounted cash flows:

	2018					
	On demand	**Due within 1 month**	**1 to 3 months**	**3 to 12 months**	**Beyond 1 year**	**Total**
Financial Assets						
Cash and other cash items	**₱7,871,827**	**₱–**	**₱–**	**₱–**	**₱–**	**₱7,871,827**
Due from BSP	**74,342,915**	**–**	**–**	**–**	**–**	**74,342,915**
Due from other banks	**181,319,354**	**437,177,127**	**20,155,000**	**–**	**–**	**638,651,481**
Loans and receivable	**19,443,363**	**164,495,014**	**1,894,815,531**	**3,870,304**	**–**	**3,149,727,898**
Investment securities at amortized cost	**–**	**296,291**	**216,453**	**5,691,213**	**34,812,014**	**41,015,971**
Other assets	**–**	**–**	**–**	**11,262,255**	**2,482,232**	**13,744,487**
Total Financial Assets	**282,977,459**	**601,968,432**	**1,087,475,139**	**1,911,768,999**	**41,164,550**	**3,925,354,579**
Financial Liabilities						
Deposit liabilities	**850,185,938**	**233,325,249**	**311,797,805**	**685,069,707**	**307,002,863**	**2,387,381,562**
Bills payable	**–**	**–**	**232,500,000**	**547,500,000**		**780,000,000**
Other liabilities:						
Accrued interest payable	**–**	**1,927,367**	**3,395,899**	**2,467,139**	**3,802,064**	**11,592,469**
Accounts payable	**5,033,726**	**2,694,194**	**–**	**–**	**–**	**7,727,920**
Dividends payable	**57,672**	**–**	**–**	**–**	**–**	**57,672**
Total Financial Liabilities	**855,277,336**	**237,946,810**	**547,693,704**	**1,235,036,846**	**310,804,927**	**3,186,759,623**
Net	**(₱572,299,877)**	**₱364,021,622**	**₱539,781,435**	**₱676,732,153**	**(₱269,640,377)**	**₱738,594,956**

	2017					
	On demand	Due within 1 month	1 to 3 months	3 to 12 months	Beyond 1 year	Total
Financial Assets						
Cash and other cash items	₱2,209,287	₱–	₱–	₱–	₱–	₱2,209,287
Due from BSP	47,321,849	–	–	–	–	47,321,849
Due from other banks	181,484,046	115,078,025	99,379,623	–	–	395,941,694
Loans and receivable	24,538,911	57,936,845	405,046,082	1,609,593,936	46,647,434	2,143,763,208
Other Assets					8,875,290	8,875,290
Total Financial Assets	255,554,093	173,014,870	504,425,705	1,609,593,936	55,522,724	2,598,111,328
Financial Liabilities						
Deposit liabilities	945,663,224	12,221,160	60,166,179	63,493,455	467,457,523	1,549,001,541
Bills payable	–	12,691,667	202,403,845	293,538,550	–	508,634,062
Other liabilities:						
Accrued other expenses	–	13,214,780	–	–	–	13,214,780
Accrued interest payable	–	–	5,304,870	–	–	5,304,870
Accounts payable	4,441,514	–	–	–	–	4,441,514
Dividends payable	13,147	–	–	–	–	13,147
Total Financial Liabilities	950,117,885	38,127,607	267,874,894	357,032,005	467,457,523	2,080,622,429
Net	(₱694,563,792)	₱134,887,263	₱236,550,811	₱1,252,561,931	(₱411,934,799)	₱517,501,414

6. Due from BSP and Other Banks

The 'Due from BSP' account represents the aggregate balance of non-interest-bearing peso deposit account with the BSP which the Bank maintains primarily to meet reserve requirements and to serve as a clearing account for interbank claims.

Due from other banks represent funds deposited with domestic banks which are used by the Bank as part of its working funds. These deposits earn interest at annual rates ranging from 0.25% to 7.00% and from 0.10% to 2.00% in 2018 and 2017, respectively.

7. **Loans and Receivables and Investment Securities at Amortized Cost**

Loans and Receivables

This account consists of:

	2018	2017
Loans and receivables		
Microfinance loans	**₱2,745,682,924**	₱1,863,440,606
Other loans	**338,286,003**	222,108,988
	3,083,968,927	2,085,549,594
UDSCL	–	53,266,902
Accrued interest receivable	**62,888,938**	27,333,746
Accounts receivable (Note 19)	**2,870,033**	189,707
	3,149,727,898	2,166,339,949
Less allowance for credit losses	**32,897,156**	44,238,383
	₱3,116,830,742	₱2,122,101,566

Interest income on loans and receivables follow:

	2018	2017
Loans and receivables	**₱1,231,160,619**	₱788,425,094
UDSCL	–	684,728
	₱1,231,160,619	₱789,109,822

Microfinance and other loans carry annual effective interest rates ranging from 33.47% to 50.47% in 2018 and 2017.

BSP Reporting
In accordance with BSP regulations, the Bank considers a loan as part of portfolio-at-risk (PAR) when an installment payment is past due for one day. As at December 31, 2018 and 2017, the Bank's PAR amounted to ₱47.51 million and ₱26.43 million, respectively. The allowance for credit losses recognized for past due loans amounted to ₱14.98 million and ₱23.65 million as of December 31, 2018 and 2017, respectively.

As of December 31, 2018 and 2017, nonperforming loans (NPLs) based on Circular No. 941 and as reported to the BSP amounted to ₱47.51 million and ₱26.43 million, respectively.

Generally, NPLs refer to loans whose principal and/or interest are unpaid after due date or after they have become past due in accordance with existing BSP rules and regulations. This shall apply to loans receivable in lump sum and loans receivable in quarterly, semi-annual, or annual installments, in which case, the total outstanding balance thereof shall be considered nonperforming.

In the case of loans that are payable in monthly installments, the total outstanding balance thereof shall be considered nonperforming when three or more installments are in arrears.

In the case of loans that are payable in daily, weekly, or semi-monthly installments, the total outstanding balance thereof shall be considered nonperforming at the same time that they become past due in accordance with existing BSP regulations, i.e., the entire outstanding balance of the receivable shall be considered as past due when the total amount of arrearages reaches ten percent (10.00%) of the total receivable balance.

