

**CARD SME Bank, Inc., A Thrift  
Bank**

Financial Statements  
December 31, 2017 and 2016

and

Independent Auditor's Report



## **INDEPENDENT AUDITOR'S REPORT**

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

### **Report on the Audit of the Financial Statements**

#### **Opinion**

We have audited the financial statements of CARD SME Bank, Inc., A Thrift Bank (the Bank), which comprise the statements of financial position as at December 31, 2017 and 2016, 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, 2017 and 2016, 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.



## **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.

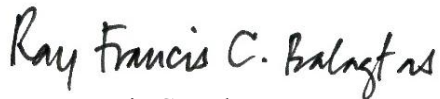
We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.



**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 23 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 SME Bank, Inc., A Thrift Bank. The information has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

SYCIP GORRES VELAYO & CO.



Ray Francis C. Balagtas

Partner

CPA Certificate No. 108795

SEC Accreditation No. 1510-A (Group A),

October 1, 2015, valid until September 30, 2018

Tax Identification No. 216-950-288

BIR Accreditation No. 08-001998-107-2018,

February 14, 2018, valid until February 13, 2021

PTR No. 6621226, January 9, 2018, Makati City

March 10, 2018



**CARD SME BANK, INC., A THRIFT BANK**  
**STATEMENTS OF FINANCIAL POSITION**

|   | <b>December 31</b>    |                       |
|---|-----------------------|-----------------------|
|   | <b>2017</b>           | <b>2016</b>           |
| <b>ASSETS</b>   |                       |                       |
| Cash and Other Cash Items (Note 6)                    | <b>₱16,419,549</b>    | ₱8,550,182            |
| Due from Bangko Sentral ng Pilipinas (Notes 6 and 12) | <b>233,021,335</b>    | 156,044,613           |
| Due from Other Banks (Note 6)                         | <b>430,501,434</b>    | 217,923,219           |
| Loans and Receivables (Note 7)                        | <b>4,057,932,876</b>  | 2,773,465,206         |
| Property and Equipment (Note 8)                       | <b>152,464,228</b>    | 129,507,157           |
| Investment Properties (Note 9)                        | <b>7,781,349</b>      | 8,357,492             |
| Intangible Assets (Note 10)                           | <b>6,131,180</b>      | 8,795,939             |
| Retirement Asset (Note 17)                            | <b>102,426,693</b>    | 75,590,128            |
| Deferred Tax Assets (Note 18)                         | <b>18,364,365</b>     | 16,396,816            |
| Other Assets (Note 11)                                | <b>44,171,591</b>     | 38,576,206            |
| <b>TOTAL ASSETS</b>                                   | <b>₱5,069,214,600</b> | <b>₱3,433,206,958</b> |
| <b>LIABILITIES AND EQUITY</b>                         |                       |                       |
| <b>Liabilities</b>                                    |                       |                       |
| Deposit Liabilities (Notes 12 and 19)                 |                       |                       |
| Demand  | <b>₱9,410,781</b>     | ₱7,911,981            |
| Savings   | <b>2,893,808,218</b>  | 1,891,728,854         |
|   | <b>2,903,218,999</b>  | 1,899,640,835         |
| Bills Payable (Note 13)                               | <b>1,038,425,577</b>  | 694,069,886           |
| Income Tax Payable                                    | <b>53,152,097</b>     | 28,093,464            |
| Other Liabilities (Note 14)                           | <b>199,272,291</b>    | 65,768,756            |
|   | <b>4,194,068,964</b>  | 2,687,572,941         |
| <b>Equity</b>   |                       |                       |
| Common Stock (Note 16)                                | <b>495,279,400</b>    | 469,917,000           |
| Surplus   | <b>354,459,052</b>    | 266,182,858           |
| Remeasurement Gains on Retirement Plan (Note 17)      | <b>25,407,184</b>     | 9,534,159             |
|   | <b>875,145,636</b>    | 745,634,017           |
| <b>TOTAL LIABILITIES AND EQUITY</b>                   | <b>₱5,069,214,600</b> | <b>₱3,433,206,958</b> |

*See accompanying Notes to Financial Statements.*



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

|  | <b>Years Ended December 31</b> |                |
|--|--------------------------------|----------------|
|  | <b>2017</b>                    | <b>2016</b>    |
| <b>INTEREST INCOME</b>                                 |                                |                |
| Loans and receivables (Note 7)                         | <b>₱1,473,715,149</b>          | ₱1,015,542,517 |
| Due from other banks (Note 6)                          | <b>2,642,778</b>               | 2,846,661      |
|  | <b>1,476,357,927</b>           | 1,018,389,178  |
| <b>INTEREST EXPENSE</b>                                |                                |                |
| Deposit liabilities (Notes 12 and 19)                  | <b>45,300,782</b>              | 33,659,960     |
| Bills payable (Note 13)                                | <b>30,033,318</b>              | 21,476,385     |
| Others   | <b>750,161</b>                 | 161,032        |
|  | <b>76,084,261</b>              | 55,297,377     |
| <b>NET INTEREST INCOME</b>                             | <b>1,400,273,666</b>           | 963,091,801    |
| <b>OTHER INCOME (LOSS)</b>                             |                                |                |
| Gain (loss) on sale of assets - net (Notes 8 and 9)    | <b>(842,917)</b>               | 4,491,830      |
| Miscellaneous  | <b>8,021,054</b>               | 4,633,560      |
| <b>TOTAL OPERATING INCOME</b>                          | <b>1,407,451,803</b>           | 972,217,191    |
| <b>OPERATING EXPENSES</b>                              |                                |                |
| Compensation and fringe benefits (Notes 17 and 19)     | <b>408,220,070</b>             | 293,536,563    |
| Taxes and licenses (Note 9)                            | <b>83,053,364</b>              | 59,077,255     |
| Transportation and travel (Note 19)                    | <b>79,899,977</b>              | 61,903,741     |
| Occupancy and equipment-related cost (Notes 19 and 20) | <b>73,448,592</b>              | 48,174,374     |
| Stationery and office supplies                         | <b>58,061,712</b>              | 33,544,035     |
| Employee trainings (Note 19)                           | <b>42,005,271</b>              | 34,395,470     |
| Provision for credit and impairment losses (Note 7)    | <b>40,701,770</b>              | 37,095,217     |
| Depreciation and amortization (Notes 8, 9 and 10)      | <b>32,220,527</b>              | 24,140,022     |
| Security, messengerial and janitorial                  | <b>28,601,633</b>              | 18,635,849     |
| Information technology (Note 19)                       | <b>26,470,916</b>              | 18,961,392     |
| Program monitoring                                     | <b>15,080,858</b>              | 9,631,354      |
| Representation and entertainment (Note 18)             | <b>11,016,028</b>              | 9,736,713      |
| Power, light and water                                 | <b>10,413,797</b>              | 6,936,872      |
| Fines, penalties and other charges                     | <b>9,981,963</b>               | -              |
| Postage, telephone and cable                           | <b>8,116,057</b>               | 5,741,664      |
| Meetings and seminars (Note 19)                        | <b>7,951,877</b>               | 8,109,779      |
| Insurance  | <b>6,137,325</b>               | 6,766,400      |
| Repairs and maintenance                                | <b>5,906,067</b>               | 4,404,536      |
| Honorarium and directors' fees (Note 19)               | <b>5,162,869</b>               | 5,251,392      |
| Professional fees                                      | <b>4,227,415</b>               | 5,414,473      |
| Community development                                  | <b>1,982,980</b>               | 3,122,990      |
| Miscellaneous (Note 9)                                 | <b>6,021,858</b>               | 7,141,986      |
| <b>TOTAL OPERATING EXPENSES</b>                        | <b>964,682,926</b>             | 701,722,077    |
| <b>INCOME BEFORE INCOME TAX</b>                        | <b>442,768,877</b>             | 270,495,114    |
| <b>PROVISION FOR INCOME TAX</b> (Note 18)              | <b>134,492,683</b>             | 82,186,578     |
| <b>NET INCOME</b>                                      | <b>₱308,276,194</b>            | ₱188,308,536   |

*See accompanying Notes to Financial Statements.*



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

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|  | <b>Years Ended December 31</b> |                     |
|--|--------------------------------|---------------------|
|  | <b>2017</b>                    | <b>2016</b>         |
| <b>NET INCOME</b>  | <b>₱308,276,194</b>            | <b>₱188,308,536</b> |
| <b>OTHER COMPREHENSIVE INCOME (LOSS)</b>   |                                |                     |
| <i>Other comprehensive income (loss) not recycled to profit or loss in subsequent periods:</i> |                                |                     |
| Changes in remeasurement gain (loss) on retirement plan (Note 17)                              | <b>22,675,750</b>              | <b>(8,332,119)</b>  |
| Income tax effect  | <b>(6,802,725)</b>             | <b>2,499,636</b>    |
|  | <b>15,873,025</b>              | <b>(5,832,483)</b>  |
| <b>TOTAL COMPREHENSIVE INCOME</b>  | <b>₱324,149,219</b>            | <b>₱182,476,053</b> |

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*See accompanying Notes to Financial Statements.*



**CARD SME BANK, INC., A THRIFT BANK**  
**STATEMENTS OF CHANGES IN EQUITY**

|   | Common<br>Stock<br>(Note 16) | Surplus             | Remeasurement<br>Gains on<br>Retirement<br>Plan<br>(Note 17) | Total               |
|---|------------------------------|---------------------|--|---------------------|
| <b>Balance at January 1, 2017</b>                 | <b>₱469,917,000</b>          | <b>₱266,182,858</b> | <b>₱9,534,159</b>  | <b>₱745,634,017</b> |
| Collection of subscriptions receivable            | 25,362,400                   | –                   | –  | 25,362,400          |
| Total comprehensive income for the year           | –                            | 308,276,194         | 15,873,025   | 324,149,219         |
| Cash dividends declared (Note 17)                 | –                            | (220,000,000)       | –  | (220,000,000)       |
| <b>Balance at December 31, 2017</b>               | <b>₱495,279,400</b>          | <b>₱354,459,052</b> | <b>₱25,407,184</b>   | <b>₱875,145,636</b> |
| Balance at January 1, 2016                        | ₱408,656,400                 | ₱167,819,526        | ₱15,366,642  | ₱591,842,568        |
| Collection of subscriptions receivable            | 61,260,600                   | –                   | –  | 61,260,600          |
| Total comprehensive income (loss)<br>for the year | –                            | 188,308,536         | (5,832,483)  | 182,476,053         |
| Cash dividends declared (Note 17)                 | –                            | (89,945,204)        | –  | (89,945,204)        |
| Balance at December 31, 2016                      | ₱469,917,000                 | ₱266,182,858        | ₱9,534,159   | ₱745,634,017        |

*See accompanying Notes to Financial Statements.*



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

|  | <b>Years Ended December 31</b> |               |
|--|--------------------------------|---------------|
|  | <b>2017</b>                    | <b>2016</b>   |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                    |                                |               |
| Income before income tax                                       | <b>₱442,768,877</b>            | ₱270,495,114  |
| Adjustments for:   |                                |               |
| Provision for credit and impairment losses (Note 7)            | <b>40,701,770</b>              | 37,095,217    |
| Depreciation and amortization (Notes 8, 9 and 10)              | <b>32,220,527</b>              | 24,162,368    |
| Retirement expense (Note 17)                                   | <b>11,131,442</b>              | 7,756,290     |
| Amortization of discount on bills payable (Note 13)            | <b>4,434,321</b>               | 1,708,386     |
| Loss (gain) on sale of assets (Notes 8 and 9)                  | <b>842,917</b>                 | (4,491,830)   |
| Amortization of finance lease obligation                       | <b>110,012</b>                 | 64,344        |
| Amortization of discount on unquoted debt securities (Notes 7) | <b>(5,007)</b>                 | (12,933)      |
| Amortization of premium on held-to-maturity                    | –                              | 468,557       |
| Reversal for impairment losses on investment property          | –                              | (143,697)     |
| Changes in operating assets and liabilities:                   |                                |               |
| Increase in the amounts of:                                    |                                |               |
| Loans and receivables  | <b>(1,325,164,433)</b>         | (996,609,041) |
| Other assets   | <b>(5,595,385)</b>             | (13,374,435)  |
| Increase (decrease) in the amounts of:                         |                                |               |
| Deposit liabilities  | <b>1,003,578,164</b>           | 669,742,425   |
| Other liabilities  | <b>23,640,583</b>              | (6,979,511)   |
| Net cash generated from (used in) operations                   | <b>228,663,788</b>             | (10,118,746)  |
| Income taxes paid  | <b>(118,204,324)</b>           | (80,451,709)  |
| Retirement contributions paid (Note 17)                        | <b>(15,292,257)</b>            | (46,397,966)  |
| Net cash provided by (used in) operating activities            | <b>95,167,207</b>              | (136,968,421) |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                    |                                |               |
| Acquisitions of:   |                                |               |
| Property and equipment (Notes 8 and 21)                        | <b>(42,443,700)</b>            | (30,057,145)  |
| Intangible assets (Note 10)                                    | <b>(2,104,450)</b>             | (7,729,392)   |
| Investment properties (Note 9)                                 | <b>(450,000)</b>               | –             |
| Proceeds from sale or maturities of:                           |                                |               |
| Investment properties (Note 9)                                 | <b>750,000</b>                 | 13,006,537    |
| Held-to-maturity investments                                   | –                              | 10,967,990    |
| Property and equipment (Note 8)                                | <b>27,228</b>                  | 899,357       |
| Net cash used in investing activities                          | <b>(44,220,922)</b>            | (12,912,653)  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                    |                                |               |
| Availments of bills payable (Note 13)                          | <b>1,134,561,370</b>           | 627,575,618   |
| Settlement of bills payable (Note 13)                          | <b>(794,640,000)</b>           | (422,320,000) |
| Cash dividends paid (Note 16)                                  | <b>(219,898,901)</b>           | (92,526,801)  |
| Collections of subscriptions receivable (Note 16)              | <b>25,362,400</b>              | 61,260,600    |
| Deposit for future stock subscription                          | <b>101,093,150</b>             | 5,201,900     |
| Net cash provided by financing activities                      | <b>246,478,019</b>             | 179,191,317   |

(Forward)



|   | <b>Years Ended December 31</b> |                     |
|---|--------------------------------|---------------------|
|   | <b>2017</b>                    | <b>2016</b>         |
| <b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>      | <b>₱297,424,304</b>            | <b>₱29,310,243</b>  |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b> |                                |                     |
| Cash and other cash items                             | 8,550,182                      | 9,582,664           |
| Due from Bangko Sentral ng Pilipinas                  | 156,044,613                    | 106,715,506         |
| Due from other banks                                  | 217,923,219                    | 236,909,601         |
|   | <b>₱382,518,014</b>            | <b>₱353,207,771</b> |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>       |                                |                     |
| Cash and other cash items                             | 16,419,549                     | 8,550,182           |
| Due from Bangko Sentral ng Pilipinas                  | 233,021,335                    | 156,044,613         |
| Due from other banks                                  | 430,501,434                    | 217,923,219         |
|   | <b>₱679,942,318</b>            | <b>₱382,518,014</b> |
| <b>OPERATIONAL CASH FLOWS FROM INTEREST</b>           |                                |                     |
| Interest received                                     | ₱1,453,178,865                 | ₱1,010,840,025      |
| Interest paid   | 71,990,843                     | 49,347,756          |

*See accompanying Notes to Financial Statements.*



# **CARD SME BANK, INC., A THRIFT BANK**

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## **NOTES TO FINANCIAL STATEMENTS**

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### **1. Corporate Information**

CARD SME Bank Inc., A Thrift Bank (the Bank) was incorporated in the Philippines on October 4, 1961. The Bank was granted the authority to operate by the Bangko Sentral ng Pilipinas (BSP) on May 10, 1962. Its principal place of business is at 120 M. Paulino St., corner Burgos St., San Pablo City, Laguna. The Bank offers a wide range of products and services such as deposit and loan products mainly to the consumer market. As of December 31, 2017 and 2016, the Bank has 24 and 15 branches, respectively.