In the case of microfinance loans, past due/PAR accounts shall be considered as NPL. Loans are classified as nonperforming in accordance with BSP regulations, or when, in the opinion of management, collection of interest is doubtful. Loans are not reclassified as performing until interest and principal payments are brought to current or the loans are restructured in accordance with existing BSP regulations, and future payments appear assured.

The following table shows the secured and unsecured portions of receivable from customers as at December 31, 2018 and 2017 (at gross amount):

	2018	2017
Secured portion		
Deposit hold-out	**₱731,316,104**	₱495,146,778
Unsecured portion	**2,352,652,823**	1,590,402,816
	₱3,083,968,927	₱2,085,549,594

Collateral of loans includes deposit hold-out at 15.00% of loan disbursed (Note 10).

As at December 31, 2018 and 2017, information on the concentration of receivables from customers as to industry follows (at gross amount):

	2018		2017	
	Amount	**%**	Amount	%
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	**₱1,380,640,773**	**44.77%**	₱824,843,001	39.55%
Agriculture, hunting and forestry	**530,608,213**	**17.21%**	355,118,846	17.03%
Real estate activities	**358,119,509**	**11.61%**	274,737,316	13.17%
Accommodation and food service activities	**265,597,120**	**8.61%**	125,197,796	6.00%
Education	**126,485,417**	**4.10%**	98,033,357	4.70%
Manufacturing	**125,179,946**	**4.06%**	149,465,343	7.17%
Fishing	**99,849,011**	**3.24%**	84,901,134	4.07%
Transportation and storage	**50,484,294**	**1.64%**	58,338,796	2.80%
Human health and social work activities	**41,244,079**	**1.34%**	27,152,807	1.30%
Information and communication	**33,151,122**	**1.07%**	33,411,940	1.60%
Construction	**18,765,481**	**0.60%**	3,019,597	0.14%
Administrative and support service activities	**16,877,917**	**0.55%**	14,751,872	0.71%
Water supply, sewerage, waste management and remediation activities	**14,796,328**	**0.48%**	15,836,867	0.76%
Arts, entertainment and recreation	**12,419,226**	**0.40%**	4,622,426	0.22%
Professional, scientific and technical services	**6,114,368**	**0.20%**	5,887,460	0.28%
Other services activities	**3,636,123**	**0.12%**	10,231,036	0.49%
	₱3,083,968,927	**100.00%**	₱2,085,549,594	100.00%

The BSP considers that loan concentration exists when total loan exposure to a particular industry or economic sector exceeds 30.00% of total loan portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

The movements in the allowance for credit losses follow:

	2018	2017
Balance at beginning of year	**₱44,238,383**	₱34,554,432
PFRS 9 ECL transition adjustment (Note 2)	**(33,911,891)**	–
Provisions	**23,427,828**	11,465,405
Write-offs	**(857,163)**	(1,781,454)
Balance at end of year	**₱32,897,156**	₱44,238,383

The tables below illustrate the movements of the allowance for impairment and credit losses during the year (effect of movements in ECL due to transfers between stages are shown in the total column):

	2018		
	ECL Staging		
	Stage 1 12-month ECL	**Stage 3** Lifetime ECL	**Total**
Loss allowance at January 1, 2018, as restated	**₱3,268,306**	**₱7,564,182**	**₱10,832,488**
Movements with P&L impact			
Transfers:			
Transfer from Stage 1 to Stage 3	**(18,713)**	**18,713**	–
Transfer from Stage 3 to Stage 1	–	–	–
New financial assets originated or purchased	**19,365,241**	**9,906,621**	**29,271,863**
Changes in PDs/LGDs/EADs	**(4)**	**2,199,965**	**2,199,961**
Financial assets derecognized during the period	**(8,549,993)**	**(10,326,491)**	**(18,876,484)**
Total net P&L charge during the period	**14,064,837**	**9,362,990**	**23,427,828**
Other movements without P&L impact			
Write-offs and other movements	–	**9,469,328**	**9,469,328**
Total movements without P&L impact	–	**9,469,328**	**9,469,328**
Loss allowance at December 31, 2018	**₱14,064,837**	**₱18,832,318**	**₱32,897,156**

The movements in gross carrying amount of receivables from customers between stages follow:

	2018		
	ECL Staging		
	Stage 1 **12-month ECL**	**Stage 3** **Lifetime ECL**	**Total**
Gross carrying amount as at January 1, 2018	**₱2,088,168,260**	**₱28,310,762**	**₱2,116,479,022**
Transfers:			
Transfer from Stage 1 to Stage 3	**(8,479,471)**	**8,479,471**	–
Transfer from Stage 3 to Stage 1	–	–	–
New financial assets originated or purchased	**3,718,114,926**	**31,682,199**	**3,749,797,125**
Movements in outstanding balances	–	**(4,102,889)**	**(4,102,889)**
Financial assets derecognized during the period	**(2,702,842,165)**	**(13,294,977)**	**(2,716,137,142)**
Write-offs and other movements	–	**(857,163)**	**(857,163)**
Gross carrying amount as at December 31, 2018	**₱3,094,961,550**	**₱50,217,403**	**₱3,145,178,953**

While the Bank recognizes through the statements of income the movements in the expected credit losses computed using the models, the Bank also complies with BSP's regulatory requirement to appropriate a portion of its surplus at an amount necessary to bring to at least 1% the allowance for credit losses on loans. In 2018, the amount of surplus reserve for this purpose increased by ₱26.70 million.

Investment securities at Amortized Cost

As at December 31, 2018, investment securities at amortized cost consist of the following:

	2018
Agrarian Reform 10-year bond	₱35,015,971
Small Business Corporation (SBC)	6,000,000
	₱41,015,971

Agrarian reform bonds pertain to long-term certificates issued by the National Government and earn annual interest rates of 2.15% to 2.25% in 2018 and 2017.

Investments in SBC pertain to non-negotiable Micro, Small and Medium Enterprise Notes with annual interest rate of 2.00% and 1.98% to 2.57% for 2018 and 2017, respectively, subject to annual repricing.

In 2018, interest income on investment securities at amortized cost amounted to ₱2.05 million.