In 2007, the Bank (with existing branches in Sto. Tomas and Lipa City Batangas and Tagaytay City, Cavite) became a member of Center for Agriculture and Rural Development (CARD) - Mutually Reinforcing Institutions (MRI) when CARD, Inc. and CARD Employees Multi-Purpose Cooperative (EMPC) acquired the majority of its voting stock. The rehabilitation court and the BSP approved the sale and transfer of shares of stock on September 5, 2007 and February 7, 2008, respectively. This strategic move supports the graduating microenterprises clients of CARD - MRI, by empowering them through continuous access to financial resources and nonfinancial services. CARD - MRI's social mission of poverty alleviation has been folded into bank's operation through its microfinance operation.

On May 20, 2010, the Monetary Board of BSP approved the increase in the authorized capital stock of the Bank from ₱20.00 million to ₱500.00 million and the number of Board of Directors (BOD) from five (5) to nine (9) members. Likewise on December 9, 2010, the Monetary Board of BSP thru its Resolution No. 1757 approved the conversion of the operation of the Bank from rural bank category to a regular thrift bank.

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

- a. Change of the corporate name from 'Rural Bank of Sto. Tomas (Batangas), Inc.' to 'CARD SME Bank, Inc., A Thrift Bank';
- b. Change of the primary and secondary purposes from that of rural banking to thrift banking;
- c. Change of the principal office address from 'General Malvar Avenue, Sto. Tomas, Batangas' to 'San Pablo City, Laguna'; and
- d. Extension of the Bank's corporate life for another fifty (50) years from the date of expiration on February 6, 2012.

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

As a thrift bank, the Bank can (1) provide short term working capital, medium and long-term financing, to business engaged in agricultural services, industry and housing; (2) provide diversified financial and allied services for its chosen market and constituents especially for small and medium enterprises, microfinance and individuals; and (3) carry on activities specified under Section 10 of Republic Act (RA) No. 7906, otherwise known as '*Thrift Banks Act of 1995*'.

As of December 31, 2017 and 2016, the Bank is 33.8% owned by CARD, Inc.



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## 2. Summary Significant Accounting Policies

### Basis of Preparation

The accompanying financial statements have been prepared on a historical cost basis. The financial statements are presented in Philippine peso, which is the Bank's functional currency. All values are rounded to the nearest peso unless otherwise indicated.

### Statement of Compliance

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

### Presentation of Financial Statements

The statements of financial position of the Bank are presented 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) is presented in Note 15.

### Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position only when there is a legally enforceable right to offset the recognized amounts and there is intention to settle on a net basis, or to realize the assets and settle the liabilities 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.

Income and expense are not offset in the statement of comprehensive income unless required or permitted by any accounting standard or interpretation and as specifically disclosed in the accounting policies of the Bank. This is not generally the case with master netting agreements, where the related assets and liabilities are presented gross amounts in the statement of financial position.

### **Changes in Accounting Policies and Disclosures**

The accounting policies adopted are consistent with those of the previous financial year except for the following amendments and improvements to PFRS which are effective beginning on or after January 1, 2017.

- Amendments to PFRS 12, *Disclosure of Interests in Other Entities, Clarification of the Scope of the Standard* (Part of *Annual Improvements to PFRSs 2014 - 2016 Cycle*)
- Amendments to Philippine Accounting Standard (PAS) 7, *Statement of Cash Flows, Disclosure Initiative*

On January 1, 2017, the Bank adopted the amendments to PAS 7. The amendments require to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financial activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). On initial application of the amendments, entities are not required to provide comparative information to preceding periods.

The reconciliation analysis of liabilities arising from financing activities is presented in Note 21.



- Amendments to PAS 12, *Income Taxes, Recognition of Deferred Tax Assets for Unrealized Losses - Clarification on the accounting for deferred tax assets on debt instruments measured at fair value*

The aforementioned new and amended standards and interpretations did not have any impact on the financial position or performance of the Bank.

### **Significant Accounting Policies**

#### Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items, amounts due from BSP and other banks that are highly liquid, readily convertible to known amounts of cash, with original maturities of three months or less from dates of placements and that are subject to an insignificant risk of changes in value. Due from BSP includes statutory reserves required by the BSP, which the Bank considers as cash equivalents wherein drawings can be made to meet cash requirement.

#### Fair Value Measurement

The Bank measures assets and liabilities at fair value on initial recognition date. Also, fair values of financial instruments measured at amortized cost and investment properties are disclosed in Note 4.

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

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

The principal or the most advantageous market must be accessible to the Bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

If an asset or a liability measured at fair value has a bid price and ask price, the price within the bid-ask spread that is most representative of fair value in the circumstance 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 nonfinancial 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 statement are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:



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

For assets and liabilities that are recognized in the financial statement 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 the end of each reporting period. The Bank does not have assets and liabilities carried at fair value as of December 31, 2017 and 2016.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as disclosed above (Note 4).

#### Financial Instruments - Initial Recognition and Subsequent Measurement

##### *Date of recognition*

Purchases or sales of financial assets that require delivery of the assets within the time frame established by regulation or convention in the marketplace are recognized on settlement date, the date that an asset is delivered to or by the Bank. Deposits and loans and receivables are recognized when cash is received by the Bank or advanced to the borrowers.

##### *Initial recognition of financial instruments*

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

As of December 31, 2017 and 2016, the Bank has no outstanding financial instruments at FVPL, HTM and AFS investments.

##### *'Day 1' difference*

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



#### *Loans and receivables*

This accounting policy relates to 'Due from BSP', 'Due from other banks', 'Loans and receivables' and refundable 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 FVPL;
- those that the Bank, upon initial recognition, designates as AFS; and
- those for which the Bank may not cover substantially all of its initial investment other than because of credit deterioration.

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

#### *Other financial liabilities*

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

After initial measurement, other financial liabilities not qualified and not designated as FVPL, are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account the impact of applying the effective interest method of amortization for any related premium, discount and any directly attributable transaction costs.

When the Bank breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorization of the financial statement for issue, not to demand payment as a consequence of the breach. The Bank classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.

These policies apply to liabilities classified under 'Deposit liabilities', 'Bills payable' and other financial liabilities under 'Other liabilities' in the statement of financial position.

#### Derecognition of Financial Assets and Liabilities

##### *Financial assets*

A financial asset (or, where applicable a part of a financial asset or part of a group of financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired; or
- the Bank retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or



- the Bank has transferred its rights to receive cash flows from the asset 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. 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.

#### *Financial liabilities*

A financial liability is derecognized when the obligation under the liability is discharged, 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.

#### Impairment of Financial Assets

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or 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 initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

#### *Financial assets at amortized cost*

For financial assets carried at amortized cost, the Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant.

If 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 present value of the estimated future cash flows is discounted at the financial asset's original EIR.

If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR, adjusted for the original credit risk premium. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

For the purpose of a collective assessment of impairment, financial assets are grouped on the basis of credit risk characteristics such as past due status of the borrowers. Future cash flows in a group of financial assets that are collectively assessed for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows reflect, and are directionally consistent with changes in related observable data from period to period (such as changes in property prices, 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.

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 under 'Provision for credit and impairment losses'. Interest income continues to be recognized based on the original EIR of the asset. The 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 future write-off is later recovered, any amounts formerly charged are credited under 'Miscellaneous income' in the statement of income.

#### *Restructured loans*

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



### Property and Equipment

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

The initial cost of property and equipment consists of its purchase price, including nonrefundable taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after items of property and equipment have been put into operation, such as repairs and maintenance are normally charged against operations in the period in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property and equipment.

Depreciation is computed using the straight-line method over the estimated useful lives (EUL) of the respective assets. Leasehold improvements are amortized over lease term and the shorter of the terms of the covering leases and EUL of the improvements.

The range of the EULs of the property and equipment follows:

|                                   |               |
|-----------------------------------|---------------|
| Building and improvements         | 5 to 15 years |
| Leasehold improvements            | 3 to 5 years  |
| Furniture, fixtures and equipment | 2 to 3 years  |
| Transportation equipment          | 3 to 5 years  |

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

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

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising from 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 under 'Gain on sale of asset - net' in the period the asset is derecognized.

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

### Investment Properties

Investment properties are measured initially at cost, including transaction costs. An investment property acquired through an exchange transaction is measured at fair value of the asset acquired unless the fair value of such an asset cannot be measured in which case the investment property acquired is measured at the carrying amount of asset given up. Foreclosed properties are classified under 'Investment properties' upon either: a) entry of judgment in case of judicial foreclosure, b) execution of sheriff's certificate of sale in case of extra-judicial foreclosure; or c) notarization of the deed of dacion in case of payment in kind (dacion en pago).



The difference between the fair value of the asset acquired and the carrying amount of the asset given up is recognized under 'Other income' in the statement of income.

Subsequent to initial recognition, investment properties are stated at cost less accumulated depreciation (for depreciable investment properties) and accumulated impairment losses, if any.

Depreciation on buildings and improvements is calculated on a straight-line basis over the EUL of ten years from the time of acquisition of the depreciable investment properties.

Investment properties are derecognized when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognized in the statement of income in the period of retirement or disposal. Expenditures incurred after the investment properties have been put into operations, such as repairs and maintenance costs, are charged against income in the period in which the costs are incurred.

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

#### Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses. Internally generated intangibles, excluding capitalized development costs, are not capitalized and the related expenditure is reflected in profit or loss in the period in which the expenditure is incurred.

The useful lives of intangible assets are assessed as either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the statement of income in the expense category that is consistent with the function of the intangible assets.

Intangible assets consist of software costs which are amortized on a straight-line basis over three years.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the statement of income when the asset is derecognized.

#### Impairment of Nonfinancial Assets

At each reporting date, the Bank assesses whether there is any indication that its nonfinancial 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 (VIU) 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 group 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 (or CGU) is considered impaired and is written down to its recoverable amount. In assessing VIU, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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

#### Retirement Benefits

##### *Defined benefit plan*

The Bank operates a defined benefit retirement plan and a hybrid retirement plan which require contribution 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 end of the reporting period reduced by the fair value of plan assets and adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

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; and
- 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. Retirement expense is presented under 'Compensation and fringe benefits' 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 'Changes in remeasurement gain (loss) on retirement liabilities' under other comprehensive income (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.

#### *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 wholly before 12 months after the end of the annual reporting period is recognized for services rendered by employees up to the end of the reporting period.

#### Equity

##### *Common stock*

Common stock represents the aggregate amount of paid capital stock which is determined using the nominal or par value of shares that have been issued. When the shares are sold at a premium, the difference between the proceeds and par value is credited to 'Capital paid in excess of par value', net of direct costs incurred related to the equity issuance. If 'Capital paid in excess of par value' is not sufficient, the excess is charged against surplus.

Subscribed common stock is recognized at subscribed amount net of subscription receivable. This will be debited upon full payment of the subscription and issuance of the shares of stock. Subscriptions receivable pertains to uncollected portion of subscribed stocks. The Bank accounts for the subscription receivable as a contra equity account.

##### *Surplus*

Surplus represents the accumulated earnings, dividend contributions, prior period adjustments, effect of changes in accounting policy and other capital adjustments.

Own equity instruments which are reacquired (treasury stocks) are recognized at cost and deducted from equity. No gain or loss is recognized in the statement of income on the purchase, sale, issue or cancellation of the Bank's own equity instruments. Any difference between the carrying amount and the consideration, if reissued, is recognized in 'Capital paid in excess of par value'. Voting rights related to treasury stocks are nullified for the Bank and no dividends are allocated to them. When the stocks are retired, the 'Common stock' account is reduced by its par value and the excess of cost over par value upon retirement is debited to 'Capital paid in excess of par value' at the time the stocks were retired and to surplus for the remaining balance.



#### *Cash dividends*

Dividend distributions are at the discretion of the Bank. A dividend distribution to the Bank's shareholders is accounted for as a deduction from retained earnings. A proposed cash dividend is recognized as a liability in the period in which it is approved by the BOD.

#### Deposit for Future Stock Subscription

Deposit for future stock subscription (DFS) shall be classified under equity account if all of the following conditions are present as of reporting date:

- the unissued authorized capital stock of the Bank is insufficient to cover the amount of shares indicated in the contract;
- there is BOD approval on the proposed increase in authorized capital stock (for which a deposit was received by the Bank);
- there is stockholders' approval of said proposed increase; and
- the application for the approval of the proposed increase has been filed with the BSP and the SEC.

DFS does not meet the foregoing provisions and is treated as a non-financial liability.

As of December 31, 2017 and 2016, the Bank has DFS subscription recorded under 'Other liabilities' in the statement of financial position amounting to ₱106.3 million and ₱5.2 million, respectively (Note 17).

#### Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured regardless of when payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty. The Bank assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The Bank has concluded that it is acting as a principal in all of its revenue arrangements. The following specific recognition criteria must also be met before revenue is recognized:

#### *Interest income*

Interest on financial instruments is recognized based on the effective interest method of accounting. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and allocating the interest income over a relevant period.

The EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options), includes any fees (such as service fees) or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses. The adjusted carrying amount is calculated based on the original EIR. The change in carrying amount is recorded as 'Interest income'. Once the recorded value of a financial asset or group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original EIR applied to the new carrying amount.

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



*Gain (loss) on sale of assets - net*

Gain or loss from exchange or sale of assets is recognized upon completion of the earning process. For disposal of nonfinancial assets, this will include whether the collectability of the consideration is reasonably assured.

*Loan fees, service fees and penalties*

Loan fees are recognized over the term of the credit lines granted to each borrower. Service fees are accrued when earned. Penalties are recognized only upon collection or where there is a reasonable degree of certainty as to their collectability. These items are recognized under 'Miscellaneous income' in the statement of income.

Expense Recognition

Expense is recognized when it is probable that decrease in the future economic benefits related to decrease in an asset or an increase in liability has occurred and that the decrease in economic benefits can be measured reliably. Revenues and expenses that relate to the same transaction or other event are recognized simultaneously.

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

*Interest expense*

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

*Taxes and licenses*

This includes all other taxes, local and national, including gross receipts taxes (GRT), documentary taxes, real estate taxes, licenses and permit fees that are recognized when incurred.

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

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

Where 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 under 'Occupancy and equipment-related cost' in the statement of income on a straight-line basis over the lease term.



### Income Taxes

Income tax on profit or loss for the year comprises current and deferred taxes. Income tax is determined in accordance with tax laws and is recognized in the statement of income, except to the extent that it relates to items directly recognized in OCI.

#### *Current tax*

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

#### *Deferred tax*

Deferred tax is provided, using the balance sheet liability method, on all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for all deductible temporary differences, carryforward benefits 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 carryforward benefits of unused excess MCIT over RCIT and unused NOLCO can be utilized.

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.

Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax asset to be recovered.

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

Current and deferred taxes relating to items recognized directly in equity are recognized in OCI, and not in the statement of income.

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

### Provisions and Contingencies

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



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

#### Events After the Reporting Date

Any post-year-end events that provide additional information about the Bank's position at the reporting date (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material 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, 2018*

- Amendments to PFRS 2, *Share-based Payment, Classification and Measurement of Share-based Payment Transactions*
- Amendments to PFRS 4, *Insurance Contracts, Applying PFRS 9, Financial Instruments, with PFRS 4*
- PFRS 15, *Revenue from Contracts with Customers*
- Amendments to PAS 40, *Investment Property, Transfers of Investment Property*
- 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)*
- Philippine Interpretation IFRIC-22, *Foreign Currency Transactions and Advance Consideration*

##### *Effective beginning on or after January 1, 2019*

- Amendments to PFRS 9, *Prepayment Features with Negative Compensation*
- Amendments to PAS 28, *Long-term Interests in Associates and Joint Ventures*
- Philippine Interpretation IFRIC-23, *Uncertainty over Income Tax Treatments*

##### *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*

Pronouncements that are deemed to have significant impact on the financial statements of the Bank are described below:

##### *Effective beginning on or after January 1, 2018*

- *PFRS 9, Financial Instruments*  
PFRS 9 reflects all phases of the financial instruments project and replaces PAS 39, *Financial Instruments: Recognition and Measurement*, and all previous versions of PFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. Retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions. The Bank plans to adopt the new standard on the mandatory effective date and will not restate comparative information.



The Bank is currently assessing the impact of adopting PFRS 9.

*Effective beginning on or after January 1, 2019*

- *PFRS 16, Leases*

Under the new standard, lessees will no longer classify their leases as either operating or finance leases in accordance with PAS 17, *Leases*. Rather, lessees will apply the single-asset model. Under this model, lessees will recognize the assets and related liabilities for most leases on their balance sheets, and subsequently, will depreciate the lease assets and recognize interest on the lease liabilities in their profit or loss. Leases with a term of 12 months or less or for which the underlying asset is of low value are exempted from these requirements.

The accounting by lessors is substantially unchanged as the new standard carries forward the principles of lessor accounting under PAS 17. Lessors, however, will be required to disclose more information in their financial statements, particularly on the risk exposure to residual value.

Entities may early adopt PFRS 16 but only if they have also adopted PFRS 15. When adopting PFRS 16, an entity is permitted to use either a full retrospective or a modified retrospective approach, with options to use certain transition reliefs.

The Bank is currently assessing the impact of adopting PFRS 16.

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### 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.

As of December 31, 2017 and 2016, management assessed that there is no significant accounting judgment exercised in respect to the preparation of the financial statements

#### Estimates

(a) *Credit losses on loans and receivables*

The Bank reviews its loans and receivables to assess impairment at each reporting date. 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 borrowers or national or local economic conditions that correlate with defaults on the loans and receivables. Past-due accounts for more than 90 days, and loans wherein the borrower requested moratorium but no subsequent collection is made after the moratorium period ends as of year-end, fall under specific loan loss.



In addition to specific allowance against individually significant loans and receivables, the Bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. For the purpose of a collective impairment, loans and receivables are grouped on the basis of their credit risk characteristics. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical experience for assets with credit risk characteristics similar to those on the group.

As of December 31, 2017 and 2016, the carrying values of loans and receivables and related allowance for credit losses are disclosed in Note 7.

(b) *Present value of defined benefit obligation*

The cost of defined benefit plan, as well as the present value of defined benefit obligation, 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 as of 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 of the Philippines. The present value of the retirement liability and fair value of plan assets are disclosed in Note 17.

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#### 4. Fair Value Measurement and Fair Value Hierarchy

##### Fair Value Measurement

As of December 31, 2017 and 2016, except as discussed below, the carrying values of the Bank's financial assets and financial liabilities as reflected in the statements of financial position and related notes approximate their fair values.

Inputs used in estimating fair values of financial instruments carried at cost and categorized under Level 3 include risk-free rates and applicable risk premium.

The methods and assumptions used by the Bank in estimating fair values of financial instruments and nonfinancial asset for which fair value is disclosed are as follows:

*Cash and other cash items, due from BSP, due from other banks, current portion of receivables and unquoted debt securities, accrued interest receivable, refundable deposits, current portion of deposit liabilities, bills payable and finance lease liabilities, accrued expenses, accrued interest payable, accounts payable and dividends payable*

Fair values of these financial instruments approximate their carrying values in view of the short term maturities of these instruments.

*Noncurrent portion of receivables and unquoted debt securities*

Fair values of noncurrent portion of receivables and unquoted debt securities are estimated using the discounted cash flow methodology using interest rates offered for similar loans to borrowers with similar credit ratings and taking into account the remaining maturities ranging from 3.5% to 5.9% and 2.3% to 5.4% in 2017 and 2016, respectively.



*Noncurrent portion of deposit liabilities, bills payable and finance lease liabilities*

Fair values of noncurrent deposit liabilities are estimated using the discounted cash flow methodology using the Bank's current incremental borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued, if any ranging from 3.5% to 4.5% and 2.3% to 3.9% in 2017 and 2016, respectively.

Fair values of noncurrent portion of bills payable are estimated using the discounted cash flow methodology, using incremental borrowing rates for similar financial liabilities, taking into account the remaining maturities and applicable spreads of the counterparties.

*Investment properties*

Fair values of the Bank's investment properties have been determined based on valuations made by independent external appraiser based on the recent sales of similar properties in the same area as the investment properties and taking into account the economic conditions prevailing at the time the valuations were made and comparability of similar properties sold with the property being valued.

The Bank uses a hierarchy for determining and disclosing the fair value of its assets and liabilities (Note 2).

The following table summarizes the valuation techniques used and the significant unobservable inputs valuation for investment properties held by the Bank:

|          | <b>Valuation Techniques</b>       | <b>Significant Unobservable inputs</b>                                     |
|----------|-----------------------------------|--|
| Land     | Market Data Approach              | Location, size, shape, utility/neighborhood, improvements and time element |
| Building | Modified Quantity Survey Approach | Depreciated replacement cost   |

Description of the valuation techniques, inputs and assumptions used to value the Bank's investment properties are as follows:

| <b>Valuation Techniques, Inputs and Assumptions</b> | <b>Description</b>  |
|---|---|
| Market Data Approach                                | A process of comparing the subject property being appraised to similar comparable properties recently sold or being offered for sale.   |
| Modified Quantity Survey Approach                   | A method wherein each building component is priced based on the current cost of materials and labor and indirect costs such as contractor's profits, overhead, taxes, fees and other related expenses are then added in lump sum. |

Fair Value Hierarchy

The following table summarizes the carrying values and the fair values by level of the fair value hierarchy of the Bank's assets and liabilities as of December 31, 2017 and 2016 for which fair values are required to be disclosed.



| 2017  |                |         |         |              |                  |
|---|----------------|---------|---------|--------------|------------------|
|   | Carrying Value | Level 1 | Level 2 | Level 3      | Total Fair Value |
| <b>Assets and liabilities for which fair values are disclosed*:</b> |                |         |         |              |                  |
| <i>Financial assets</i>   |                |         |         |              |                  |
| Loans and receivables   |                |         |         |              |                  |
| SME (Small and medium-sized enterprises) loans                      | ₱375,910,336   | ₱-      | ₱-      | ₱326,824,366 | ₱326,824,366     |
| Unquoted debt securities  | 116,749,391    | -       | -       | 90,222,119   | 90,222,119       |
| <i>Nonfinancial asset</i>   |                |         |         |              |                  |
| Investment properties   | 7,781,349      | -       | -       | 8,717,765    | 8,717,765        |
| <i>Financial liabilities</i>  |                |         |         |              |                  |
| Deposit liabilities   | 1,571,881      | -       | -       | 1,002,887    | 1,002,887        |
| Bills payable   | 97,964,677     | -       | -       | 118,157,298  | 118,157,298      |
| Finance lease payable   | 5,633,357      | -       | -       | 5,313,292    | 5,313,292        |

\* Pertains to noncurrent assets and liabilities

| 2016  |                |         |         |              |                  |
|---|----------------|---------|---------|--------------|------------------|
|   | Carrying Value | Level 1 | Level 2 | Level 3      | Total Fair Value |
| <b>Assets and liabilities for which fair values are disclosed*:</b> |                |         |         |              |                  |
| <i>Financial assets</i>   |                |         |         |              |                  |
| Loans and receivables*  |                |         |         |              |                  |
| SME (Small and medium-sized enterprises) loans                      | ₱254,420,379   | ₱-      | ₱-      | ₱233,763,569 | ₱233,763,569     |
| Unquoted debt securities  | 85,482,031     | -       | -       | 73,891,658   | 73,891,658       |
| <i>Nonfinancial asset</i>   |                |         |         |              |                  |
| Investment properties   | 8,357,492      | -       | -       | 8,833,224    | 8,833,224        |
| <i>Financial liabilities</i>  |                |         |         |              |                  |
| Deposit liabilities   | 2,642,382      | -       | -       | 2,492,417    | 2,492,417        |
| Bills payable   | 119,429,886    | -       | -       | 129,913,873  | 129,913,873      |
| Finance lease payable   | 890,745        | -       | -       | 977,351      | 977,351          |

\* Pertains to noncurrent assets and liabilities

As of December 31, 2017 and 2016, the Bank has no financial instruments carried at fair value.

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 2017 and 2016.

## 5. Financial Risk Management Objectives and Policies

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

The Bank adheres to the proactive and prudent approach of managing the business that recognizes and manages risks to continuously provide quality financial services to clients and to protect shareholders' value.

Risk management process involves setting of revenue goals, definition of risk philosophy and creating risk culture, determining opportunities that would create risk in the future, identifying and assessing the risk, evaluating and defining risk tolerance, taking actions to mitigate and control the risks through defined roles and responsibilities, close monitoring of the scenarios, reporting of risk taking performance, revalidation of risk methodologies and adjustment of the systems and policies necessary to effectively minimize risk level.



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

#### 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*

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

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

Furthermore, the Bank has a preventive delinquency management approach through proper and strict credit delivery, monitoring and collection. Close monitoring through conduct of weekly center meetings is being implemented allowing the early determination of early warning signals on each borrower-member. A daily monitoring on the number of defaulted members and intensive follow-up areas are strictly being implemented. Various remedial measures are likewise being implemented to allow rehabilitation of defaulted borrowers. Defaulted borrowers which failed to cooperate despite remedial efforts done are referred to the Bank's legal counsel for collection or filing of appropriate legal action.

In general, borrowers are also perpetual savers. Consequently, their Pledge Savings accounts are pledged and serve as guarantee to their loans, which increase their borrowing capacity. Each business unit has a Unit Manager who reports on all credit-related matters to the local management consisting of the AM, RD and EVP.

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



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

*Maximum exposure to credit risk*

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

| 2017                   |                                  |  |   |                             |
|------------------------|----------------------------------|--|---|-----------------------------|
|                        | Maximum Exposure to Credit Risk* | Fair Value of Collateral and Credit Enhancements | Financial Effect of Collateral or Credit Enhancements | Net Exposure to Credit Risk |
| Loans and receivables: |                                  |  |   |                             |
| Microfinance loans     | ₱3,388,059,761                   | ₱1,918,735,261                                   | ₱800,789,259  | ₱2,587,270,502              |
| SME loans              | 551,497,227                      | 318,961,860                                      | 275,089,156   | 276,408,071                 |

\* Includes accrued interest receivable and net of unearned discount and allowance for credit losses

| 2016                   |                                  |  |   |                             |
|------------------------|----------------------------------|--|---|-----------------------------|
|                        | Maximum Exposure to Credit Risk* | Fair Value of Collateral and Credit Enhancements | Financial Effect of Collateral or Credit Enhancements | Net Exposure to Credit Risk |
| Loans and receivables: |                                  |  |   |                             |
| Microfinance loans     | ₱2,310,820,654                   | ₱1,226,763,648                                   | ₱545,766,611  | ₱1,765,054,043              |
| SME loans              | 376,189,555                      | 123,716,863                                      | 145,992,056   | 230,197,499                 |

\* Includes accrued interest receivable and net of unearned discount and allowance for credit losses

Credit enhancement for microfinance loans pertains to deposit hold-out from center fund savings equivalent to 15.0% of the loaned amount of the member as of December 31, 2017 and 2016. Credit enhancement for SME loans consists of chattel and real estate mortgages.

As of December 31, 2017 and 2016, the Bank has no financial assets with rights to offset in accordance with Amendments to PAS 32, *Financial Instruments - Offsetting Financial Assets and Financial Liabilities*. 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 PFRS.

Additionally, the tables below show the distribution of maximum credit exposure by industry sector of the Bank as of December 31, 2017 and 2016:

| 2017   |                              |                       |                      |                |
|--|------------------------------|-----------------------|----------------------|----------------|
|  | Due from BSP and other banks | Loans and receivables | Refundable deposits* | Total          |
| Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods | ₱-                           | ₱2,219,958,225        | ₱-                   | ₱2,219,958,225 |
| Other community, social and personal service activities  | -                            | 546,695,184           | -                    | 546,695,184    |
| Real estate and construction   | -                            | 535,708,453           | 5,942,471            | 541,650,924    |
| Agriculture, hunting and forestry  | -                            | 484,096,457           | -                    | 484,096,457    |
| Financial intermediaries   | 430,501,434                  | -                     | -                    | 430,501,434    |



| 2017                           |                                    |                          |                         |                       |
|--------------------------------|------------------------------------|--------------------------|-------------------------|-----------------------|
|                                | Due from<br>BSP and<br>other banks | Loans and<br>receivables | Refundable<br>deposits* | Total                 |
| Government                     | 233,021,335                        | 128,828,378              | -                       | 361,849,713           |
| Manufacturing                  | -                                  | 274,665,535              | -                       | 274,665,535           |
|                                | 663,522,769                        | 4,189,952,232            | 5,942,471               | 4,859,417,472         |
| Allowance for credit losses    | -                                  | (130,205,306)            | -                       | (130,205,306)         |
| Unearned interest and discount | -                                  | (1,814,050)              | -                       | (1,814,050)           |
| <b>Total</b>                   | <b>₱663,522,769</b>                | <b>₱4,057,932,876</b>    | <b>₱5,942,471</b>       | <b>₱4,727,398,116</b> |

\* Included under 'Other assets' (Note 12)

| 2016  |                                    |                          |                         |                       |
|---|------------------------------------|--------------------------|-------------------------|-----------------------|
|   | Due from<br>BSP and<br>other banks | Loans and<br>receivables | Refundable<br>deposits* | Total                 |
| Wholesale and retail trade, repair of motor vehicles,<br>motorcycles and personal and household goods | ₱-                                 | ₱1,372,542,770           | ₱-                      | ₱1,372,542,770        |
| Other community, social and personal service activities   | -                                  | 887,390,884              | -                       | 887,390,884           |
| Real estate and construction  | -                                  | 111,482,231              | 5,832,155               | 117,314,386           |
| Agriculture, hunting and forestry   | -                                  | 298,508,790              | -                       | 298,508,790           |
| Financial intermediaries  | 217,923,219                        | -                        | -                       | 217,923,219           |
| Government  | 156,044,613                        | 85,482,033               | -                       | 241,526,646           |
| Manufacturing   | -                                  | 113,063,015              | -                       | 113,063,015           |
|   | 373,967,832                        | 2,868,469,723            | 5,832,155               | 3,248,269,710         |
| Allowance for credit losses   | -                                  | (93,574,325)             | -                       | (93,574,325)          |
| Unearned interest and discount  | -                                  | (1,430,192)              | -                       | (1,430,192)           |
| <b>Total</b>  | <b>₱373,967,832</b>                | <b>₱2,773,465,206</b>    | <b>₱5,832,155</b>       | <b>₱3,153,265,193</b> |

\* Included under 'Other assets' (Note 12)

#### Credit quality per class of financial assets

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

It is the Bank's policy to dispose repossessed properties in an orderly transaction. The proceeds are used to reduce or repay the outstanding claims. In general, the Bank does not occupy repossessed properties for business use. The Bank has a program of disposal of its investment properties to reduce the nonperforming assets in its books. Investment properties may be disposed through redemption, negotiated sale or lease purchase.