8. Property and Equipment

The composition of and movements in this account follow:

2018

	Land	**Building**	**Furniture, Fixtures and Equipment**	**Information Technology Equipment**	**Transportation Equipment**	**Leasehold Improvements**	**Construction in Progress**	**Total**
Cost								
Balance at beginning of year	**₱20,030,959**	**₱29,981,083**	**₱30,566,994**	**₱6,113,992**	**₱214,417**	**₱36,292,787**	**₱537,816**	**₱123,738,048**
Additions	–	–	**14,252,520**	**3,403,241**	–	**299,472**	**28,978,006**	**46,933,239**
Reclassification	–	–	**(23,490)**	**23,490**	–	**21,778,238**	**(21,778,238)**	–
Disposals	–	–	**(28,900)**	–	–	–	–	**(28,900)**
Balance at end of year	**20,030,959**	**29,981,083**	**44,767,124**	**9,540,723**	**214,417**	**58,370,497**	**7,737,584**	**170,642,387**
Accumulated Depreciation								
Balance at beginning of year	–	**8,204,594**	**16,427,751**	**2,608,238**	**214,416**	**6,135,108**	–	**33,590,107**
Depreciation	–	**3,033,073**	**8,508,354**	**1,853,214**	–	**9,016,861**	–	**22,411,502**
Reclassification	–	–	**(653)**	**653**	–	–	–	–
Disposals	–	–	**(28,900)**	–	–	–	–	**(28,900)**
Balance at end of year	–	**11,237,667**	**24,906,552**	**4,462,105**	**214,416**	**15,151,969**	–	**55,972,709**
Net Book Value	**₱20,030,959**	**₱18,743,416**	**₱19,860,572**	**₱5,078,618**	**₱1**	**₱43,218,528**	**₱7,737,584**	**₱114,669,678**

2017

	Land	Building	Furniture, Fixtures and Equipment	Information Technology Equipment	Transportation Equipment	Leasehold Improvements	Construction in Progress	Total
Cost								
Balance at beginning of year	₱20,030,959	₱28,881,083	₱21,061,413	₱4,143,427	₱214,417	₱12,267,539	₱–	₱86,598,838
Additions	–	–	9,660,707	2,034,565	–	240,000	25,423,064	37,358,336
Reclassification	–	1,100,000	–	–	–	23,785,248	(24,885,248)	–
Disposals	–	–	(155,126)	(64,000)	–	–	–	(219,126)
Balance at end of year	20,030,959	29,981,083	30,566,994	6,113,992	214,417	36,292,787	537,816	123,738,048
Accumulated Depreciation								
Balance at beginning of year	–	5,228,813	9,901,487	1,572,216	214,416	2,401,021	–	19,317,953
Depreciation	–	2,975,781	6,680,737	1,100,675	–	3,734,087	–	14,491,280
Disposals	–	–	(154,473)	(64,653)	–	–	–	(219,126)
Balance at end of year	–	8,204,594	16,427,751	2,608,238	214,416	6,135,108	–	33,590,107
Net Book Value	₱20,030,959	₱21,776,489	₱14,139,243	₱3,505,754	₱1	₱30,157,679	₱537,816	₱90,147,941

As of December 31, 2018 and 2017, the cost of fully depreciated property and equipment that are still in use amounted to ₱14.30 million and ₱6.23 million, respectively.

9. Other Assets

This account consists of:

	2018	2017
Financial assets		
Refundable rental deposits	**₱13,744,487**	₱8,875,290
Nonfinancial assets		
Prepaid expenses (Note 19)	**41,354,011**	1,347,215
Stationery and supplies on hand	**14,662,281**	11,375,485
Prepaid rent	**5,195,315**	2,974,628
	61,211,607	15,697,328
	₱74,956,094	₱24,572,618

Prepaid expenses include advance lease payments of office and IT equipment from CARD Leasing and Finance Corporation (CLFC), as well as IT services from CARD MRI Information Technology, Inc. (CMIT). Prepaid rent pertains to advances paid on lease of offices.

No impairment loss was recognized on other assets in 2018 and 2017.

10. Deposit Liabilities

The Bank's deposit liabilities include regular savings amounting to ₱1.89 billion and ₱1.15 billion as at December 31, 2018 and 2017, respectively. These mostly comprise of the ₱50.00 per week aggregate compulsory savings collected from each member/nonmember/borrower plus any voluntary deposit. Under an assignment agreement, the "pledge" savings balances serve as security for loans granted by the Bank to its members. The "pledge" savings earn annual interest of 2.00% in 2018 and 2017. In 2018 and 2017, a member/borrower is required to maintain a pledge savings balance equivalent to 15.00% of the original loan amount (Note 7).

Other regular savings accounts are "Kusang-ipon", "Tagumpay", "Agap-ipon" and "Katuparan" savings deposit accounts which cater to non-members and Bank employees, and carry interest rates of 1.50% and 5.00%, respectively.

Special savings deposits have interest rates ranging from 2.00% to 4.25% in 2018 and 2017.

Interest expense on deposit liabilities are as follows:

	2018	2017
Regular savings deposits	**₱43,709,618**	₱15,733,102
Special savings deposit	**595,520**	12,828,359
Balance at end of year	**₱44,305,138**	₱28,561,461

Circular No. 830 of the BSP prescribes 5.00% and 3.00% reserve requirements on demand and savings deposits, respectively.

As of December 31, 2018 and 2017, available reserves pertain to Due from BSP of ₱74.34 million and ₱47.32 million, respectively. The Bank is compliant with the applicable reserve requirements on demand and savings deposits, respectively.

11. Bills Payable and Other Liabilities

Bills Payable
Bills payable represents borrowings from financing institutions which are subject to certain terms and conditions and bears annual nominal interest rates ranging from 3.80% to 7.25% in 2018 and from 2.875% to 7.25% in 2017. Maturity period for the outstanding bills payable ranges from six months to one year and three months to one year in 2018 and 2017, respectively.

The composition of and movements in this account follow:

	2018	2017
Face value		
Balance at beginning of year	**₱500,000,000**	₱440,000,000
Availments	**910,000,000**	580,000,000
Principal payments	**(630,000,000)**	(520,000,000)
Balance at end of year	**780,000,000**	500,000,000
Unamortized transaction cost		
Balance at beginning of year	**1,976,410**	1,558,440
Availments	**6,634,110**	2,854,520
Amortization	**(4,045,311)**	(2,436,550)
Balance at end of year	**4,565,209**	1,976,410
Carrying value	**₱775,434,791**	₱498,023,590

Other Liabilities
This account consists of the following:

	2018	2017
Financial liabilities:		
Accrued other expenses	**₱26,233,520**	₱13,214,781
Accrued interest payable	**11,592,469**	5,304,870
Accounts payable (Note 19)	**7,727,920**	4,441,514
Dividends payable	**57,672**	13,146
	45,611,581	22,974,311
Nonfinancial liabilities:		
Gross receipt taxes payable	**18,549,621**	3,570,100
Accrued leaves	**8,982,410**	8,982,410
Withholding taxes payable	**2,198,412**	2,418,208
Documentary stamp taxes payable	**463,699**	213,555
	30,194,142	15,184,273
	₱75,805,723	₱38,158,584

Accounts payable include due to suppliers and contractors, regulatory bodies, employees and related parties.

Accrued other expenses include accrued rent and other operating expenses.

12. 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 one year from statement of financial position dates:

	2018			2017		
	Within One Year	Beyond One Year	**Total**	Within One Year	Beyond One Year	Total
Financial Assets						
Cash and other cash items	**₱7,871,827**	**₱–**	**₱7,871,827**	₱2,209,287	₱–	₱2,209,287
Due from BSP	**74,342,915**	–	**74,342,915**	47,321,849	–	47,321,849
Due from other banks	**638,651,481**	–	**638,651,481**	395,614,336	–	395,614,336
Loans and receivables	**3,129,284,264**	**20,443,634**	**3,149,727,898**	2,118,760,476	47,579,473	2,166,339,949
Investment securities at amortized cost	**5,354,275**	**35,376,266**	**41,015,971**	–	–	–
Other assets (Note 9)	–	**13,744,487**	**13,744,487**	–	8,875,290	8,875,290
Nonfinancial Assets				–		–
Property and equipment	–	**170,642,388**	**170,642,387**	–	123,738,048	123,738,048
Retirement asset	–	**34,564,180**	**34,564,180**	–	30,213,290	30,213,290
Deferred tax assets	–	**6,729,264**	**6,729,264**	–	11,904,261	11,904,261
Other assets (Note 9)	**56,016,292**	**5,195,315**	**61,211,607**	15,697,328	–	15,697,328
Total Assets	**₱3,911,806,484**	**₱286,695,533**	**₱4,198,502,017**	₱2,579,603,276	₱222,310,362	₱2,801,913,638
Allowance for credit and impairment losses			**(32,897,156)**			(44,238,383)
Accumulated depreciation and Amortization			**(55,972,709)**			(33,590,107)
			₱4,109,632,151			₱2,724,085,148
Financial Liabilities						
Deposit liabilities	**₱2,087,578,790**	**₱299,802,772**	**₱2,387,381,562**	₱1,325,492,147	₱200,939,476	₱1,526,431,623
Bills payable	**775,434,791**	–	**775,434,791**	498,023,590	–	498,023,590
Other liabilities (Note 11)	**44,354,802**	**1,256,778**	**45,611,581**	21,424,794	1,549,517	22,974,311
Deposit for future stock subscription	–	–	–	51,592,800	–	51,592,800
Nonfinancial Liabilities						
Income tax payable	**45,099,406**	–	**45,099,406**	35,986,373	–	35,986,373
Other liabilities (Note 11)	**21,211,732**	**8,982,410**	**30,194,142**	6,201,863	8,982,410	15,184,273
Total Liabilities	**₱2,973,679,521**	**₱310,041,961**	**₱3,283,721,482**	₱1,938,721,567	₱211,471,403	₱2,150,192,970

13. Equity

Capital Stock

The Bank's authorized capital stock amounted to ₱250.00 million, consisting of 2,000,000 shares of common stock with par value of ₱100 per share and 250,000 private preferred shares with par value of ₱200 per share.

As at December 31, 2018 and 2017, the Bank's capital stock consists of:

	2018		2017	
	Shares	**Amount**	Shares	Amount
Common stock - ₱100 par value, 4,000,000 authorized shares				
Common stock at the beginning of the year	**1,983,954**	**₱198,395,400**	1,772,732	₱177,273,200
Application of DFS subscription to issued shares	**515,928**	**51,592,800**	–	–
Issuance of shares	**109,072**	**10,907,200**	–	–
Issuance of shares of stocks from settlement of subscriptions receivable	**16,046**	**1,604,600**	211,222	21,122,200
Issuance of stock dividend	**787,496**	**78,749,600**	–	–
Common stock at the end of the year	**3,412,496**	**341,249,600**	1,983,954	198,395,400
Subscribed	–	–	16,046	1,604,600
Subscription receivable	–	–	–	(1,604,600)
	3,412,496	**₱341,249,600**	2,000,000	₱198,395,400

	2018		2017	
	Shares	**Amount**	Shares	Amount
Preferred stock - ₱200 par value, 500,000 authorized shares				
Preferred stock at the beginning of the year	**250,000**	**₱50,000,000**	185,017	₱37,003,400
Issuance of shares	**20,000**	**4,000,000**	64,983	12,996,600
Preferred stock at the end of the year	**270,000**	**₱54,000,000**	250,000	₱50,000,000

Preferred shares have the following features: (a) cumulative, (b) non-voting, and (c) non-redeemable. Preferred shareholders shall be entitled to a dividend rate of eight percent (8.00%) per annum or whatever is determined by the BOD. As of December 31, 2018 and 2017, cumulative dividends preferred shares amounted to ₱4.32 million and ₱4.00 million, respectively.

In 2017, the Bank issued 64,983 preferred shares at par amounting to ₱13.00 million. In addition, the Bank's collections from subscriptions receivable on common shares amounted to ₱1.60 million and ₱21.12 million in 2018 and 2017, respectively.

In 2018, the Bank issued 625,000 common shares and 20,000 preferred shares at par amounting to ₱62.50 million and ₱4.00 million, respectively.

Deposit for Future Stock Subscriptions

On May 14, 2016, the BOD and the stockholders approved and ratified the increase in the Bank's capitalization from ₱250.00 million to ₱500.00 million by increasing its authorized common and preferred stock by 2.00 million and 0.25 million, respectively. As at October 5, 2018, the Bank received the approval of its application for increase in authorized capital stock with the SEC.

Deposit for future stock subscriptions pertains to total consideration received in excess of the authorized capital of the Bank with the purpose of applying the same as payment for future issuance of shares. Deposit for future stock subscriptions of ₱51.59 million was classified under liabilities as of December 2017 in accordance with the requirement of SEC Financial Reporting Bulletin No. 006, as discussed in Note 2 to the financial statements. As at December 31, 2018, the Bank's DFS met the foregoing provisions and is treated as equity.