High grade represents receivables and investments which have a high probability of collection. The counterparty has the apparent ability to satisfy its obligation and the securities, such as real estate mortgage on the receivables are readily enforceable. These also include deposits with reputable institutions from which the deposits may be withdrawn and recovered with certainty.

Standard grade represents deposits, receivables and investments where collections are probable due to the reputation and the financial ability of the counterparty to pay but with experience of default.

The tables below show the credit quality per class of financial assets (gross of allowance for credit losses and unearned interest income) as of December 31, 2017 and 2016:

| 2017                   |                               |                |    |           |                                 |                          |              |
|------------------------|-------------------------------|----------------|----|-----------|---------------------------------|--------------------------|--------------|
|                        | Neither Past Due Nor Impaired |                |    | Unrated   | Past Due<br>but not<br>Impaired | Individually<br>Impaired | Total        |
|                        | High Grade                    | Standard Grade | P- |           |                                 |                          |              |
| Due from BSP           | ₱233,021,335                  | -              | ₱- | ₱-        | ₱-                              | ₱-                       | ₱233,021,335 |
| Due from other banks   | -                             | 430,501,434    | -  | -         | -                               | -                        | 430,501,434  |
| Loans and receivables: |                               |                |    |           |                                 |                          |              |
| Loans and discounts:   |                               |                |    |           |                                 |                          |              |
| Microfinance           | -                             | 3,364,778,551  | -  | 8,943,043 | 34,058,446                      | 3,407,780,040            |              |
| SME                    | 186,365,630                   | 364,923,392    | -  | 5,337,188 | 42,255,769                      | 598,881,979              |              |



| 2017                               |                     |                       |                   |                           |                       |                       |
|------------------------------------|---------------------|-----------------------|-------------------|---------------------------|-----------------------|-----------------------|
| Neither Past Due Nor Impaired      |                     |                       |                   |                           |                       |                       |
|                                    | High Grade          | Standard Grade        | Unrated           | Past Due but not Impaired | Individually Impaired | Total                 |
| Real estate mortgage               | -                   | -                     | -                 | -                         | 64,980                | 64,980                |
| Unquoted debt securities           | -                   | 116,749,390           | -                 | -                         | 9,078,988             | 125,828,378           |
| Other receivables:                 |                     |                       |                   |                           |                       |                       |
| Accrued interest receivable        | -                   | 54,971,664            | -                 | -                         | -                     | 54,971,664            |
| Accounts receivable                | -                   | -                     | 908,367           | -                         | 1,516,824             | 2,425,191             |
| Other assets - refundable deposits | -                   | -                     | 5,942,471         | -                         | -                     | 5,942,471             |
|                                    | <b>₱419,386,965</b> | <b>₱4,331,924,431</b> | <b>₱6,850,838</b> | <b>₱14,280,231</b>        | <b>₱86,975,007</b>    | <b>₱4,859,417,472</b> |

| 2016                               |                     |                       |                   |                           |                       |                       |
|------------------------------------|---------------------|-----------------------|-------------------|---------------------------|-----------------------|-----------------------|
| Neither Past Due Nor Impaired      |                     |                       |                   |                           |                       |                       |
|                                    | High Grade          | Standard Grade        | Unrated           | Past Due but not Impaired | Individually Impaired | Total                 |
| Due from BSP                       | ₱156,044,613        | ₱-                    | ₱-                | ₱-                        | ₱-                    | ₱156,044,613          |
| Due from other banks               | -                   | 217,923,219           | -                 | -                         | -                     | 217,923,219           |
| HTM investments                    |                     |                       |                   |                           |                       |                       |
| Loans and receivables:             |                     |                       |                   |                           |                       |                       |
| Loans and discounts:               |                     |                       |                   |                           |                       |                       |
| Microfinance                       | -                   | 2,316,009,626         | -                 | 5,830,581                 | 17,142,690            | 2,338,982,897         |
| SME                                | 108,754,146         | 252,506,781           | -                 | 9,365,922                 | 31,265,333            | 401,892,182           |
| Real estate mortgage               | -                   | -                     | -                 | -                         | 64,980                | 64,980                |
| Unquoted debt securities           | -                   | 85,482,031            | -                 | -                         | 9,078,988             | 94,561,019            |
| Other receivables:                 |                     |                       |                   |                           |                       |                       |
| Accrued interest receivable        | 383,329             | 31,409,273            | -                 | -                         | -                     | 31,792,602            |
| Accounts receivable                | -                   | -                     | 907,986           | -                         | 268,057               | 1,176,043             |
| Other assets - refundable deposits | -                   | -                     | 5,832,155         | -                         | -                     | 5,832,155             |
|                                    | <b>₱265,182,088</b> | <b>₱2,903,330,930</b> | <b>₱6,740,141</b> | <b>₱15,196,503</b>        | <b>₱57,820,048</b>    | <b>₱3,248,269,710</b> |

As of December 31, 2017 and 2016, the Bank's receivables 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 table shows the total aggregate amount of loans and discounts that are contractually past due but not considered as impaired per delinquency bucket as of December 31, 2017 and 2016.

| 2017         |                   |                   |                   |                    |
|--------------|-------------------|-------------------|-------------------|--------------------|
|              | Less than 30 days | 31 to 60 days     | 61 to 90 days     | Total              |
| Microfinance | ₱1,399,441        | ₱3,899,596        | ₱3,644,006        | ₱8,943,043         |
| SME          | 1,049,529         | 2,200,425         | 2,087,234         | 5,337,188          |
|              | <b>₱2,448,970</b> | <b>₱6,100,021</b> | <b>₱5,731,240</b> | <b>₱14,280,231</b> |
| 2016         |                   |                   |                   |                    |
|              | Less than 30 days | 31 to 60 days     | 61 to 90 days     | Total              |
| Microfinance | ₱1,495,495        | ₱2,585,806        | ₱1,749,280        | ₱5,830,581         |
| SME          | 5,024,431         | 2,618,884         | 1,722,607         | 9,365,922          |
|              | <b>₱6,519,926</b> | <b>₱5,204,690</b> | <b>₱3,471,887</b> | <b>₱15,196,503</b> |



Liquidity Risk

Liquidity risk is generally defined as the current and prospective risk to earnings or capital arising from the Bank's inability to meet its obligations when they come due without incurring unacceptable losses or costs.

The Asset-Liability Management Committee is responsible in 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.

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.

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

*Analysis of financial assets and financial liabilities by remaining maturities*

The table below shows the maturity profile of the Bank's financial assets and financial liabilities based on contractual undiscounted cash flows as of December 31, 2017 and 2016:

|                           | 2017                  |                               |                              |                     | Total                 |
|---------------------------|-----------------------|-------------------------------|------------------------------|---------------------|-----------------------|
|                           | Up to 1 month         | More than 1 month to 6 months | More than 6 months to 1 year | Beyond 1 year       |                       |
| <b>Financial Assets</b>   |                       |                               |                              |                     |                       |
| Cash and other cash items | ₱16,419,549           | ₱-                            | ₱-                           | ₱-                  | ₱16,419,549           |
| Due from BSP              | 233,021,335           |                               |                              |                     | 233,021,335           |
| Due from other banks*     | 425,689,493           | -                             | 15,600,295                   | -                   | 441,289,788           |
| Loans and receivables*:   |                       |                               |                              |                     |                       |
| Loans and discounts       | 3,880,054,713         | 413,655,965                   | 419,831,260                  | 95,658,318          | 4,809,200,256         |
| Unquoted debt securities  | -                     | -                             | 3,082,854                    | 167,661,294         | 170,744,148           |
| Other receivables:        |                       |                               |                              |                     |                       |
| Accounts receivable       | 908,367               | -                             | -                            | -                   | 908,367               |
|                           | <b>₱4,556,093,457</b> | <b>₱413,655,965</b>           | <b>₱438,514,409</b>          | <b>₱263,319,612</b> | <b>₱5,671,583,443</b> |

(Forward)



|  | 2017                  |                               |                              |                      | Total                 |
|--|-----------------------|-------------------------------|------------------------------|----------------------|-----------------------|
|  | Up to 1 month         | More than 1 month to 6 months | More than 6 months to 1 year | Beyond 1 year        |                       |
| <b>Financial Liabilities</b>                           |                       |                               |                              |                      |                       |
| Deposit liabilities:                                   |                       |                               |                              |                      |                       |
| Demand   | ₱9,410,781            | ₱-                            | ₱-                           | ₱-                   | ₱9,410,781            |
| Savings*   | 2,610,763,719         | 27,266,808                    | 99,309,945                   | 233,770,853          | 2,971,111,325         |
| Bills payable*   | 28,187,500            | 269,000,000                   | 671,684,500                  | 103,320,000          | 1,072,192,000         |
| Other liabilities                                      |                       |                               |                              |                      |                       |
| Accrued expenses                                       | -                     | 43,710,208                    | -                            | -                    | 43,710,208            |
| Accounts payable                                       | -                     | 11,156,794                    | -                            | -                    | 11,156,794            |
| Finance lease payable                                  | 322,227               | 1,933,365                     | 1,933,365                    | 6,122,285            | 10,311,243            |
| Dividends payable                                      | -                     | 182,191                       | -                            | -                    | 182,191               |
|  | <b>2,648,684,227</b>  | <b>353,249,366</b>            | <b>772,927,810</b>           | <b>343,213,138</b>   | <b>4,118,074,542</b>  |
| <b>Net undiscounted financial assets (liabilities)</b> | <b>₱1,907,409,230</b> | <b>₱60,406,599</b>            | <b>(₱334,413,401)</b>        | <b>(₱79,893,526)</b> | <b>₱1,553,508,901</b> |

\* Includes future interests

|  | 2016                    |                               |                              |                       | Total                 |
|--|-------------------------|-------------------------------|------------------------------|-----------------------|-----------------------|
|  | Up to 1 month           | More than 1 month to 6 months | More than 6 months to 1 year | Beyond 1 year         |                       |
| <b>Financial Assets</b>                                |                         |                               |                              |                       |                       |
| Cash and other cash items                              | ₱8,550,182              | ₱-                            | ₱-                           | ₱-                    | ₱8,550,182            |
| Due from BSP   | 156,044,613             | -                             | -                            | -                     | 156,044,613           |
| Due from other banks*                                  | 197,831,874             | 20,149,136                    | -                            | -                     | 217,981,010           |
| Loans and receivables*:                                |                         |                               |                              |                       |                       |
| Loans and discounts                                    | 103,098,210             | 2,011,966,204                 | 518,657,595                  | 1,169,764,907         | 3,803,486,916         |
| Unquoted debt securities                               | 250,417                 | 85,251                        | 14,073,510                   | 108,766,399           | 123,175,577           |
| Other receivables:                                     |                         |                               |                              |                       |                       |
| Accounts receivable                                    | -                       | 907,986                       | -                            | -                     | 907,986               |
|  | <b>₱465,775,296</b>     | <b>₱2,033,108,577</b>         | <b>₱532,731,105</b>          | <b>₱1,278,531,306</b> | <b>₱4,310,146,284</b> |
| <b>Financial Liabilities</b>                           |                         |                               |                              |                       |                       |
| Deposit liabilities:                                   |                         |                               |                              |                       |                       |
| Demand   | 7,911,981               | -                             | -                            | -                     | 7,911,981             |
| Savings*   | 1,495,805,074           | 21,855,124                    | 338,350,359                  | 39,281,146            | 1,895,291,703         |
| Bills payable*   | -                       | 352,320,000                   | 222,320,000                  | 123,040,000           | 697,680,000           |
| Other liabilities                                      |                         |                               |                              |                       |                       |
| Accrued expenses                                       | -                       | 28,915,238                    | -                            | 388,703               | 29,303,941            |
| Accounts payable                                       | -                       | 10,435,444                    | -                            | -                     | 10,435,444            |
| Finance lease payable                                  | 60,583                  | 363,498                       | 363,498                      | 1,151,070             | 1,938,649             |
| Dividends payable                                      | -                       | 81,092                        | -                            | -                     | 81,092                |
|  | <b>1,503,777,638</b>    | <b>413,970,396</b>            | <b>561,033,857</b>           | <b>163,860,919</b>    | <b>2,642,642,810</b>  |
| <b>Net undiscounted financial assets (liabilities)</b> | <b>(₱1,038,002,342)</b> | <b>₱1,619,138,181</b>         | <b>(₱28,302,752)</b>         | <b>₱1,114,670,387</b> | <b>₱1,667,503,474</b> |

\* Includes future interests

As of December 31, 2017 and 2016, the Bank had a total of ₱1,330.0 million and ₱930.0 million credit lines with local banks, respectively, out of which, ₱1,140.0 million and ₱550.0 million had been drawn as of December 31, 2017 and 2016, respectively.

### 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 therefore are not subject to any interest rate risk.



*Interest rate risk*

The Bank's nominal interest rate for REM loans are set at a fixed rate of 21.0% in 2017 and 2016. Microfinance loans earn nominal interest rates ranging from 2.6% to 28.0% with equivalent effective interest rate ranging from 32.8% to 62.5% per annum in 2017 and 2016. For SME loans, interest rate charged to a borrower depends on the credit risk rating classification, the deposit level of the client as a percentage of the loan, and the internal basic interest rate.

As of December 31, 2017, repricing debt instrument only comprise 2% of total loan, thus the effect of interest repricing on loans is immaterial to the Bank. As of December 31, 2016, the Bank has no repricing financial instruments.

The Bank's savings deposit liabilities include compulsory and voluntary savings that earn 1.5% to 6.0% interest per annum in 2017 and 2016. Special savings deposits earn 1.75% to 3.0% and 1.8% to 3.0% interest annum in 2017 and 2016. These special savings deposits are concentrated on 30 days to one year maturity.

The Bank pays fixed interest rates on bills payable from 3.0% to 6.6% in 2017 and from 4.2% to 6.6% in 2016.

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

*Foreign currency risk*

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

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## 6. Cash and Cash Equivalents

The composition of this account follows:

|                           | 2017                | 2016         |
|---------------------------|---------------------|--------------|
| Cash and other cash items | <b>₱16,419,549</b>  | ₱8,550,182   |
| Due from BSP              | <b>233,021,335</b>  | 156,044,613  |
| Due from other banks      | <b>430,501,434</b>  | 217,923,219  |
|                           | <b>₱679,942,318</b> | ₱382,518,014 |

Due from BSP represents the aggregate balance of noninterest-bearing peso deposit account with the BSP which the Bank maintains in compliance with the BSP requirements to meet regular and liquidity reserves on deposits. As of December 31, 2017 and 2016, the Bank is compliant with the applicable reserve requirements (Note 12).

Due from other banks consists of:

|                           | 2017                | 2016         |
|---------------------------|---------------------|--------------|
| Demand deposit            | <b>₱12,550,480</b>  | ₱145,272,747 |
| Savings deposit (Note 20) | <b>307,207,631</b>  | 52,559,127   |
| Time deposit              | <b>110,923,323</b>  | 20,091,345   |
|                           | <b>₱430,681,434</b> | ₱217,923,219 |



Due from other banks consist of funds deposited in domestic banks which are used as part of the Bank's working capital. These deposits bear annual interest rates ranging from 0.3% to 1.0% and 0.3% to 2.3% for the years ended December 31, 2017 and 2016, respectively.

Time deposits earn interests ranging from 1.5% to 1.8% and from 1.5% to 2.2% with maturity ranging from 30 to 90 days in 2017 and 2016, respectively.

Interest income on due from other banks amounted to ₱2.6 million and ₱2.8 million in 2017 and 2016, respectively.