Dividends

On December 8, 2018, the BOD declared stocks dividends of ₱30.00 per share to common stockholders. Stocks dividends declared amounting to ₱78.750 million for common stockholders were issued starting December 17, 2018 to stockholders of record as at November 30, 2018.

On November 10, 2018, the BOD declared cash dividends of 16.00% of outstanding preferred stock balance and ₱25.00 per share to common stockholders. Cash dividends declared amounting to ₱65.63 million and ₱8.64 million for common stockholders and preferred stockholders, respectively, were paid starting November 14, 2018 to stockholders of record as at October 31, 2018.

On July 14, 2018, the BOD declared cash dividends of 16.00% of outstanding preferred stock balance and ₱25.00 per share to common stockholders. Cash dividends declared amounting to ₱50.00 million and ₱8.00 million for common stockholders and preferred stockholders, respectively, were paid starting July 20, 2018 to stockholders of record as at June 30, 2018.

On April 14, 2018, the BOD declared cash dividends of 16.00% of outstanding preferred stock balance and ₱30.00 per share to common stockholders. Cash dividends declared amounting to ₱60.00 million and ₱8.00 million for common stockholders and preferred stockholders, respectively, were paid starting April 20, 2018 to stockholders of record as at March 31, 2018.

On March 11, 2017, the BOD declared cash dividends of 8.00% of outstanding preferred stock balance and ₱15.00 per share to common stockholders. Cash dividends declared amounting to ₱30.00 million and ₱3.03 million for common stockholders and preferred stockholders, respectively, were paid starting March 22, 2017 to stockholders of record as at February 28, 2017.

On June 10, 2017, the BOD declared another cash dividend of 8.00% of outstanding preferred stock balance and ₱20.00 per share to common stockholders. Cash dividends declared amounting to ₱40.00 million and ₱3.25 million for common stockholders and preferred stockholders, respectively, were paid starting June 13, 2017 to stockholders of record as at May 31, 2017

On October 14, 2017, the BOD declared another cash dividend of 8.00% of outstanding preferred stock balance and ₱25.00 per share to common stockholders. Cash dividends declared amounting to ₱50.00 million and ₱4.00 million for common stockholders and preferred stockholders, respectively, were paid starting October 30, 2017 to stockholders of record as at September 30, 2017.

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 on the capital management objectives, policies and processes from previous years.

Regulatory Qualifying Capital

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

BSP Circular No. 688, Revised Risk-Based Capital Adequacy Framework for stand-alone thrift banks, rural banks and cooperative banks which took effect on January 1, 2012 represents BSP's commitment to align existing prudential regulations with international standards, which is consistent with the BSP's goal of promoting the soundness and stability of individual banks and of the banking system as a whole.

Under current banking regulations, the combined capital accounts of each bank should not be less than an amount equal to ten percent (10.00%) of its risk assets. The qualifying capital of the Bank for purposes of determining the capital-to-risk assets ratio to total equity excludes:

- unbooked valuation reserves and other capital adjustments as may be required by the BSP;
- total outstanding unsecured credit accommodations to directors, officers, stakeholders and related interests (DOSRI);
- deferred tax asset or liability; and
- other regulatory deductions.

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

Under BSP Circular No. 360, effective July 1, 2003, the risk-based capital adequacy ratio (CAR) is to be inclusive of a market risk charge. BSP Circular No. 560 dated January 31, 2007 which took effect on February 22, 2007, requires the deduction of unsecured loans, other credit accommodations and guarantees granted to subsidiaries and affiliates from capital accounts for purposes of computing CAR.

On October 9, 2014, BSP issued the Circular No. 854, which states that rural banks with head offices in areas outside the National Capital Region and with up to ten branches are required to comply with the minimum capital requirement of ₱30.00 million. As at December 31, 2018 and 2017, the Bank is in compliance with the capitalization requirement.

Under BSP Circular No. 854, regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, surplus including current year profit less accrued dividends, net long positions in own shares and goodwill. The other component of regulatory capital is Tier 2 capital, which includes revaluation reserves. Certain adjustments are made to PFRS-based results and reserves, as prescribed by the BSP.

The CAR of the Bank as at December 31, 2018 and 2017, as reported to the BSP, is shown in the table below (amounts in millions):

	2018	2017
Tier 1 capital	**₱711.69**	₱488.56
Tier 2 capital	**84.36**	73.98
Total qualifying capital	**₱796.05**	₱562.54
Risk weighted assets	**₱4,265.95**	₱2,849.88
Tier 1 capital ratio	**16.68%**	17.14%
Tier 2 capital ratio	**1.98%**	2.60%
Total CAR	**18.66%**	19.74%

As of December 31, 2018 and 2017, the Bank's CAR is in compliance with the regulatory requirements.

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios adopted by the BSP in supervising the Bank.

The amount of surplus funds available for dividend declaration is determined also on the basis of regulatory net worth after considering certain adjustments.

Covered banks and quasi-banks are enjoined to consider the forthcoming regulatory changes in capital planning exercises and conduct preliminary assessments of the likely impact of the changes.

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

	2018	2017
Return on average equity	**56.09%**	46.28%
Return on average assets	**12.13%**	10.96%
Net interest margin	**38.03%**	35.13%

14. Compensation and Benefits

This account consists of:

	2018	2017
Salaries and wages	**₱136,160,516**	₱89,338,024
Employee benefits	**112,871,609**	75,015,309
Retirement expense (Note 15)	**3,769,246**	6,287,394
Other short-term benefits	**14,790,901**	9,658,685
	₱267,592,272	₱180,299,412

Other short term benefits pertain to the Bank's share in contribution to employee's SSS, and health benefit plans.

15. Retirement Plan

The Bank, CARD Bank, Inc., CARD MRI Development Institute, Inc., CARD Mutual Benefit Association, Inc., CARD SME Bank, Inc., CARD MRI Insurance Agency, Inc., CARD Business Development Service Foundation, Inc., CMIT, CARD Employees Multi-Purpose Cooperative, Responsible Investments for Solidarity and Empowerment Financing Co., BotiCARD Inc., CLFC, CARD, Inc., Mga Likha ni Inay Inc., CARD MRI Property Holdings Inc., CARD MRI Publishing House Inc. and CARD MRI Hijos Tours 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 and CARD Group Employees' Retirement Plan (Hybrid Plan) applicable to employees hired on or after July 1, 2016. MERP and Hybrid Plan comply with the requirements of Republic Act No. 7641, *Retirement Pay Law.*

MERP is valued using the projected unit cost method and is financed solely by the Bank and its related parties. MERP provides lump sum benefits equivalent to up to 120% 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 voluntary separation after completion of at least one year of service with the participating companies.