## 7. Loans and Receivables

This account consists of:

|                               | 2017                  | 2016           |
|-------------------------------|-----------------------|----------------|
| Loans and discounts:          |                       |                |
| Microfinance                  | ₱3,407,780,040        | ₱2,338,982,898 |
| SME                           | 598,881,979           | 401,892,181    |
| Real estate mortgage          | 64,980                | 64,980         |
|                               | <b>4,006,726,999</b>  | 2,740,940,059  |
| Unquoted debt securities      | 125,828,378           | 94,561,019     |
|                               | <b>4,132,555,377</b>  | 2,835,501,078  |
| Unearned interest income      | (1,814,050)           | (1,430,192)    |
|                               | <b>4,130,741,327</b>  | 2,834,070,886  |
| Other receivables:            |                       |                |
| Accrued interest receivable   | 54,971,664            | 31,792,602     |
| Accounts receivable (Note 19) | 2,425,191             | 1,176,043      |
|                               | <b>4,188,138,182</b>  | 2,867,039,531  |
| Allowance for credit losses   | (130,205,306)         | (93,574,325)   |
|                               | <b>₱4,057,932,876</b> | ₱2,773,465,206 |

Loans and discounts earn interest at rates ranging from 32.8% to 62.5% in 2017 and 2016.

Unquoted debt securities include Micro, Small and Medium Enterprise Notes and Agrarian Reform Bonds with maturity ranging from one to ten years and interest ranging from 1.5% to 2.3% in 2017 and 2016, respectively. Amortization amounted to ₱1.4 million and ₱0.5 million in 2017 and 2016, respectively.

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

|                          | 2017                  | 2016           |
|--------------------------|-----------------------|----------------|
| Loans and discounts:     |                       |                |
| Microfinance (Note 12)   | ₱1,386,819,510        | ₱957,674,624   |
| SME                      | 85,059,331            | 57,355,000     |
| REM                      | —                     | 154,302        |
| Unquoted debt securities | 1,836,308             | 358,591        |
|                          | <b>₱1,473,715,149</b> | ₱1,015,542,517 |

No interest income is accreted on individually-impaired loans in 2017 and 2016.



The movements in allowance for credit losses follow:

|   | 2017                |                          |                     |                     |
|---|---------------------|--------------------------|---------------------|---------------------|
|   | Loans and discounts | Unquoted debt securities | Accounts receivable | Total               |
| <b>Balance at beginning of year</b>   | <b>₱84,227,280</b>  | <b>₱9,078,988</b>        | <b>₱268,057</b>     | <b>₱93,574,325</b>  |
| Provisions  | 39,391,003          | –                        | 1,310,767           | 40,701,770          |
| Write-offs and others   | (4,008,789)         | –                        | (62,000)            | (4,070,789)         |
| <b>Balance at end of year</b>   | <b>₱119,609,494</b> | <b>₱9,078,988</b>        | <b>₱1,516,824</b>   | <b>₱130,205,306</b> |
| Individually-impaired   | ₱76,379,195         | ₱9,078,988               | ₱1,516,824          | ₱86,975,007         |
| Collectively-impaired   | 43,230,299          | –                        | –                   | 43,230,299          |
|   | <b>₱119,609,494</b> | <b>₱9,078,988</b>        | <b>₱1,516,824</b>   | <b>₱130,205,306</b> |
| Gross amounts of loans individually determined to be impaired, before deducting any individually assessed impairment losses | <b>₱76,379,195</b>  | <b>₱9,078,988</b>        | <b>₱1,516,824</b>   | <b>₱86,975,007</b>  |

|   | 2016                |                          |                     |                    |
|---|---------------------|--------------------------|---------------------|--------------------|
|   | Loans and discounts | Unquoted debt securities | Accounts Receivable | Total              |
| Balance at beginning of year  | ₱56,894,464         | ₱9,078,988               | ₱89,288             | ₱66,062,740        |
| Provisions  | 36,916,448          | –                        | 178,769             | 37,095,217         |
| Write-offs and others   | (9,583,632)         | –                        | –                   | (9,583,632)        |
| Balance at end of year  | ₱84,227,280         | ₱9,078,988               | ₱268,057            | ₱93,574,325        |
| Individually-impaired   | ₱48,473,003         | ₱9,078,988               | ₱268,057            | ₱57,820,048        |
| Collectively-impaired   | 35,754,277          | –                        | –                   | 35,754,277         |
|   | <b>₱84,227,280</b>  | <b>₱9,078,988</b>        | <b>₱268,057</b>     | <b>₱93,574,325</b> |
| Gross amounts of loans individually determined to be impaired, before deducting any individually assessed impairment losses | <b>₱48,473,003</b>  | <b>₱9,078,988</b>        | <b>₱268,057</b>     | <b>₱57,820,048</b> |

### Regulatory Reporting

In accordance with BSP regulations, the Bank considers loans with one-day past due as part of its portfolio-at-risk (PAR). As of December 31, 2017 and 2016, the Bank's PAR amounted to ₱99.7 million and ₱73.0 million, respectively. The allowance for credit losses recognized for past due loans amounted to ₱91.4 million and ₱61.0 million as of December 31, 2017 and 2016, respectively.

As of December 31, 2017 and 2016, nonperforming loans (NPLs) based on Circular No. 772 and as reported to the BSP amounted to 99.7 million and 73.0 million, respectively.

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 current or the loans are restructured in accordance with existing BSP regulations, and future payments appear assured.



Generally, NPLs refer to loans whose principal and/or interest is unpaid for thirty days or more after due date or after they have become past due in accordance with existing BSP rules and regulations. This shall apply to loans that are payable in lump sum and loans that are payable 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 (10.0%) of the total receivable balance.

In the case of microfinance loans, past due/PAR accounts shall be considered as NPLs.

The following table shows the secured and unsecured portions of loans and discounts as of December 31, 2017 and 2016:

|                            | 2017                  | 2016           |
|----------------------------|-----------------------|----------------|
| Secured portion            |                       |                |
| Deposit hold-out (Note 12) | <b>₱3,407,780,035</b> | ₱2,338,982,898 |
| REM                        | <b>186,365,630</b>    | 108,819,128    |
| Chattel mortgage           | <b>88,723,526</b>     | 37,172,928     |
|                            | <b>3,682,869,191</b>  | 2,484,974,954  |
| Unsecured portion          | <b>1,293,857,808</b>  | 255,965,105    |
|                            | <b>₱4,976,726,999</b> | ₱2,740,940,059 |

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

|  | 2017                  |              | 2016           |       |
|--|-----------------------|--------------|----------------|-------|
|  | Amount                | %            | Amount         | %     |
| Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods | <b>₱2,165,561,370</b> | <b>54.0</b>  | ₱1,745,846,895 | 63.7  |
| Other community, social and personal service activities  | <b>546,695,184</b>    | <b>13.6</b>  | 472,039,128    | 17.2  |
| Real estate and construction   | <b>535,708,453</b>    | <b>13.4</b>  | 111,482,231    | 4.1   |
| Agriculture, hunting and forestry  | <b>484,096,457</b>    | <b>12.1</b>  | 298,508,790    | 10.9  |
| Manufacturing  | <b>274,665,535</b>    | <b>6.9</b>   | 113,063,015    | 4.1   |
|  | <b>₱4,006,726,999</b> | <b>100.0</b> | ₱2,740,940,059 | 100.0 |

The BSP considers that loan concentration exists when total loan exposure to a particular industry or economic sector exceeds 30.0% of total loan portfolio. Identified concentrations of credit risks are controlled and managed accordingly.



## 8. Property and Equipment

The composition of and movements in this account follow:

|                                 | 2017               |                           |                        |                                   |                          |                          | Total               |
|---------------------------------|--------------------|---------------------------|------------------------|-----------------------------------|--------------------------|--------------------------|---------------------|
|                                 | Land               | Building and Improvements | Leasehold Improvements | Furniture, Fixtures and Equipment | Transportation Equipment | Construction in Progress |                     |
| <b>Cost</b>                     |                    |                           |                        |                                   |                          |                          |                     |
| Balance at beginning of year    | ₱46,915,616        | ₱46,776,778               | ₱33,524,360            | ₱49,780,645                       | ₱7,093,130               | ₱-                       | ₱184,090,529        |
| Acquisition                     | -                  | 1,098,394                 | 15,262,950             | 21,048,263                        | -                        | 13,592,784               | 51,002,391          |
| Disposals                       | -                  | -                         | (2,211,763)            | (963,349)                         | (1,240,015)              | -                        | (4,415,127)         |
| Transfers                       | -                  | 7,752,944                 | 2,842,400              | -                                 | -                        | (10,595,344)             | -                   |
| <b>Balance at end of year</b>   | <b>46,915,616</b>  | <b>55,628,116</b>         | <b>49,417,947</b>      | <b>69,865,559</b>                 | <b>5,835,115</b>         | <b>2,997,440</b>         | <b>230,677,793</b>  |
| <b>Accumulated Depreciation</b> |                    |                           |                        |                                   |                          |                          |                     |
| Balance at beginning of year    | -                  | 7,682,418                 | 11,120,616             | 29,948,675                        | 5,831,663                | -                        | 54,583,372          |
| Depreciation                    | -                  | 5,326,825                 | 8,692,219              | 12,844,510                        | 584,371                  | -                        | 27,447,925          |
| Disposals                       | -                  | (2,354)                   | (1,626,593)            | (948,779)                         | (1,240,006)              | -                        | (3,817,732)         |
| <b>Balance at end of year</b>   | <b>-</b>           | <b>13,006,889</b>         | <b>18,186,242</b>      | <b>41,844,406</b>                 | <b>5,176,028</b>         | <b>-</b>                 | <b>78,213,565</b>   |
| <b>Net Book Value</b>           | <b>₱46,915,616</b> | <b>₱42,621,227</b>        | <b>₱31,231,705</b>     | <b>₱28,021,153</b>                | <b>₱659,087</b>          | <b>₱2,997,440</b>        | <b>₱152,464,228</b> |

|                                 | 2016               |                           |                        |                                   |                          |                          | Total               |
|---------------------------------|--------------------|---------------------------|------------------------|-----------------------------------|--------------------------|--------------------------|---------------------|
|                                 | Land               | Building and Improvements | Leasehold Improvements | Furniture, Fixtures and Equipment | Transportation Equipment | Construction in Progress |                     |
| <b>Cost</b>                     |                    |                           |                        |                                   |                          |                          |                     |
| Balance at beginning of year    | ₱46,330,516        | ₱34,735,938               | ₱27,250,575            | ₱35,625,049                       | ₱7,317,074               | ₱14,184,000              | ₱165,443,152        |
| Acquisition                     | 585,100            | 1,160,787                 | 13,137,389             | 16,868,216                        | -                        | -                        | 31,751,492          |
| Disposals                       | -                  | (3,303,947)               | (6,863,604)            | (2,712,620)                       | (223,944)                | -                        | (13,104,115)        |
| Transfers                       | -                  | 14,184,000                | -                      | -                                 | -                        | (14,184,000)             | -                   |
| <b>Balance at end of year</b>   | <b>46,915,616</b>  | <b>46,776,778</b>         | <b>33,524,360</b>      | <b>49,780,645</b>                 | <b>7,093,130</b>         | <b>-</b>                 | <b>184,090,529</b>  |
| <b>Accumulated Depreciation</b> |                    |                           |                        |                                   |                          |                          |                     |
| Balance at beginning of year    | -                  | 5,612,919                 | 11,371,073             | 23,262,587                        | 5,259,276                | -                        | 45,505,855          |
| Depreciation                    | -                  | 4,639,190                 | 5,537,665              | 9,370,043                         | 796,325                  | -                        | 20,343,223          |
| Disposals                       | -                  | (2,569,691)               | (5,788,122)            | (2,683,955)                       | (223,938)                | -                        | (11,265,706)        |
| <b>Balance at end of year</b>   | <b>-</b>           | <b>7,682,418</b>          | <b>11,120,616</b>      | <b>29,948,675</b>                 | <b>5,831,663</b>         | <b>-</b>                 | <b>54,583,372</b>   |
| <b>Net Book Value</b>           | <b>₱46,915,616</b> | <b>₱39,094,360</b>        | <b>₱22,403,744</b>     | <b>₱19,831,970</b>                | <b>₱1,261,467</b>        | <b>₱-</b>                | <b>₱129,507,157</b> |

The Bank received ₱0.03 million and ₱0.9 million in 2017 and 2016, respectively, for the disposal of property and equipment. Loss on disposal of property and equipment amounted to ₱0.6 million and ₱0.9 million in 2017 and 2016, respectively.

The total cost of fully depreciated assets still in use is ₱33.4 million and ₱20.3 million as of December 31, 2017 and 2016, respectively.

There are no restrictions on titles on property and equipment and the Bank does not have any contractual commitments for the acquisition of property and equipment as of December 31, 2017 and 2016.



## 9. Investment Properties

The composition of and movements in this account follow:

|  | 2017              |               |                   |                   |
|--|-------------------|---------------|-------------------|-------------------|
|  | Land              | Building      | Asset held by SPV | Total             |
| <b>Cost</b>                            |                   |               |                   |                   |
| Balance at beginning of year           | ₱8,457,123        | ₱231,001      | ₱5,351,413        | ₱14,039,537       |
| Additions                              | 450,000           | -             | -                 | 450,000           |
| Disposals                              | (727,650)         | -             | (454,000)         | (1,181,650)       |
| Balance at end of year                 | 8,179,473         | 231,001       | 4,897,413         | 13,307,887        |
| <b>Accumulated Depreciation</b>        |                   |               |                   |                   |
| Balance at beginning of year           | -                 | 227,607       | -                 | 227,607           |
| Depreciation                           | -                 | 3,393         | -                 | 3,393             |
| Balance at end of year                 | -                 | 231,000       | -                 | 231,000           |
| <b>Allowance for Impairment Losses</b> |                   |               |                   |                   |
| Balance at beginning of year           | 2,758,282         | -             | 2,696,156         | 5,454,438         |
| Disposals                              | -                 | -             | (158,900)         | (158,900)         |
| Reversal                               | -                 | -             | -                 | -                 |
| Balance at end of year                 | 2,758,282         | -             | 2,537,256         | 5,295,538         |
| <b>Net Book Value</b>                  | <b>₱5,421,191</b> | <b>₱1</b>     | <b>₱2,360,157</b> | <b>₱7,781,349</b> |
|  | 2016              |               |                   |                   |
|  | Land              | Building      | Asset held by SPV | Total             |
| <b>Cost</b>                            |                   |               |                   |                   |
| Balance at beginning of year           | ₱16,214,277       | ₱231,001      | ₱5,351,413        | ₱21,796,691       |
| Disposals                              | (7,757,154)       | -             | -                 | (7,757,154)       |
| Balance at end of year                 | 8,457,123         | 231,001       | 5,351,413         | 14,039,537        |
| <b>Accumulated Depreciation</b>        |                   |               |                   |                   |
| Balance at beginning of year           | -                 | 204,507       | -                 | 204,507           |
| Depreciation                           | -                 | 23,100        | -                 | 23,100            |
| Balance at end of year                 | -                 | 227,607       | -                 | 227,607           |
| <b>Allowance for Impairment Losses</b> |                   |               |                   |                   |
| Balance at beginning of year           | 3,083,478         | -             | 2,696,156         | 5,779,634         |
| Disposals                              | (181,499)         | -             | -                 | (181,499)         |
| Reversal                               | (143,697)         | -             | -                 | (143,697)         |
| Balance at end of year                 | 2,758,282         | -             | 2,696,156         | 5,454,438         |
| <b>Net Book Value</b>                  | <b>₱5,698,841</b> | <b>₱3,394</b> | <b>₱2,655,257</b> | <b>₱8,357,492</b> |

Direct operating expenses on investment properties amounting to ₱0.4 million and ₱0.1 million in 2017 and 2016 are included under 'Taxes and licenses' and ₱0.3 million and nil in 2017 and 2016, respectively are included in 'Miscellaneous expense'. In 2017 and 2016, all of the Bank's investment properties are non-revenue generating.