In addition to the Bank's defined benefit retirement plan, the Bank also operates defined contribution plan referred to as "Hybrid Plan" which provides a retirement benefit equal to 100% of the member's employer accumulated value (the Bank's contributions of 8% plan salary to Fund A plus credited earnings) and 100% of the member's employee accumulated value (member's own contributions up to 10% of plan salary to Fund B plus credited earnings), if any, provided that in no case shall 100% of the employee accumulated value in Fund A be less than 100% of plan salary for every year of credited service.

Employee benefits include expenses recorded related to the Hybrid Plan amounting to ₱3.86 million and ₱1.57 million in 2018 and 2017.

The date of the latest actuarial valuation report for MERP is December 31, 2018.

Changes in retirement asset in 2018 and 2017 are as follow:

	2018												
		Net benefit cost in statement of income					Remeasurements in other comprehensive income						
	January 1	Current service cost	Net interest	Subtotal	Transfer to the Plan net of benefits paid	Benefits paid from plan assets	Return on plan assets (excluding amount included in net interest)	Actuarial changes arising from changes in the effect of asset ceiling	Actuarial changes arising from changes in demographic assumptions	Actuarial changes arising from changes in financial assumptions	Subtotal	Contribution by employer	December 31
Fair value of plan assets	**₱85,959,848**	**₱–**	**₱5,135,827**	**₱5,135,827**	**₱4,202,024**	**(₱1,960,948)**	**(₱518,789)**	**₱–**	**₱–**	**₱–**	**₱1,722,287**	**₱3,857,498**	**₱96,675,460**
Present value of defined benefit obligation	**(49,331,213)**	**(5,688,497)**	**(2,846,411)**	**(8,534,908)**	**(4,202,024)**	**1,960,948**	**(6,731,597)**	**–**	**1,227,013**	**15,145,703**	**7,400,043**	**–**	**(50,466,078)**
Asset ceiling	**(6,415,345)**	**–**	**(370,165)**	**(370,165)**	**–**	**–**	**–**	**(4,859,692)**	**–**	**–**	**(4,859,692)**	**–**	**(11,645,202)**
Net defined benefit asset (liability)	**₱30,213,290**	**(₱5,688,497)**	**₱1,919,251**	**(₱3,769,246)**	**₱–**	**₱–**	**(₱7,250,386)**	**(₱4,859,692)**	**₱1,227,013**	**₱15,145,703**	**₱4,262,638**	**₱3,857,498**	**₱34,564,180**

	2017											
		Net benefit cost in statement of income				Remeasurements in other comprehensive income						
	January 1	Current service cost	Net interest	Subtotal	Transfer to the Plan net of benefits paid	Return on plan assets (excluding amount included in net interest)	Actuarial changes arising from changes in the effect of asset ceiling	Actuarial changes arising from changes in demographic assumptions	Actuarial changes arising from changes in financial assumptions	Subtotal	Contribution by employer	December 31
Fair value of plan assets	₱65,738,965	₱–	₱4,331,760	₱4,331,760	₱10,635,546	(₱746,423)	₱–	₱–	₱–	₱9,889,123	₱6,000,000	₱85,959,848
Present value of defined benefit obligation	(46,519,664)	(6,205,159)	(2,726,052)	(8,931,211)	(10,635,546)	(735,079)	–	717,045	16,773,242	6,119,662	–	(49,331,213)
Asset ceiling	(2,059,328)	–	(120,677)	(120,677)	–	–	(4,235,340)	–	–	(4,235,340)	–	(6,415,345)
Net defined benefit asset (liability)	₱17,159,973	(₱6,205,159)	₱1,485,031	(₱4,720,128)	₱–	(₱1,481,502)	(₱4,235,340)	₱717,045	₱16,773,242	₱11,773,445	₱6,000,000	₱30,213,290

In 2018 and 2017, net benefit cost is recognized under ‘Compensation and benefits’ in the statements of income.

The maximum economic benefit available is a combination of expected refunds from the plan and reductions in future contributions. The fair value of plan assets by each class as at December 31, 2018 and 2017 follows:

	2018	2017
Cash and cash equivalents	**₱48,395,735**	₱35,424,053
Government securities	**42,943,240**	43,641,815
Mutual fund	**5,336,485**	404,012
Loans and receivables	**−**	3,782,233
Other assets	**−**	2,707,735
Fair value of plan assets	**₱96,675,460**	₱85,959,848

All plan assets do not have quoted prices in an active market except for government bonds. Cash and cash equivalents are with reputable financial institutions and related parties and are deemed to be standard grade. Mutual fund, loans and other assets are unrated.

The plan assets have diverse investments and do not have any concentration risk other than those in government securities which are of low risk.

The overall investment policy and strategy of the Bank's defined benefit plans is guided by the objective of achieving an investment return which, together with contributions, ensures that there will be sufficient assets to pay pension benefits as they fall due while also mitigating the various risks of the plans.

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

	2018	2017
Discount rate		
January 1	**5.77%**	**5.86%**
December 31	**7.70%**	**5.77%**
Future salary increases	**5.00%**	**5.00%**

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

	2018		2017	
	Increase (decrease) in basis points	**Increase (decrease) in present value of obligation**	Increase (decrease) in basis points	Increase (decrease) in present value of obligation
Discount rates	**+100**	**(₱5,861,224)**	+100	(₱6,883,012)
	(100)	**7,113,445**	(100)	8,570,887
Future salary increases	**+100**	**7,239,435**	+100	8,020,097
	(100)	**(6,050,142)**	(100)	(6,597,039)

The Bank plans to contribute ₱9.26 million to the defined benefit retirement plan in 2019.

As at December 31, 2018, the average duration of defined benefit obligations is 12.9 years.

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

	2018	2017
More than 5 years to 10 years	**₱17,664,212**	₱31,444,277
More than 10 years to 15 years	**32,391,726**	26,432,056
More than 15 years to 20 years	**43,436,942**	53,854,917
More than 20 years to 25 years	**198,975,200**	208,739,358
More than 25 years	**487,995,255**	356,065,446

16. **Leases**

Office spaces
The Bank leases the premises occupied by some of its branches in which lease payments are subjected to escalation clauses from 5.00% to 20.00% starting on the second or third year of lease. The lease contracts are for the periods ranging from one to five years and are renewable upon mutual agreement between the Bank and the lessors.