The Bank received ₱0.8 million and ₱13.0 million in 2017 and 2016, respectively, for the sale of investment properties. Total net gain (loss) on sale of investment properties amounted to (₱0.3 million) and ₱5.4 million in 2017 and 2016, respectively.

### *Assets held by a Special Purpose Vehicle*

Assets held by a Special Purpose Vehicle (SPV) represents foreclosed properties (land) which have been specifically identified for sale under a sale and purchase agreement (SPA) with an SPV.

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



Major provisions of the SPA follow:

- The proceeds of the sale shall be paid by the buyer to the Bank on or before November 20, 2018. The payment shall not be subject to any interest;
- The buyer covenants and undertakes that any and all proceeds from any subsequent sale, disposition or settlement of any asset shall be earmarked for the payment of the purchase price; and
- If on the due date, the amount of the net proceeds is less than the purchase price, the difference between the net proceeds and purchase price shall be applied against the unpaid balance.

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## 10. Intangible Assets

The composition of and movements in this account follow:

|                                 | 2017              | 2016              |
|---------------------------------|-------------------|-------------------|
| <b>Cost</b>                     |                   |                   |
| Balance at beginning of year    | ₱13,860,534       | ₱6,131,142        |
| Acquisition                     | 2,104,450         | 7,729,392         |
| Balance at end of year          | 15,964,984        | 13,860,534        |
| <b>Accumulated Amortization</b> |                   |                   |
| Balance at beginning of year    | 5,064,595         | 1,290,896         |
| Amortization                    | 4,769,209         | 3,773,699         |
| Balance at end of year          | 9,833,804         | 5,064,595         |
| <b>Net Book Value</b>           | <b>₱6,131,180</b> | <b>₱8,795,939</b> |

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## 11. Other Assets

This account consists of

|                            | 2017               | 2016               |
|----------------------------|--------------------|--------------------|
| <b>Financial assets</b>    |                    |                    |
| Refundable deposits        | ₱5,942,471         | ₱5,832,155         |
| <b>Nonfinancial assets</b> |                    |                    |
| Prepaid expenses           | 19,766,536         | 21,124,814         |
| Stationeries and supplies  | 16,625,178         | 11,469,237         |
| Chattel mortgage           | 1,305,890          | —                  |
| Miscellaneous              | 531,516            | 150,000            |
|                            | 38,229,120         | 32,744,051         |
|                            | <b>₱44,171,591</b> | <b>₱38,576,206</b> |

The chattel mortgage refers to the repossessed vehicle in 2017. No gain or loss was recognized during the repossession of the vehicle.



## 12. Deposit Liabilities

The Bank's savings deposit liabilities include pledge savings amounting to ₱1.9 billion and ₱1.2 billion as of December 31, 2017 and 2016, respectively. These represent the aggregate compulsory savings of ₱50.0 per week collected from each microfinance member in 2017 and 2016. Under an assignment agreement, the pledge savings earn annual interest of 2.0% in 2017 and 2016. Pledge savings equivalent to 15.0% of the loan proceeds serves as guarantee fund of outstanding receivables from members (Note 7).

Savings deposits include regular and special savings deposits. Regular savings deposits include "Isave", "Tagumpay", "Maagap" and "Pangarap" savings which earn annual interest ranging from 1.5% to 6.0% in 2017 and 2016. Special savings deposits include "Earnmore" savings. This account earns interest ranging from 1.8% to 3.0% in 2017 and 2016.

Details of interest expense on deposit liabilities follow:

|                         | 2017               | 2016               |
|-------------------------|--------------------|--------------------|
| Savings deposit         | ₱33,808,547        | ₱22,368,008        |
| Special savings deposit | 11,492,235         | 11,279,282         |
| Demand deposit          | —                  | 12,670             |
|                         | <b>₱45,300,782</b> | <b>₱33,659,960</b> |

BSP Circular No. 832 requires 8.0% reserve requirement for thrift banks. Available reserves as of December 31, 2017 and 2016 amounted to ₱233.0 million and ₱156.0 million, respectively (Note 6).

As of December 31, 2017 and 2016, the Bank is compliant with the applicable reserve requirements.

## 13. Bills Payable

The composition of and movements in this account follow:

|                                     | 2017                  | 2016          |
|-------------------------------------|-----------------------|---------------|
| <b>Face value</b>                   |                       |               |
| Balance at beginning of year        | ₱697,680,000          | ₱490,000,000  |
| Availments                          | 1,140,000,000         | 630,000,000   |
| Principal payments                  | (794,640,000)         | (422,320,000) |
| Balance at end of year              | <b>1,043,040,000</b>  | 697,680,000   |
| <b>Unamortized transaction cost</b> |                       |               |
| Balance at beginning of year        | 3,610,114             | 2,894,118     |
| Availments                          | 5,438,630             | 2,424,382     |
| Amortization                        | (4,434,321)           | (1,708,386)   |
| Balance at end of year              | <b>4,614,423</b>      | 3,610,114     |
| <b>Carrying value</b>               | <b>₱1,038,425,577</b> | ₱694,069,886  |

### Local banks

These are promissory notes from various local banks with term of one year obtained for working capital requirement of the Bank with annual interest rates ranging from 3.0% to 4.0% and from 4.2% to 5.0% in 2017 and 2016, respectively.



International Finance Corporation (IFC)

On December 16, 2016, the Bank entered into a Loan Agreement (Agreement) with IFC for the availment of loan amounting to ₱160.0 million which will mature on December 15, 2022 (the Loan). The purpose of the loan is to provide funds to be used by the Bank for financing its lending operations to small and medium-sized enterprises and microfinance entities. The note bears a Philippine fixed base rate of 6.6%, inclusive of 2.7% spread, and has a tenor of seven years. The principal of the note is repaid semi-annually.

Borrowings from IFC contain the following embedded derivatives:

- a. Prepayment option which allows the Bank to redeem the loan (or portion of the loan not less than ₱45.0 million) prior to respective maturities; and
- b. Cross currency swap which allows the parties to exchange interest payments and principals denominated in different currencies (in USD and Philippine Pesos).

The Bank assessed that these embedded derivatives are clearly and closely related to the host bond instruments, since their redemption price approximate the bonds' amortized cost on redemption dates. Accordingly, these embedded derivatives were not accounted for separately from the host bond instruments.

*Debt covenants*

The Agreement covering the loan with IFC provides for restrictions and requirements which include the following negative and financial covenants, among others:

a. Negative covenants

Unless IFC otherwise agrees, the Bank shall not take action on the following, among others:

- Declare or pay any dividend or make any distribution on its share capital (other than dividends or distribution payable in shares of the Bank) unless: (i) the proposed payment or distribution is out of net income of the current Financial Year (excluding any amount resulting from the revaluation of any of the Borrower's assets); (ii) no Event of Default or Potential Event of Default has occurred and is then continuing; and (iii) after giving effect to any such action the Borrower is in compliance with the financial covenants;
- Purchase, redeem or otherwise acquire any shares of the Bank or any option over them;
- Incur, create, assume or permit to exist any liability that is covered or ranks prior or senior to the Loan, except those that is in existence as of the date of the Agreement;
- Create or permit to exist any lien on any property, revenues or other assets, present or future, of the Bank subject to exceptions indicated in the Agreement;
- Enter into any transaction except in the ordinary course of business on ordinary commercial terms and on the basis of arm's-length arrangements;
- Enter into or establish any partnership, profit-sharing or royalty agreement or other similar arrangement whereby the Bank's income or profits are, or might be, shared with any other person; or enter into any management contract or similar arrangement whereby its business or operations are managed by any other persons;
- Have any subsidiaries subject to exceptions indicated in the Agreement;
- Change its charter in any manner which would be inconsistent with the provisions of the agreement or any other transaction document, its financial year, or the nature or scope of its present or contemplated business or operations;
- Undertake or permit any merger, spin-off, consolidation or reorganization; or sell, transfer, lease or otherwise dispose of all or a substantial part of its assets, other than assets acquired in



the enforcement of security created in favor of the Bank in the ordinary course of its banking business, whether in a single transaction or in a series of transaction; and

- Prepay or repurchase any long-term debt (other than the Loan) subject to conditions indicated in the Agreement.

b. Financial covenants

The Bank agreed to prudently manage its financial position in accordance with sound banking and financial practices, applicable laws and the prudential standards of the BSP. To the extent that the banking regulation imposes financial requirements or ratios that are more stringent than the following, the Bank shall observe and comply with those more stringent requirements or ratios.

- a Risk Weighted Capital Adequacy Ratio of not less than 10.0%
- an Equity to Assets Ratio of not less than 5.0%
- an Economic Group Exposure Ratio of not more than 15.0%
- an Aggregate Large Exposure Ratio of not more than 400.0%
- a Related Party Exposure Ratio of not more than 15.0%
- an Open Credit Exposures Ratio of not more than 25.0%
- a Fixed Assets Plus Equity Participants Ratio of not more than 35.0%
- an Aggregate Foreign Exchange Risk Ratio of not more than 25.0%
- a Single Currency Foreign Exchange Risk Ratio of not more than 10.0%
- an Interest Rate Risk Ratio of not less than -10.0% and not more than 10.0%
- an Aggregate Interest Rate Risk Ratio of not less than -20.0% and not more than 20.0%
- a Foreign Currency Maturity Gap Ratio of not less than (i.e., more negative than) -150.0%;
- an Aggregate Negative Maturity Gap Ratio of not less than (i.e., more negative than) -300.0%.

The period of compliance with the above covenants commenced on March 31, 2017. Microfinance loans amounting to ₱192.4 million were held as collateral for the above borrowings as of December 31, 2017 and 2016 (Note 7).

Interest expense on bills payable in 2017 and 2016 amounted to ₱30.0 million and ₱21.5 million, respectively. Amortization of bills payable amounted to ₱4.4 million and ₱1.7 million in 2017 and 2016, respectively.

As of December 31, 2017 and 2016, the Bank is in compliance with the debt covenants.



#### 14. Other Liabilities

This account consists of:

|   | 2017                | 2016        |
|---|---------------------|-------------|
| <b>Financial liabilities</b>                    |                     |             |
| Accrued expenses                                | <b>₱43,710,208</b>  | ₱29,303,941 |
| Accounts payable (Note 19)                      | <b>11,156,794</b>   | 10,435,444  |
| Accrued interest payable                        | <b>10,579,210</b>   | 7,490,101   |
| Finance lease payable (Note 20)                 | <b>9,487,782</b>    | 1,678,324   |
| Dividends payable                               | <b>182,191</b>      | 81,092      |
|   | <b>75,116,185</b>   | 48,988,902  |
| <b>Nonfinancial liabilities</b>                 |                     |             |
| Deposit for future stock subscription (Note 16) | <b>106,295,050</b>  | 5,201,900   |
| Accrued taxes                                   | <b>11,462,993</b>   | 7,848,206   |
| Others  | <b>6,398,063</b>    | 3,729,748   |
|   | <b>124,156,106</b>  | 16,779,854  |
|   | <b>₱199,272,291</b> | ₱65,768,756 |

Accrued taxes include withholding taxes and documentary stamps tax payable. Others include accruals for operating expenses and employee bonuses and benefits.

#### 15. Maturity Analysis of Assets and Liabilities

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

|                                | 2017                       |                       |                      | 2016                       |                       |               |
|--------------------------------|----------------------------|-----------------------|----------------------|----------------------------|-----------------------|---------------|
|                                | Less than<br>Twelve Months | Over Twelve<br>Months | Total                | Less than<br>Twelve Months | Over Twelve<br>Months | Total         |
| <b>Financial Assets</b>        |                            |                       |                      |                            |                       |               |
| Cash and other cash items      | <b>₱16,419,549</b>         | ₱-                    | <b>₱16,419,549</b>   | ₱8,550,182                 | ₱-                    | ₱8,550,182    |
| Due from BSP                   | <b>233,021,335</b>         | -                     | <b>233,021,335</b>   | 156,044,613                | -                     | 156,044,613   |
| Due from other Banks           | <b>430,501,434</b>         | -                     | <b>430,501,434</b>   | 217,923,219                | -                     | 217,923,219   |
| Loans and receivables - gross  | <b>3,645,193,680</b>       | <b>544,758,552</b>    | <b>4,189,952,232</b> | 2,486,948,750              | 381,520,973           | 2,868,469,723 |
| Other assets:                  |                            |                       |                      |                            |                       |               |
| Refundable deposits            | <b>5,443,528</b>           | <b>498,943</b>        | <b>5,942,471</b>     | 3,333,880                  | 2,498,275             | 5,832,155     |
|                                | <b>4,330,579,526</b>       | <b>545,257,495</b>    | <b>4,875,837,021</b> | 2,872,800,644              | 384,019,248           | 3,256,819,892 |
| <b>Nonfinancial Assets</b>     |                            |                       |                      |                            |                       |               |
| Property and equipment - gross | -                          | <b>230,677,793</b>    | <b>230,677,793</b>   | -                          | 184,090,529           | 184,090,529   |
| Investment properties - gross  | -                          | <b>13,307,887</b>     | <b>13,307,887</b>    | -                          | 14,039,537            | 14,039,537    |
| Intangible assets - gross      | -                          | <b>15,964,984</b>     | <b>15,964,984</b>    | -                          | 13,860,534            | 13,860,534    |
| Retirement asset               | -                          | <b>102,426,693</b>    | <b>102,426,693</b>   | -                          | 75,590,128            | 75,590,128    |
| Deferred tax asset             | -                          | <b>18,364,365</b>     | <b>18,364,365</b>    | -                          | 16,396,816            | 16,396,816    |
| Other assets                   | <b>12,464,464</b>          | <b>25,764,656</b>     | <b>38,229,120</b>    | 8,135,357                  | 24,608,694            | 32,744,051    |
|                                | <b>12,464,464</b>          | <b>406,506,378</b>    | <b>418,970,842</b>   | 8,135,357                  | 328,586,238           | 336,721,595   |
|                                | <b>₱4,343,043,990</b>      | <b>₱951,763,873</b>   |                      | <b>₱2,880,936,001</b>      | <b>₱712,605,486</b>   |               |