Rent for office spaces recorded under 'Rent' in 2018 and 2017 amounted to ₱39.14 million and ₱24.12 million, respectively.

	2018	2017
Within one year	**₱43,504,796**	₱27,727,237
Beyond one year but not beyond five years	**58,558,303**	45,978,848
	₱102,063,099	₱73,706,085

Transportation and IT equipment
The Bank leases the transportation and IT equipment from CLFC. The lease contracts have a term of 18 months.

Lease for transportation and IT equipment recorded under 'Rent' amounted ₱15.38 million and ₱10.06 million in 2018 and 2017, respectively.

Future minimum rental lease payments on operating leases of the Bank are as follows:

	2018	2017
Within one year	**₱12,973,467**	₱6,387,200
Beyond one year but not beyond five years	**2,066,026**	851,640
	₱15,039,493	₱7,238,840

17. **Miscellaneous Expenses**

This account consists of:

	2018	2017
Postage, telephone, cables and telegrams	**₱3,577,810**	₱1,983,968
Repairs and maintenance	**1,158,407**	1,091,950
Program and monitoring	**624,809**	767,283
Advertising and publicity	**362,896**	67,368
Other expenses	**6,513,894**	4,619,404
	₱12,237,816	₱8,529,973

Other expenses include various expenses such as notarial and other legal expenses, bank charges, awards to top performing branches, expenditures related to the opening of the new branch and other small value expenses that are non-recurring.

18. **Income Taxes**

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

Income taxes include RCIT, as discussed below and final taxes paid at the rate of 20.00%, which is a final withholding tax on gross interest income from government securities and other deposit substitutes.

Republic Act No. 9337, *An Act Amending National Internal Revenue Code*, provides that the RCIT rate shall be 30.00%, and deductible interest expense shall be reduced by 33.00% of interest income subjected to final tax. Current tax regulations also provide for MCIT of 2.00% on modified gross income and allow a NOLCO. The MCIT and NOLCO may be applied against the Bank's income tax liability and taxable income, respectively, over a three-year period from the year of inception. Further, current tax regulations set a limit for entertainment, amusement and recreation (EAR) expenses that can be deducted for income tax purposes. EAR expenses are limited to 1.00% of net revenue for sellers of services. EAR expenses are presented under 'Miscellaneous expenses' in the statements of income. The Bank incurred no EAR expenses in 2018 and 2017.

Provision for income tax consists of:

	2018	201
Current:		
RCIT	**₱157,734,720**	₱100,200,529
Final tax	**2,024,611**	1,103,040
	159,759,331	101,303,569
Deferred	**(6,277,362)**	(2,770,916)
	₱153,481,969	₱98,532,653

As at December 31, 2018 and 2017, net deferred tax assets are as follows:

	2018	2017
Deferred tax assets		
Allowance for credit and impairment losses	**₱9,869,147**	₱13,271,515
Unamortized past service cost	**4,157,614**	4,795,057
Accumulated vacation leave credits	**2,694,723**	2,694,723
Accrued rent under PAS 17	**377,034**	206,953
	17,098,518	20,968,248
Deferred tax liability		
Retirement asset	**10,369,254**	9,063,987
	₱6,729,264	₱11,904,261

Deferred tax recognized in OCI amounted to a provision of ₱1.28 million and ₱3.53 million for the years ended December 31, 2018 and 2017, respectively. The Bank did not recognize deferred tax asset on monetized vacation leave credits amounting to ₱0.18 million in December 2018 and 2017.

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

	2018	2017
Statutory income tax	**₱153,281,727**	₱98,075,288
Income tax effects of:		
Interest income subject to final tax	**1,788,261**	(599,041)
Nondeductible expenses	**(1,588,019)**	873,066
Movements in unrecognized deferred taxes	**–**	183,340
Provision for income tax	**₱153,481,969**	₱98,532,653

19. **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. Entities are considered to be related if they are subjected under common control or significant influence. 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
- other related parties within the CARD-MRI Group.

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.

Transactions with Retirement Plans
Under PFRS, certain post-employment benefit plans are considered as related parties. CARD MRI's MERP is a stand-alone entity assigned in facilitating the contributions to retirement starting 2015. The plan assets are mostly invested in time deposits and special savings accounts and government bonds (Note 15). As at December 31, 2018 and 2017, the retirement funds do not hold or trade the Bank's shares of stock.

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

The compensation of key management personnel included under 'Compensation and benefits' in the statement of income are as follows:

	2018	2017
Short-term employee benefits	**₱4,554,671**	₱4,434,000
Post-employment benefits	**820,006**	421,839
	₱5,374,677	₱4,855,839

The Bank also provides banking services to directors and other key management personnel and persons connected to them. These transactions are presented in the tables that follow.

Other Related Party Transactions
Transactions between the Bank and its key management personnel meet the definition of related party transactions. Transactions between the Bank and related parties within the CARD-MRI, also qualify as related party transactions.

Loans receivable
As of December 31, 2018 and 2017, the Bank has no outstanding loan that was granted to related parties.

Deposit liabilities, accounts receivable and accounts payable
Deposit liabilities, accounts receivable and accounts payable held by the Bank for key management personnel, shareholder and other related parties as at December 31, 2018 and 2017 follow:

	December 31, 2018		
Category	**Amount/Volume**	**Outstanding Balance**	**Nature, Terms and Conditions**
Key management personnel			
Deposit liabilities		**₱7,141,480**	Consists of regular, tagumpay and special savings deposit account with annual interest rate of 1.50% and 5.00%, respectively.
Deposits	**₱16,331,153**		
Withdrawals	**9,189,673**		
Interest expense/payable	**84,051**		
Shareholders			
Deposit liabilities		**223,862,721**	Consists of regular savings deposit account with annual interest rate of 1.50% and special savings deposit and tagumpay savings account with annual interest rate ranging from 3.25% to 6.00%.
Deposits	**1,006,171,080**		
Withdrawals	**782,308,358**		
Interest expense/payable	**1,206,105**		
Accounts receivable		**978,940**	Pertains to shareholders' share in share in expenses still payable to the Bank.
Billings	**6,484,809**		
Collection	**5,505,869**		
Accounts payable		**666,092**	Pertains to share on various expenses.
Billings	**9,891,998**		
Payment	**9,450,028**		