(Forward)



|  | 2017                       |                       |                       | 2016                       |                       |                       |
|--|----------------------------|-----------------------|-----------------------|----------------------------|-----------------------|-----------------------|
|  | Less than<br>Twelve Months | Over Twelve<br>Months | Total                 | Less than<br>Twelve Months | Over Twelve<br>Months | Total                 |
| Less: Allowance for credit and impairment losses |                            |                       | (₱135,500,844)        |                            |                       | (₱99,028,763)         |
| Unearned interest                                |                            |                       | (1,814,050)           |                            |                       | (₱1,430,192)          |
| Accumulated depreciation and amortization        |                            |                       | (88,278,369)          |                            |                       | (59,875,574)          |
|  |                            |                       | <u>₱5,069,214,600</u> |                            |                       | <u>₱3,433,206,958</u> |
| <b>Financial Liabilities</b>                     |                            |                       |                       |                            |                       |                       |
| Deposit liabilities                              |                            |                       |                       |                            |                       |                       |
| Demand   | ₱9,410,781                 | ₱-                    | ₱9,410,781            | ₱7,911,981                 | ₱-                    | ₱7,911,981            |
| Savings  | 2,892,236,337              | 1,571,881             | 2,893,808,218         | 1,889,086,472              | 2,642,382             | 1,891,728,854         |
| Bills payable                                    | 940,460,900                | 97,964,677            | 1,038,425,577         | 574,640,000                | 119,429,886           | 694,069,886           |
| Other liabilities                                |                            |                       |                       |                            |                       |                       |
| Accrued expenses                                 | 43,710,208                 | -                     | 43,710,208            | 28,915,239                 | 388,702               | 29,303,941            |
| Accounts payable                                 | 11,156,794                 | -                     | 11,156,794            | 10,435,444                 | -                     | 10,435,444            |
| Accrued interest payable                         | 10,579,210                 | -                     | 10,579,210            | 7,490,101                  | -                     | 7,490,101             |
| Finance lease payable                            | 3,854,425                  | 5,633,357             | 9,487,782             | 787,579                    | 890,745               | 1,678,324             |
| Dividends payable                                | 182,191                    | -                     | 182,191               | 81,092                     | -                     | 81,092                |
|  | <u>3,911,590,846</u>       | <u>105,169,915</u>    | <u>4,016,760,761</u>  | <u>2,519,347,908</u>       | <u>123,351,715</u>    | <u>2,642,699,623</u>  |
| <b>Nonfinancial Liabilities</b>                  |                            |                       |                       |                            |                       |                       |
| Deposit for future stock subscription            | 106,295,050                | -                     | 106,295,050           | 5,201,900                  | -                     | 5,201,900             |
| Income tax payable                               | 53,152,097                 | -                     | 53,152,097            | 28,093,464                 | -                     | 28,093,464            |
| Other liabilities                                |                            |                       |                       |                            |                       |                       |
| Accrued taxes                                    | 11,462,993                 | -                     | 11,462,993            | 7,848,206                  | -                     | 7,848,206             |
| Others   | 6,398,063                  | -                     | 6,398,063             | 3,729,748                  | -                     | 3,729,748             |
|  | <u>177,308,203</u>         | <u>-</u>              | <u>177,308,203</u>    | <u>44,873,318</u>          | <u>-</u>              | <u>44,873,318</u>     |
|  | <u>₱4,088,899,049</u>      | <u>₱105,169,915</u>   | <u>₱4,194,068,964</u> | <u>₱2,564,221,226</u>      | <u>₱123,351,715</u>   | <u>₱2,687,572,941</u> |

## 16. Equity

### Capital Stock

As of December 31, 2017 and 2016, the Bank's capital stock consists of:

|   | 2017             |                     | 2016              |                     |
|---|------------------|---------------------|-------------------|---------------------|
|   | Shares           | Amount              | Shares            | Amount              |
| <b>Common stock - ₱100 par value,<br/>5,000,000 authorized shares</b>     |                  |                     |                   |                     |
| Issued and outstanding  |                  |                     |                   |                     |
| Issued shares at beginning of year  | 3,426,217        | ₱342,621,700        | 2,813,611         | ₱281,361,100        |
| Issuances of shares of stocks from settlement of subscriptions receivable | 1,035,785        | 103,578,500         | 612,606           | 61,260,600          |
| Issued and outstanding at end of the year                                 | 4,462,002        | 446,200,200         | 3,426,217         | 342,621,700         |
| Subscribed  | 537,998          | 53,799,800          | 1,573,783         | 157,378,300         |
| Subscriptions receivable  |                  | (4,720,600)         | -                 | (30,083,000)        |
|   | <u>5,000,000</u> | <u>₱495,279,400</u> | <u>₱5,000,000</u> | <u>₱469,917,000</u> |



#### Deposit for Future Stock Subscription

Deposit for future stock subscription 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.

On May 14, 2016, the BOD and the stockholders approved and ratified, respectively, the increase in the Bank's capitalization from ₱0.5 billion to ₱1.0 billion by increasing its authorized common stock by 5.0 million. As at December 31, 2016, DFS amounting to ₱5.2 million was classified as liability as the Bank has yet to file the application for the increase in capital stock with the SEC.

On April 4, 2017, the application for the increase in capital stock was filed by the Bank with the BSP. On January 23, 2018, the Bank filed the application for increase in capital stock with the SEC. The Bank's application was subsequently approved by the BSP and the SEC on December 7, 2017 and March 16, 2018, respectively. DFS of ₱106.3 million and ₱5.2 million were classified under 'Other liabilities' as of December 31, 2017 and 2016 in accordance with the requirements of SEC Financial Reporting Bulletin No. 006, as discussed in Note 2 to the financial statements.

#### Dividends

On October 14, 2017, the BOD approved the declaration of cash dividends amounting to ₱50.0 million or ₱10.0 per share to stockholders of record as of September 30, 2017.

On May 13, 2017, the BOD approved the declaration of cash dividends amounting to ₱70.0 million or ₱14.0 per share to stockholders of record as of April 30, 2017.

On March 11, 2017, the BOD approved the declaration of cash dividends amounting to ₱100.0 million or ₱20.0 per share to stockholders of record as of December 31, 2016.

On August 13, 2016, the BOD approved the declaration of cash dividends amounting to ₱35.0 million or ₱7.0 per share to stockholders of record as of August 16, 2016.

On April 9, 2016, the BOD approved the declaration of cash dividends amounting to ₱54.9 million or ₱11.0 per share to stockholders of record as of March 31, 2016.

#### Capital Management

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

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

#### Regulatory Qualifying Capital

The determination of the Bank's compliance with the regulatory requirements and ratios is based on the amount of the Bank's unimpaired capital (regulatory net worth) reported to the BSP, determined on the basis of regulatory accounting policies which differ from PFRS in some respects. The amount of surplus funds available for dividend declaration is determined also on the basis of regulatory net worth after considering certain adjustments.



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 consistent with the BSP's goal of promoting the soundness and stability of individual banks and of the banking system as a whole. BSP Circular No. 688 replaced BSP Circular No. 280 which is primarily based on Basel 1.

Under current banking regulations, the combined capital accounts of each bank should not be less than an amount equal to ten percent (10.0%) of its risk assets. The qualifying capital of the Bank for purposes of determining the capital-to-risk assets ratio to total equity excluding:

- 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 interest (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 on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits, and other non-risk items as determined by the Monetary Board of the BSP.

Under BSP Circular No. 360, effective July 1, 2003, the 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, the BSP issued BSP Circular No. 854 which amends the provisions of the Manual of Regulations for Banks on the minimum capitalization of banks and on the prerequisites for the grant of authority to establish a branch. Based on this circular, thrift banks with up to ten branches and those with 11 to 50 branches are required to maintain a minimum capitalization of ₱300.0 million and ₱400.0 million, respectively.

The CAR of the Bank as of December 31, 2017 and 2016, as reported to the BSP, is shown in the table below (amounts in thousands):

|                          | <b>2017</b>       | 2016       |
|--------------------------|-------------------|------------|
| Tier 1                   | <b>₱933,517</b>   | ₱679,148   |
| Tier 2                   | <b>39,161</b>     | 26,160     |
| Total qualifying capital | <b>972,678</b>    | 705,308    |
| Risk-weighted assets     | <b>₱4,990,951</b> | ₱3,404,373 |
| Tier 1 capital ratio     | <b>18.7%</b>      | 19.9%      |
| Tier 2 capital ratio     | <b>0.8%</b>       | 0.8%       |
| CAR                      | <b>19.5%</b>      | 20.7%      |

As of December 31, 2017 and 2016, the Bank's CAR and capital is in compliance with the regulatory capital 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.



Financial Performance

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

|                          | <b>2017</b>  | 2016  |
|--------------------------|--------------|-------|
| Return on average equity | <b>38.0%</b> | 28.2% |
| Return on average assets | <b>7.3%</b>  | 6.5%  |
| Net interest margin      | <b>37.5%</b> | 37.4% |

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**17. Retirement Benefits**

The Bank, CARD MRI Development Institute, Inc. (CMDI), CARD Mutual Benefit Association, Inc. (MBA), CARD Bank, Inc., CARD MRI Insurance Agency (CAMIA), Inc., CARD Business Development Service Foundation, Inc. (BDSFI), Inc., CARD MRI Information Technology, Inc. (CMIT), CARD Employees Multi-Purpose Cooperative (EMPC), Responsible Investments for Solidarity and Empowerment Financing Co. (RISE), BotiCARD Inc., CARD Leasing and Finance Corporation (CLFC), Rizal Bank, Inc. (RBI), CARD, Inc. and Mga Likha ni Inay, Inc. (MLNI), 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, 2017. MERP is valued using the projected unit cost method and is financed solely by the Bank and its related parties.

MERP and Hybrid Plan comply with the requirements of RA No. 7641 (Retirement Law). MERP provides lump sum benefits equivalent to up to 120.0% of final salary for every year of credited service, a fraction of at least six 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.

Hybrid Plan provides a retirement benefit equal to 100.0% of the member's employer accumulated value (the Bank's contributions of 8.0% plan salary to Fund A plus credited earnings) and 100.0% of the Member's Employee accumulated value (member's own contributions up to 10.0% of plan salary to Fund B plus credited earnings), if any. Provided that in no case shall 100.0% of the Employee Accumulated Value in Fund A be less than 100.0% of plan salary for every year of credited service.

Total retirement expense in 2017 and 2016 related to Hybrid Plan amounted to ₱3.3 million and ₱0.3 million, respectively.

The latest actuarial valuation report covers reporting period as of December 31, 2017.



Changes in retirement asset are as follows:

|   | 2017   |                      |              |                      |               |                           |   |  |  |  |              |             |                          |             |
|---|--|----------------------|--------------|----------------------|---------------|---------------------------|---|--|--|--|--------------|-------------|--------------------------|-------------|
|   | Net benefit cost recognized in the statement of income |                      |              |                      |               |                           | Remeasurements in other comprehensive income (loss)               |  |  |  |              |             | Contribution by employer | December 31 |
|   | January 1  | Current service cost | Net interest | Net pension expense* | Benefits paid | Transfer from plan assets | Return on plan assets (excluding amount included in net interest) | Actuarial changes arising from demographic assumptions | Actuarial changes arising from financial assumptions | Changes in the effect of limiting net defined benefit asset to the asset ceiling | Subtotal     |             |                          |             |
| Fair value of plan assets                   | ₱204,532,084   | ₱ –                  | ₱12,558,952  | ₱12,558,952          | (₱1,026,733)  | ₱5,303,494                | (₱1,189,440)  | ₱ –  | ₱ –  | ₱ –  | (₱1,189,440) | ₱15,292,257 | ₱235,470,614             |             |
| Present value of defined benefit obligation | (114,772,134)  | (16,134,395)         | (6,725,647)  | (22,860,042)         | 1,026,733     | (5,303,494)               | –   | 1,402,102  | 45,371,316   | –  | 46,773,418   | –           | (95,135,519)             |             |
| Effect of asset ceiling                     | (14,169,822)   | –                    | (830,352)    | (830,352)            | –             | –                         | –   | –  | –  | (22,908,228)   | (22,908,228) | –           | (37,908,402)             |             |
| Net defined benefit asset                   | ₱75,590,128  | (₱16,134,395)        | ₱5,002,953   | (₱11,131,442)        | ₱ –           | ₱ –                       | (₱1,189,440)  | ₱1,402,102   | ₱45,371,316  | (₱22,908,228)  | ₱22,675,750  | ₱15,292,257 | ₱102,426,693             |             |

\* Included in Compensation and fringe benefits' in the statements of income.

|   | 2016   |                      |              |                      |               |                           |   |  |  |  |              |             |                          |             |
|---|--|----------------------|--------------|----------------------|---------------|---------------------------|---|--|--|--|--------------|-------------|--------------------------|-------------|
|   | Net benefit cost recognized in the statement of income |                      |              |                      |               |                           | Remeasurements in other comprehensive income (loss)               |  |  |  |              |             | Contribution by employer | December 31 |
|   | January 1  | Current service cost | Net interest | Net pension expense* | Benefits paid | Transfer from plan assets | Return on plan assets (excluding amount included in net interest) | Actuarial changes arising from demographic assumptions | Actuarial changes arising from financial assumptions | Changes in the effect of limiting net defined benefit asset to the asset ceiling | Subtotal     |             |                          |             |
| Fair value of plan assets                   | ₱151,801,373   | ₱ –                  | ₱8,532,929   | ₱8,532,929           | (₱1,701,506)  | ₱2,850,153                | (₱3,348,831)  | ₱ –  | ₱ –  | ₱ –  | (₱3,348,831) | ₱46,397,966 | ₱204,532,084             |             |
| Present value of defined benefit obligation | (100,526,329)  | (11,112,308)         | (4,885,580)  | (15,997,888)         | 1,701,506     | (2,850,153)               | –   | 3,194,136  | (293,406)  | –  | 2,900,730    | –           | (114,772,134)            |             |
| Effect of asset ceiling                     | (5,994,473)  | –                    | (291,331)    | (291,331)            | –             | –                         | –   | –  | –  | (7,884,018)  | (7,884,018)  | –           | (14,169,822)             |             |
| Net defined benefit asset                   | ₱45,280,571  | (₱11,112,308)        | ₱3,356,018   | (₱7,756,290)         | ₱ –           | ₱ –                       | (₱3,348,831)  | ₱3,194,136   | (₱293,406)   | (₱7,884,018)   | (₱8,332,119) | ₱46,397,966 | ₱75,590,128              |             |

\* Included in Compensation and fringe benefits' in the statements of income.

Transfer from (to) plan assets represents transfer of obligation and plan assets to the respective CARD-MRI entity as a result of movements in employees among the CARD-MRI entities.



The maximum economic benefit of plan assets available is a combination of expected refunds from the plan and reduction in future contributions. The fair values of plan assets by each class as at the end of the reporting period follow:

|                                  | 2017                | 2016                |
|----------------------------------|---------------------|---------------------|
| Cash and cash equivalents        | <b>₱97,037,440</b>  | ₱84,962,628         |
| Investments                      |                     |                     |
| Government securities            | <b>119,548,431</b>  | 96,048,267          |
| Private bonds                    | <b>4,379,753</b>    | 4,254,267           |
| Mutual funds                     | <b>1,106,712</b>    | 1,063,567           |
| Receivables                      | <b>10,360,707</b>   | 15,442,172          |
| Other assets                     | <b>3,037,571</b>    | 2,761,183           |
| <b>Fair value of plan assets</b> | <b>₱235,470,614</b> | <b>₱204,532,084</b> |

All plan assets do not have quoted prices in an active market except for government securities. Cash and cash equivalents are deposited in 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 risk 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:

|                         | 2017         | 2016  |
|-------------------------|--------------|-------|
| Discount rates          |              |       |
| January 1               | <b>5.86%</b> | 4.86% |
| December 31             | <b>5.77%</b> | 5.86% |
| Future salary increases |              |       |
| January 1               | <b>7.00%</b> | 7.00% |
| December 31             | <b>5.00%</b> | 7.00% |

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:

|                | 2017                 |                     | 2016          |              |
|----------------|----------------------|---------------------|---------------|--------------|
|                | +100bps              | -100bps             | +100bps       | -100bps      |
| Discount rates | <b>(₱13,555,787)</b> | <b>₱16,865,895</b>  | (₱18,988,891) | ₱24,045,012  |
| Salary rates   | <b>15,794,350</b>    | <b>(13,005,942)</b> | 22,229,828    | (18,062,771) |

The Bank plans to contribute ₱54.0 million to the defined benefit retirement plan in 2018.



As of December 31, 2017 and 2016, the average duration of the defined benefit obligation is 16.0 years and 18.8 years, respectively.

Shown below is the twenty-five year maturity analysis of the undiscounted benefit payments:

|                                | 2017               | 2016        |
|--------------------------------|--------------------|-------------|
| Less than 1 year               | <b>₱3,094,881</b>  | ₱2,631,187  |
| More than 1 year to 5 years    | <b>23,236,938</b>  | 20,525,329  |
| More than 5 years to 10 years  | <b>56,665,118</b>  | 49,366,499  |
| More than 10 years to 15 years | <b>67,181,318</b>  | 61,216,464  |
| More than 15 years to 20 years | <b>217,375,516</b> | 172,533,343 |
| More than 20 years to 25 years | <b>393,498,659</b> | 361,285,676 |
| More than 25 years             | <b>578,406,004</b> | 568,557,149 |

## 18. Income Taxes

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

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

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

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

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

Current tax regulations also provide for the ceiling on the amount of entertainment, amusement and representation (EAR) expense that can be claimed as a deduction against taxable income. Under the regulation, EAR expense allowed as a deductible expense for a service company like the Bank is limited to the actual EAR paid or incurred but not to exceed 1.0% of net revenue. EAR expenses of the Bank amounted to ₱11.0 million and ₱9.7 million in 2017 and 2016, respectively.