(Forward)

Category	Amount/Volume	Outstanding Balance	Nature, Terms and Conditions
		December 31, 2018	
Affiliates			
Deposit liabilities		**₱513,478,843**	Consists of regular, savings, special savings deposit and tagumpay accounts with annual interest rate ranging from 1.50% to 6.00%.
Deposits	**₱557,628,523**		
Withdrawal	**44,149,680**		
Interest expense/payable	**2,974,519**		
Accounts receivable		–	Pertains to affiliates' share in share in expenses still payable to the Bank.
Billings	**492,698**		
Collections	**492,698**		
Prepaid expenses		**35,714,467**	Pertains to advance payment of annual fee for the Software as a Service agreement for the Core Banking System
Accounts payable		–	Pertains to share on various expenses.
Billings	**72,797,678**		
Payments	**72,797,678**		

Category	Amount/Volume	Outstanding Balance	Nature, Terms and Conditions
		December 31, 2017	
Key management personnel			
Deposit liabilities		₱2,271,636	Consists of regular and special savings deposit account with annual interest rate of 1.50% and 2.00%, respectively.
Deposits	₱9,576,730		
Withdrawals	7,665,303		
Interest expense/payable	48,630	–	
Shareholders			
Deposit liabilities		170,384,186	Consists of regular savings deposit account with annual interest rate of 1.50% and special savings deposit account with annual interest rate ranging from 3.25% to 4.25%.
Deposits	355,995,145		
Withdrawals	297,187,685		
Interest expense/payable	481,201	–	
Accounts receivable		–	Pertains to shareholders' share in share in expenses still payable to the Bank.
Billings	786,081		
Collection	787,796		
Accounts payable		224,122	Pertains to share on various expenses.
Billings	6,630,341		
Payment	6,406,219		
Affiliates			
Deposit liabilities		₱386,054,345	Consists of checking, savings and special savings deposit accounts with annual interest rate ranging from 1.50% to 5.00%.
Deposits	202,500,307		
Withdrawal	68,915,994		
Interest expense/payable	9,383,761	–	
Accounts receivable		–	Pertains to affiliates' share in share in expenses still payable to the Bank.
Billings	77,294		
Collections	77,294		
Accounts payable		42,185	Pertains to share on various expenses.
Billings	39,471,199		
Payments	39,429,014		

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, 2018 and 2017, the Bank is in compliance with the regulatory requirements.

As of December 31, 2018 and 2017, DOSRI includes fringe benefit loans to officer amounting to ₱1.43 million and ₱0.80 million, respectively. The Bank submits regular report to BSP on "Availment of Financial Assistance to Officers and Employees" as prescribed under Subsection X339.4 of the Manual of Regulations for Banks (MORB).

BSP Circular No. 560 provides that the total outstanding loans, other credit accommodation and guarantees to each of the bank's/quasi-bank's subsidiaries and affiliates shall not exceed 10.00% of the net worth of the lending bank/quasi-bank, provided that the unsecured portion of which shall not exceed 5.00% of such net worth. Further, the total outstanding loans, credit accommodations and guarantees to all subsidiaries and affiliates shall not exceed 20.00% of the net worth of the lending bank/quasi-bank; and the subsidiaries and affiliates of the lending bank/quasi-bank are not related interest of any director, officer and/or stockholder of the lending institution, except where such director, officer or stockholder sits in the BOD or is appointed officer of such corporation as representative of the bank/quasi-bank.

On May 12, 2009, BSP issued Circular No. 654 allowing a separate individual limit of twenty-five (25.00%) of the net worth of the lending bank/quasi-bank to loans of banks/quasi-banks to their subsidiaries and affiliates engaged in energy and power generation.

20. Supplementary Information for Cash Flow Analysis

The following table shows the reconciliation analysis of liabilities arising from financing activities for the year ended December 31, 2018:

	December 31, 2018					
	Beginning balance	**Cash flows**	**Application of DFS to stocks**	**Dividend declaration**	**Amortization of discount**	**Ending balance**
Bills payable (Note 11)	**₱498,023,590**	**₱273,365,890**	**₱–**	**₱–**	**(₱4,045,311)**	**₱767,344,169**
Deposit for future stocks subscription (Note 13)	**51,592,800**	**–**	**(51,592,800)**	**–**	**–**	**–**
Dividends payable (Note 11)	**13,147**	**(200,220,875)**	**–**	**200,265,400**	**–**	**57,672**
Total liabilities from financing activities	**₱549,629,537**	**₱73,145,015**	**(₱51,592,800)**	**₱200,265,400**	**(₱4,045,311)**	**₱767,401,841**

	December 31, 2017				
	Beginning balance	Cash flows	Dividend declaration	Amortization of discount	Ending balance
Bills payable (Note 11)	₱440,000,000	₱57,145,480	₱–	(₱2,436,550)	₱498,023,590
Deposit for future stocks subscription (Note 13)	4,080,000	47,512,800	–	–	51,592,800
Dividends payable (Note 11)	–	(130,270,982)	130,284,129	–	13,147
Total liabilities from financing activities	₱444,080,000	(₱25,612,702)	₱130,284,129	(₱2,436,550)	₱549,629,537

21. Approval for the Release of Financial Statements

The BOD of the Bank has reviewed and approved the release of the accompanying financial statements on April 9, 2019.

22. **Supplementary Information Required under RR 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 and licenses paid or accrued during the year. The components of 'Taxes and licenses' recognized in the statement of income for the year ended December 31, 2018, follow:

GRT	₱62,429,843
DST	3,551,500
Business permits and licenses	2,501,996
Real property tax	217,809
	₱68,701,148

Withholding taxes in 2018 are categorized into:

Paid:	
Final withholding tax on interest expense and dividends declared	₱6,027,369
Withholding taxes on compensation and benefits	6,764,968
Expanded withholding tax	2,589,065
	15,381,402
Accrued:	
Withholding taxes on compensation and benefits	677,120
Expanded withholding tax	582,230
Final withholding tax on interest expense and dividends declared	939,062
	2,198,412
	₱17,579,814

Tax Assessments and Cases

As at December 31, 2018, the Company has no outstanding final assessment notice from the BIR or cases in court or bodies outside the BIR.