Provision for income tax consists of:

|           | 2017                | 2016               |
|-----------|---------------------|--------------------|
| RCIT      | <b>₱142,447,302</b> | <b>₱79,991,979</b> |
| Final tax | <b>815,655</b>      | <b>622,195</b>     |
|           | <b>143,262,957</b>  | <b>80,614,174</b>  |
| Deferred  | <b>(8,770,274)</b>  | <b>1,572,404</b>   |
|           | <b>₱134,492,683</b> | <b>₱82,186,578</b> |



Deferred tax recognized in other comprehensive income/(loss) amounted to (₱6.8 million) and ₱2.5 million for the years ended December 31, 2017 and 2016, respectively.

Components of deferred tax assets - net are as follows:

|  | 2017               | 2016        |
|--|--------------------|-------------|
| Deferred tax asset on:                           |                    |             |
| Allowance for credit and impairment losses       | ₱40,650,253        | ₱26,984,933 |
| Unamortized past service cost                    | 7,196,556          | 8,269,459   |
| Accumulated vacation leave                       | 2,119,097          | 4,718,199   |
| Accrued rent                                     | 486,768            | 116,610     |
| Accumulated depreciation - investment properties | 69,300             | 68,282      |
|  | <b>50,521,974</b>  | 40,157,483  |
| Deferred tax liability on:                       |                    |             |
| Retirement asset                                 | 30,728,008         | 22,677,038  |
| Fair value adjustment on investment properties   | 1,429,601          | 1,083,629   |
|  | <b>32,157,609</b>  | 23,760,667  |
|  | <b>₱18,364,365</b> | ₱16,396,816 |

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

|                                      | 2017                | 2016        |
|--------------------------------------|---------------------|-------------|
| Statutory income tax                 | ₱132,830,663        | ₱81,148,534 |
| Income tax effects of:               |                     |             |
| Nondeductible operating expenses     | 2,190,090           | 1,377,425   |
| Interest income subject to final tax | (528,070)           | (339,381)   |
| Provision for income tax             | <b>₱134,492,683</b> | ₱82,186,578 |

## 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. The Bank's related parties include:

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

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



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 of related party banks and government bonds (Note 17). As of December 31, 2017 and 2016, the retirement funds do not hold or trade the Bank's shares of stock.

Remunerations of Directors and Other 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 BOD and 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 fringe benefits' in the statement of income follows:

|                              | 2017               | 2016       |
|------------------------------|--------------------|------------|
| Short-term employee benefits | <b>₱9,251,991</b>  | ₱6,740,181 |
| Post-employment benefits     | <b>4,782,218</b>   | 3,252,704  |
|                              | <b>₱14,034,209</b> | ₱9,992,885 |

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

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 its affiliates within the CARD MRI, also qualify as related party transactions.

*Loans receivables*

As of December 31, 2017 and 2016, the Bank has no loan outstanding that was granted to related parties.

*Deposit liabilities, accounts receivable and accounts payable*

The table below shows deposit liabilities, accounts receivable and accounts payable held by the Bank for key management personnel and affiliates as of December 31, 2017 and 2016:

| Category                        | Amount/Volume        | December 31, 2017   |  |
|---------------------------------|----------------------|---------------------|--|
|                                 |                      | Outstanding Balance | Nature, Terms and Conditions   |
| <b>Key Management Personnel</b> |                      |                     |  |
| Deposit liabilities             |                      | <b>₱6,550,368</b>   | These are savings accounts with annual interest rates ranging from 1.5% to 6.0%. |
| Saving Deposits                 | <b>₱8,931,956</b>    |                     |  |
| Withdrawals                     | <b>(7,696,924)</b>   |                     |  |
| Interest expenses/payable       | 83,032               | -                   | Pertains to interest on deposit liabilities                                      |
| Directors' fees/payable         | 3,465,169            | -                   | Pertains to per diem payments directors  |
| <b>Shareholders</b>             |                      |                     |  |
| Deposit liabilities             |                      | <b>₱298,314,398</b> | These are savings accounts with annual interest rates ranging from 1.5% to 5.0%. |
| Deposits                        | <b>₱693,153,602</b>  |                     |  |
| Withdrawals                     | <b>(460,891,125)</b> |                     |  |
| Interest expense/payable        | 2,441,978            | -                   | Pertains to interest on deposit liabilities.                                     |
| Accounts receivable             |                      | -                   | Share on expenses of transferred staff.  |
| Charges                         | 2,121,171            |                     |  |
| Collections                     | <b>(2,121,171)</b>   |                     |  |
| Accounts payable                |                      | -                   | Pertains to share on various expenses.   |
| Charges                         | 2,529,867            |                     |  |
| Payments                        | <b>(2,530,827)</b>   |                     |  |



| <b>December 31, 2017</b>       |                        |                            |  |
|--------------------------------|------------------------|----------------------------|--|
| <b>Category</b>                | <b>Amount/Volume</b>   | <b>Outstanding Balance</b> | <b>Nature, Terms and Conditions</b>  |
| <i>(Forward)</i>               |                        |                            |  |
| <b>Other related parties*</b>  |                        |                            |  |
| Deposit liabilities            |                        | <b>₱505,604,403</b>        | These are savings accounts with annual interest rates ranging from 1.5% to 5.0%.   |
| Deposits                       | <b>₱1,787,670,057</b>  |                            |  |
| Withdrawals                    | <b>(1,726,118,533)</b> |                            |  |
| Interest expense/payable       | <b>7,124,682</b>       | -                          | Pertains to interest on deposit liabilities.   |
| Accounts receivable            |                        | <b>196,099</b>             | Training fees, seminars and meetings, and share of expenses shouldered by the Bank.  |
| Charges                        | <b>1,017,401</b>       |                            |  |
| Collections                    | <b>(821,302)</b>       |                            |  |
| Accounts payable               |                        | <b>1,404,421</b>           | Insurance premiums from members collected on behalf of CARD MBA and payments to CLFC for operating lease agreement.  |
| Charges                        | <b>94,905,843</b>      |                            |  |
| Payments                       | <b>(93,502,382)</b>    |                            |  |
| Seminars and trainings expense | <b>16,027,858</b>      |                            | Cost incurred from engaging CMDI for training and development of its members and employees (shown as part of 'Employee trainings' and 'Meetings and seminars' in the statement of income).   |
| Information technology         | <b>26,470,916</b>      |                            | This represents information technology-related support services to the Bank including software maintenance of the Bank's CARD e-System, hardware maintenance, set-up of network and centers and technical support, among others and computer equipment leased from CLFC. |
| Operating lease                | <b>18,103,399</b>      |                            | This pertains to transportation equipment leased from CLFC.  |
| Retirement plan contributions  | <b>18,642,347</b>      |                            | Pertains to the funded and formal noncontributory defined benefit retirement plan of the Bank that is handled by CARD MERP (see Note 17)   |

\*Includes CARD Bank, Inc., Rizal Bank, Inc., CARD MRI Information Technology, Inc., Responsible Investments for Solidarity and Empowerment, CARD MRI Development Institute, Inc., BotiCARD, Inc., CARD Leasing and Finance Corporation, CARD Mutual Benefit Association and CARD MRI Insurance Agency

| <b>December 31, 2016</b>        |                      |                            |  |
|---------------------------------|----------------------|----------------------------|--|
| <b>Category</b>                 | <b>Amount/Volume</b> | <b>Outstanding Balance</b> | <b>Nature, Terms and Conditions</b>  |
| <b>Key Management Personnel</b> |                      |                            |  |
| Deposit liabilities             |                      | <b>₱5,315,336</b>          | These are savings accounts with annual interest rates ranging from 1.5% to 6.0%. |
| Saving Deposits                 | <b>₱16,670,080</b>   |                            |  |
| Withdrawals                     | <b>(15,773,544)</b>  |                            |  |
| Interest expenses/payable       | <b>101,445</b>       | -                          | Pertains to interest on deposit liabilities                                      |
| Directors' fees/payable         | <b>3,281,642</b>     | -                          | Pertains to per diem payments directors  |
| <b>Shareholders</b>             |                      |                            |  |
| Deposit liabilities             |                      | <b>₱66,051,921</b>         | These are savings accounts with annual interest rates ranging from 1.5% to 5.0%. |
| Deposits                        | <b>₱460,854,096</b>  |                            |  |
| Withdrawals                     | <b>(460,891,125)</b> |                            |  |
| Interest expense/payable        | <b>1,564,229</b>     | -                          | Pertains to interest on deposit liabilities.                                     |
| Accounts receivable             |                      | -                          | Share on expenses of transferred staff.  |
| Charges                         | <b>2,345,000</b>     |                            |  |
| Collections                     | <b>(2,359,435)</b>   |                            |  |
| Accounts payable                |                      | <b>960</b>                 | Pertains to share on various expenses.   |
| Charges                         | <b>49,153,049</b>    |                            |  |
| Payments                        | <b>(49,156,007)</b>  |                            |  |

*(Forward)*



| December 31, 2016              |                 |                        |  |
|--------------------------------|-----------------|------------------------|--|
| Category                       | Amount/Volume   | Outstanding<br>Balance | Nature, Terms and Conditions   |
| <b>Other related parties*</b>  |                 |                        |  |
| Deposit liabilities            |                 | ₱444,052,879           | These are savings accounts with annual interest rates ranging from 1.5% to 5.0%.   |
| Deposits                       | ₱1,500,956,165  |                        |  |
| Withdrawals                    | (1,390,566,487) |                        |  |
| Interest expense/payable       | 7,930,956       | -                      | Pertains to interest on deposit liabilities.   |
| Accounts receivable            |                 | -                      | Training fees, seminars and meetings, and share of expenses shouldered by the Bank.  |
| Charges                        | 689,078         |                        |  |
| Collections                    | (970,048)       |                        |  |
| Accounts payable               |                 | 151,177                | Insurance premiums from members collected on behalf of CARD MBA and payments to CLFC for operating lease agreement.  |
| Charges                        | 75,735,681      |                        |  |
| Payments                       | (78,872,188)    |                        |  |
| Seminars and trainings expense | 16,027,858      |                        | Cost incurred from engaging CMDI for training and development of its members and employees (shown as part of 'Employee trainings' and 'Meetings and seminars' in the statement of income).   |
| Information technology         | 18,961,392      |                        | This represents information technology-related support services to the Bank including software maintenance of the Bank's CARD e-System, hardware maintenance, set-up of network and centers and technical support, among others and computer equipment leased from CLFC. |
| Travelling expense             | 7,704,731       |                        | This pertains to transportation equipment leased from CLFC.  |
| Retirement plan contributions  | 46,697,276      |                        | Pertains to the funded and formal noncontributory defined benefit retirement plan of the Bank that is handled by CARD MERP (see Note 17)   |

*\*Includes CARD Bank, Inc., Rizal Bank, Inc., CARD MRI Information Technology, Inc., Responsible Investments for Solidarity and Empowerment, CARD MRI Development Institute, Inc., BotiCARD, Inc., CARD Leasing and Finance Corporation, CARD Mutual Benefit Association and CARD MRI Insurance Agency*

### Regulatory Reporting

As required by BSP, the Bank discloses loan transactions with investees and with certain DOSRI. Existing banking regulations limit the amount of individual loans to DOSRI, 70.0% 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 15.0% of total loan portfolio, whichever is lower. As of December 31, 2017 and 2016, the Bank is in compliance with the regulatory requirements.

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

As of December 31, 2017 and 2016, there were no loans, other credit accommodations and guarantees classified as DOSRI accounts under the existing regulations.

Any violation of the provisions under BSP Circular No. 423 is subject to regulatory sanctions.



## 20. Lease Contracts

The Bank leases the premises occupied by some of its branches in which lease payments are subjected to escalation clauses ranging from 3.0% to 10.0%. The lease contracts are for the periods ranging from one to ten years and are renewable upon mutual agreement between the Bank and the lessors such as CARD, Inc. and third-party lessors.

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

|  | 2017               | 2016               |
|--|--------------------|--------------------|
| Within one year                              | ₱42,354,013        | ₱29,385,667        |
| Beyond one year but not more than five years | 42,917,506         | 38,508,229         |
|  | <b>₱85,271,519</b> | <b>₱67,893,896</b> |

Rent expense (presented under 'Occupancy and equipment-related cost' in the statement of income) amounted to ₱55.3 million and ₱37.5 million in 2017 and 2016, respectively.

## 21. Notes to Statements of Cash Flows

Non-cash activities of the Bank consist of the following:

|   | 2017              | 2016       |
|---|-------------------|------------|
| <b>Non-cash investing activities:</b>             |                   |            |
| Acquisitions of property and equipment on account | <b>₱8,558,691</b> | ₱1,694,347 |

The following table shows the reconciliation analysis of liabilities arising from financing activities for the year ended December 31, 2017:

|  | Beginning balance | Cash flows    | Non-cash items       |                          | Ending balance |
|--|-------------------|---------------|----------------------|--------------------------|----------------|
|  |                   |               | Dividend declaration | Amortization of discount |                |
| Bills payable (Note 13)                          | 694,069,886       | 345,360,000   | -                    | (1,004,309)              | 1,038,425,577  |
| Deposit for future stocks subscription (Note 11) | 5,201,900         | 101,093,150   | -                    | -                        | 106,295,050    |
| Dividends payable (Note 11)                      | 81,092            | (219,898,901) | 220,000,000          | -                        | 182,191        |
| Total liabilities from financing activities      | 699,352,878       | 221,115,619   | 220,000,000          | (1,004,309)              | 1,144,720,627  |

## 22. Approval of the Release of Financial Statements

The accompanying financial statements were approved and authorized for issue by the Bank's BOD on March 10, 2018.



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### 23. Supplementary Information Required under Revenue Regulations 15-2010

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

The components of 'Taxes and licenses' in 2017 follow:

|                               |             |
|-------------------------------|-------------|
| Gross receipts tax            | ₱74,379,200 |
| Business permits and licenses | 5,362,317   |
| Documentary stamp tax         | 2,437,833   |
| Real property tax             | 396,436     |
| Others                        | 477,578     |
|                               | <hr/>       |
|                               | ₱83,053,364 |
|                               | <hr/>       |

In 2017, withholding taxes remittances and withholding taxes lodged under 'Other liabilities - Accrued taxes' account follow:

|  |              |
|--|--------------|
| Remittances:                                   |              |
| Gross Receipt Tax                              | ₱67,615,292  |
| Expanded withholding tax                       | 14,240,752   |
| Withholding taxes on compensation and benefits | 12,036,658   |
| Documentary stamp tax                          | 5,573,786    |
| Final withholding tax on interest expense      | 5,517,022    |
|  | <hr/>        |
|  | ₱104,983,510 |
|  | <hr/>        |
| Accrued:                                       |              |
| Gross Receipt Tax                              | ₱6,770,198   |
| Final withholding tax on interest expense      | 2,042,857    |
| Withholding taxes on compensation and benefits | 1,408,933    |
| Expanded withholding tax                       | 719,910      |
| Documentary stamp tax                          | 521,095      |
|  | <hr/>        |
|  | ₱11,462,993  |
|  | <hr/>        |

#### Tax Cases and Assessment

The Bank has no outstanding tax assessment and/or legal case filed in court as of December 31, 2017.

